But who is going to buy all this technology?

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Despite the doom and gloom surrounding the telecommunications market, venture capital investment in hardware and software vendors continues at a good pace. At the same time, funding support for new and existing Service Providers is very hard to come by, and their share prices are being driven down, even when they meet their numbers. There is something wrong with the resulting sales equation. Sellers need buyers, yet the capital dollars are being withheld from the buyers. So, how will these technology vendors thrive, if their customers – the Service Providers – are doomed? It's something that we can't quite figure out.

Why this lopsided funding?

We've been running an informal survey of the telecom-related investments over the last few months. The results: over forty investments involving over $1B in total capital, at a time when the telecommunications market has been taking a severe beating. The investments include everything from optical networking equipment to broadband wireless to OSS platforms. However, only three of those forty investments provide capital to telecom Service Providers.

This funding inequity would seem to spell trouble for the investors in hardware and software vendors. Where will the potential technology buyers (the Service Providers) get the money to deliver revenue to the technology sellers?

The underlying demand for services is still strong. While it is true that revenue growth has been modest (or worse), quantity demand for broadband access is growing, Internet traffic remains high, and demand for wireless services is increasing rapidly. Worldwide, data and voice traffic continue to grow and overcapacity will not last for long - in many locations network investment is needed now. This does not sound like a market with no future.

Clearly, there are still hundreds of service providers, and they are buying (or will need to buy) routers, switches, transport, access, software and services. Given that communications service usage is still growing, there are lots of opportunities for technology sales – but only if the buyers have the necessary capital.

So why are the Service Providers being hammered in the markets while technology and software vendors continue to attract investment? Can a robust market emerge from just one side of the sales equation? The markets are working hard to look at this industry from a "glass half empty" point of view, not a "glass half full" perspective. Perhaps it's time we gave the Service Providers some breathing room and specifically, some differentiated treatment for those who are making their numbers.

When competition hit the US, there was a scramble to get a piece of the multi-billion dollar telecommunications market. In almost any large market there were multiple companies each with a business plan based on "conservatively" capturing 8% to 15% of the market from the incumbent. Investors lined up to lend them money and network equipment vendors fought to supply equipment "free" on a "pay when you succeed" basis. It was surprising behavior for vendors – very much like a typical venture capital formula of finding three wins out of ten deals. Vendors, however, seemed to have an expectation that all ten would be winners. The only thing this level of exuberance, and naiveté did was set the industry up for failure.

When it became clear that making quick profits from telecom was not going to be a no-brainer, the pendulum inevitably swung. A free-for-all race for opportunities quickly turned into a collapse of confidence in all telecom companies, effectively punishing everyone involved – relatively successful new entrants and incumbents, as well as companies on the brink of failure.

There continues to be a lack of differentiation based on results, capabilities, and customer acceptance. Instead, every Service Provider is being painted with the same brush. This trend can only benefit the large incumbents as it helps wipe out even their potentially viable competitors.

The lack of available capital has already had an impact on network hardware vendors, OSS application vendors, systems integrators and other companies servicing and supporting this sector.

The "dismal" US Service Provider capital spending forecasts have been as low as $60B for 2002, well below the 2001 figures, and a huge drop from the $136B in 2000. (Source: Marconi / Pacific *White Paper – The U.S. Telecommunications Capex Spending – Challenges and Opportunities: Nov 12 2001*.) No matter how you look at it, that's a significant reduction. However, looking at the pre-bubble year of 1995 and its $40B spend, and following a traditional 5% growth rate, we end up around $60B in 2002. That indicates that the 2002 market is now moving back to realistic spending levels – a good thing for sustainable markets.

Getting back on the steady growth track requires further capital injection, especially for those companies who are on track to profitability, but not there yet. The question for those who have invested in the vendor community is: where will the potential technology buyers get the money to deliver revenue to the technology sellers?

There's no doubt about it, being a Service Provider is tough business. But it can be profitable. It's only the recent trend to short-term focus on customer growth, achieved through unsustainable pricing, which caused the deviation from profitability.

So let's give some preferential consideration to those Service Providers who are making their numbers and focused on the right fundamentals of satisfying customers, creating long-term value and tracking to profitability.

Hardware and software vendors can expect to have a market for their goods **if** investors aggressively differentiate between Service Providers tracking to a realistic, success-oriented plan, and those that cannot make it, and **then** allocate funding accordingly – following normal investment rules.

In any industry, there are companies with sustainable business models and there are companies with questionable business models. It is a good thing to withhold funding from those with unsound plans and weak operational capability. On the other hand, supporting those with solid models is critical to establishing a healthy and sustainable competitive industry. Our responsibility is to know and understand the difference.