

# Pipeline

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[www.pipelinepub.com](http://www.pipelinepub.com) Volume 5, Issue 10

## The Inevitable Cable-Telco War: Fighting to Be Relevant

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The communications markets continue to experience turmoil brought about largely by technological innovation leading to the relentless push of "Convergence." Gone are the days of siloed markets, defined by technology barriers. In those days, telecommunications carriers (telcos), such as AT&T, the Baby Bells and hundreds of smaller "independent" local exchange carriers provided voice telephony and data services; cable television operators (cablecos) provided television services; and, of course, cellular carriers provided voice services wirelessly. These three sectors are fast moving on a collision course towards the same prize: providing customers of all stripes the full array of communications services. (Notice that we are referring to "communications" and not "telecommunications." To some, this might simply be a matter of semantics. To us, however, the subtleness belies the tectonic, fundamental shifts that are occurring in this market. By using the term "communications," we are including everything from broadcast radio to fiber transport to emerging wireless.)



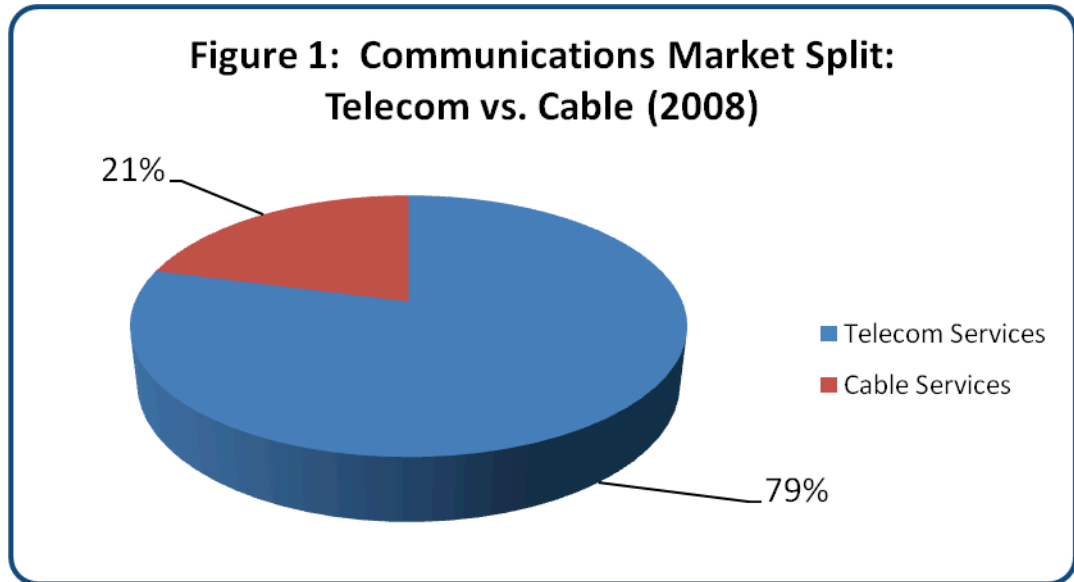
From where we stand, the most interesting marketplace battle that has been simmering for a while now is the one between cablecos and telcos. The major competitors are large and sophisticated, the stakes are high, and the outcome will ripple through the converged Web 2.0/3.0 communications market. This piece, therefore, lays out the battle ground, discusses the competitors, and provides some thoughts on each side's competitive advantages and chances for ongoing success.

### What's at Stake - Markets & Magnitudes

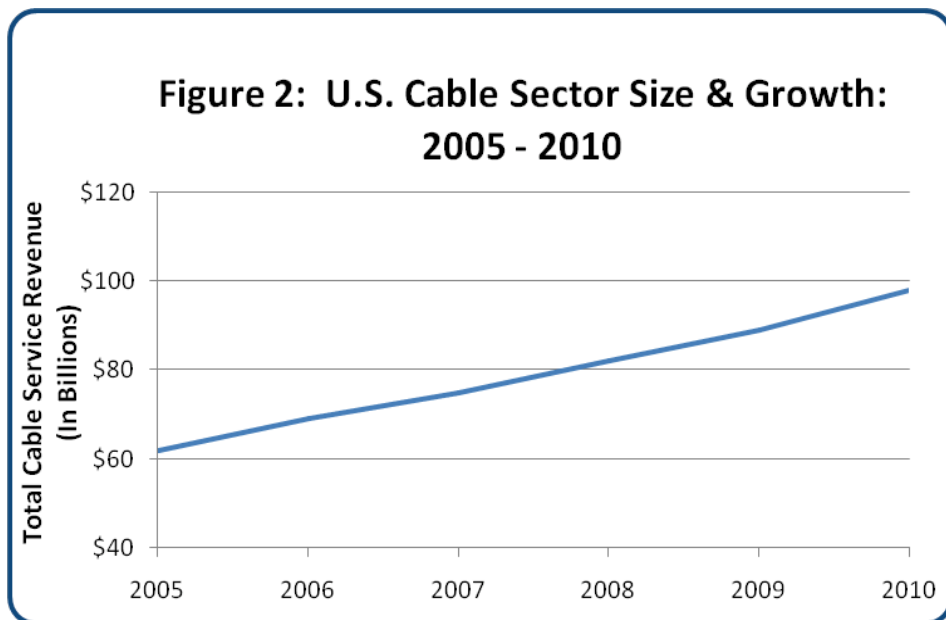
Both the telecommunications and video services markets are huge in terms of customer spending (i.e. service provider revenue) and, increasingly, impact on our national economy. While each can be disaggregated into service sectors, such as data services, we're going to focus on these markets at the macro-level.<sup>1</sup>

