



# How To Profit In 2004 And During The Second Phase Of The Convergence Revolution

By Don Kent ■ *eCablevision Consulting*

It has been approximately twenty years since District Court Judge Harold Green issued the modified final judgment that required AT&T to divest itself of the "Baby Bells." And twenty years ago, there were no DBS competitors, consumer Internet services, or digital television. TCI was the largest cable operator; the most advanced cable systems were capable of carrying 42 channels, and the cable "franchising wars" had just recently concluded. The cable industry was no more focused on providing voice than the Regional Bell Operating Companies (RBOCs) were interested in offering video. The broadcasters reigned supreme in the advertising sales wars, the cable industry had just begun the consolidation process, and DSL, VOIP, broadband, email, portals, and spam hadn't even been invented. During the last twenty years, technological enhancements that required significant amounts of capital spurred consolidation and created new businesses.

The changes that will occur during the next twenty years will be even more profound. Technology will continue to consume enormous amounts of capital, but technology will also require most companies to re-innovate their businesses. One truism is that consumers don't care how they receive their video, voice, or data—they merely want high quality and convenient service at a good value. In 2003, consumers consider long distance service a commodity. And during the next twenty years, tech-

nology and competitive pressures will cause voice, video and data to become increasing commoditized. This will result in substantial financial turmoil and the disintegration of many of today's service providers' legacy products. But most significantly, this will also generate new and compelling opportunities for entrepreneurial companies that are comfortable taking calculated risks to become agents of change during the next phase of the convergence revolution. So let's review how the revolution is progressing.

Long distance service. Prior to the modified final judgment that required Ma Bell to divest itself of its Bell Operating Companies, long distance was a little bit like cable and private cable operator's (PCO's) stable of video premium services. But during the last twenty years, technology and competition have commoditized long distance service, in part causing AT&T to lose 90% of its value (note: on a split adjusted basis, AT&T was still valued at \$200 per share in 1996) and even consider forgoing its independence by



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courting one of its offspring (Bell-South and AT&T have had on-again and off-again merger discussions for years). Today, most consumers cannot differentiate between the service of AT&T, an RBOC, or a reseller's long distance service. So much for the millions spent on advertisements that tout trying to hear a pin drop! In 2003, it's clear to see that when AT&T bet on long distance and spun off the RBOCs, they made a serious strategic error. And the RBOCs that believed the long distance

business would be a financial windfall for them in the mid-1990's, weren't expecting to be competing in an environment where resellers sold long distance for \$.03/minute. The long distance business evolved into something that the conventional wisdom of that day didn't predict. And the long distance experience is merely a harbor of things to come.

Plain Old Telephone Service (POTS). Portability requirements together with the increasing affordability of cell phones will acceler-

ate the revenue decline experienced by the RBOCs. Advances in unified messaging together with mobile devices will enable everyone to "reach out and touch someone" whenever and however they want. POTS will not disappear; its usage will merely diminish as it is displaced by more efficient and convenient technologies. I predict that within the next ten to fifteen years, less than 50% of consumers will continue to subscribe to POTS unless the cost of this service is reduced significantly. Not only will POTS no longer be the revenue darling of the RBOCs, it will not be the cash flow panacea that cable operators expect. While a foray into voice is a reasonable progression for the cable industry's convergence evolution, current cable stock prices may be based upon projected voice cash flow and revenue levels that will be difficult to



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attain under the pressure of aggressive competition by the RBOCs.

Internet Connectivity. Research companies predict that by the end of this year, 25 million Internet users will have chosen broadband and by 2007, more than 50% of Americans will have broadband in their home. Will Internet connectivity be provided by telcos, cable operators, PCOs, DBS, electric companies, or via a terrestrial wireless network? The answer is yes, consumers will have many options to choose from, and dial-up and broadband connectivity will become commoditized as much as long distance has become today. The beginning of this commoditization has begun occurring during the last couple of years, as cable operators and RBOCs have begun reducing their pricing reacting to competition and technology-driven reductions in hardware costs. Rather than high margin products that justify the significant capital expenditures that have been invested during the last five years, broadband will be a low margin and highly competitive service. Want some proof to this admitted-

ly controversial prognostication? Dial-up service is a few years further through its product life cycle, United On Line (a \$9.95 all you can eat dial-up provider) is the fastest growing national dial-up provider, and AOL will be launching a \$9.95 low cost competitor of its own in a few months. The pace



of Internet connectivity commoditization is accelerating.