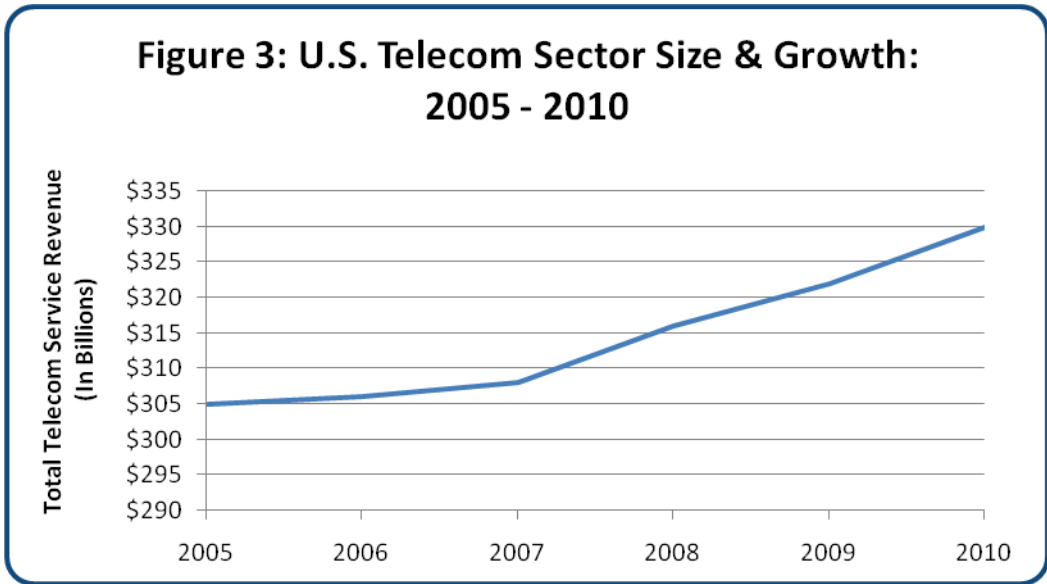
<sup>1</sup> For data and information on the service sectors comprising the communications industry see NPRG's Continuous Information and Advisory Services tracks, each focusing on specific sectors ([www.nprg.com](http://www.nprg.com)).

Figure 1 below shows how the video and telecom markets compare. Not surprisingly, the telecom services market is approximately three times the size of the cable market. However, together just these two markets within the broader communications industry represent a \$400 billion opportunity, of which increasing amounts are becoming ripe for further competitive entry, particularly by the cablecos. This chart also shows how much the telcos have at stake as competition strengthens further.