Video Services. During the last twenty years, broadcasters have become eclipsed by the cable television operators; as cable operators are losing market share to DirecTV and EchoStar today. How will consumers enjoy video in the year 2023? Appointment viewing will be an archaic term fondly remembered in the halls of the Cable Museum and personal video recorders seen as a transitional technology that has gone the way of eight-track recorders. In twenty years from today, companies utilizing technologies such as a next generation version of Microsoft's IPTV initiative will enable any provider to offer any video service via any broadband connection. Competitive and local exchange carriers and perhaps even electric companies offering video will join DBS, Private Cable, and MSOs. And if content is king, then virtual programming providers (or a great grandfather of companies like Movielink or Real Networks) will package and offer video services directly to consumers without the need of investing in and maintaining any physical plant. In fact, the studios are still f u m i n g about the s p l i t s they negotiated with the premium services back in t h e 1970's, and have been trying to improve

their splits with pay-per-view and NVD. If the gateways crumble because of multiple methods of providing broadband to consumers, expect the studios and programmers to try offer more services directly to the consumer as they are with Movielink today.

As technology progresses the connectivity life cycle, landlines and wireless pipes will all become commoditized and eventually become completely deregulated. Users will not care about the type of technology used and focus only upon the service and value they receive. As is the case for those that use a lawn service, consumers don't care what type of lawnmower the service provider uses. Consumers merely want their lawn neatly cut on time for a fair price. Similarly, it's also the same for those of us that frequent the airlines—consumers want good service, safety, and to pay a fair price when flying to their destination. The type of aircraft that one travels in is of little consequence. As is the case for most companies that prosper in a competitive environment, service and value is ultimately what's most important to customers.

How can one profit during the next phase of the convergence revolution? During the next ten or twenty years, service providers' profitability and survival will become less about being a gatekeeper to the physical plant that controls packages of services, and more about the incremental service and value that operators offers their customers. Voice, video, and data will converge, become further bundled, customized, and transcend the physical barriers that now exist. Most every consumer will be able to receive the video programming they want via Internet protocol when they want it, and most significantly, from whomever they want to receive it from—whether it's from a virtual online provider or the operator that owns the "last

mile" wires, cables, or wireless access points.

Very little if any programming will be exclusive. Companies will be required to compete by differentiating themselves through customer service excellence, anticipating their customer's future requirements, and providing their users a good value. Those that can't will find themselves at the bottom of the food chain attempting to survive by using a "price leader" strategy. Armed with this knowledge, the most successful companies will be able to see "beyond access" and develop their competitive differentiation through quality and value today.

Twenty years from now, broadband, video, and voice providers will be much like today's airlines, car rental companies, and restaurants. Customers will have unprecedented choice. Since it will be the quality and value of the service that retains customers, operators must learn what their customers want and need to be successful as the convergence revolution continues to proceed. How

to best stay informed with the pulse of the industry and specific and actionable tactics to maintain your customers' loyalty? Keep your subscription to Broadband Properties current and attend practical shows such as the annual Broadband Properties Summit. And most importantly, realize that the next phase of the convergence revolution will be more profound than the last twenty years. While the natural monopolies that once existed for voice and video providers will completely crumble, quality and excellent service will continue to be a constant in each company's formula for success. ■

#### About the Author

*Don Kent has spent over 25 years working with video operators, broadband service providers, and with early phase companies specializing in the delivery of broadband and digital content services. Please address questions or topics that you'd like to see discussed in subsequent columns to Dkent@HTINC.com.*



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