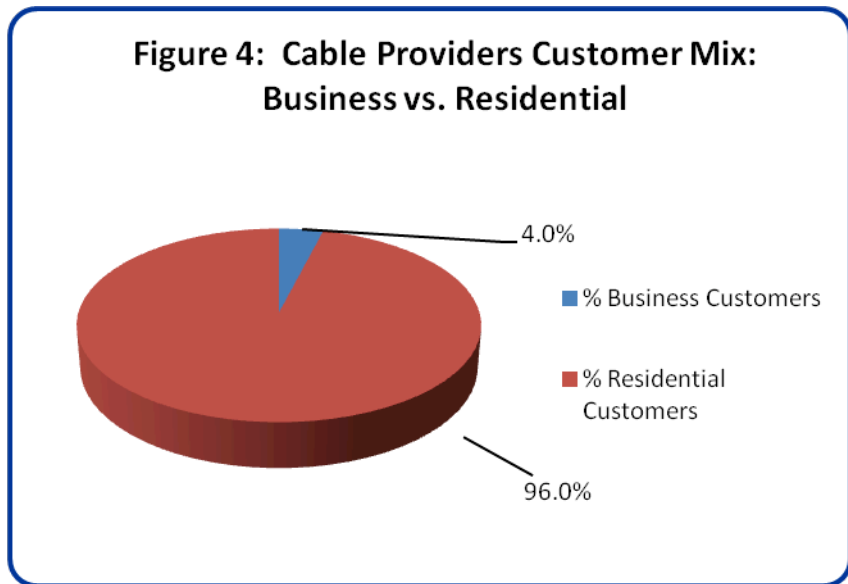


Of course, the market size shown above presents a static picture of the markets in question. The communications industry is an expanding pie with new customers and new opportunities continuously emerging. Figures 2 and 3 below present the respective growth trends of the cable and telecom sectors.



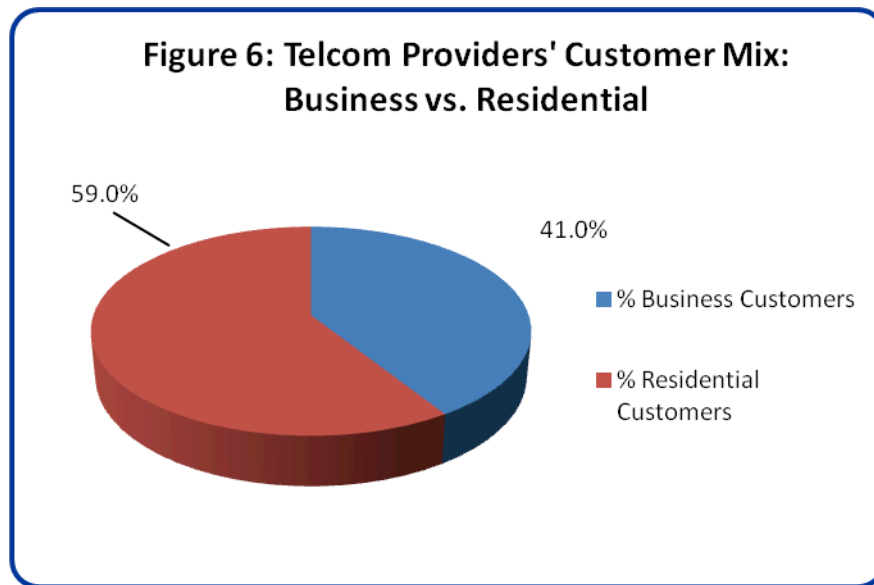


Ultimately, the two factions will continue battling on two fronts. Specifically, each will go head-to-head for residential and business customers. Currently, the vast majority of cable companies' revenue is derived from residential users. These providers' collective inexperience in the business services arena is reflected in Figure 4 below. While business users represent just four percent of their current customer base, this doesn't represent a weakness, as it is due to CATV's history and initial markets. Rather, this skewed customer mix represents a significant emerging opportunity - one that cable companies are beginning to attack.



Telcos, on the other hand, have a more balanced mix between business and residential users. Business users are high-margin customers and ones that the telcos will battle for. Historically, residential customers have been viewed as low margin accounts and telcos have been, at times, less

effective in competing for these customers. The results have been continuous line losses for the telcos due to a number of factors. Competition from cable companies providing voice services is one factor that continues to rise in importance.



Cable companies have much more to gain as they continue their assault on telco strongholds. Telcos, however, are well-positioned to hold off these competitors as they themselves turn their attention on cablecos' core video markets.

### The Competitors

Cablecos and telcos come from vastly different origins and to some extent geography and technology kept them apart. As we're witnessing, technological shifts for both cable providers and telcos have opened the doors for each side to compete in the other's core markets.

Cable operators began by serving rural communities that had difficulty receiving broadcast TV signals. These operators deployed "community antennae" that were able to receive television signal (hence the reference by many to CATV). These signals were then transported via coaxial cable to subscribers. This industry's leaders, such as Bill Bresnan, John Malone, and Glenn Jones, created an entrepreneurial spirit that is still embraced by cable providers today.

The major telcos (those with their roots in the Bell system), on the other hand, focused on providing voice telephony services to both business and residential subscribers in larger metropolitan areas. Ma Bell, founded over 100 years ago, took pride in its engineering prowess and inventiveness. Overall, the U.S. telecommunications industry remains the most advanced in the world.

There are approximately 1,200 cable television service providers and 1,100 incumbent telecommunications providers serving markets throughout the U.S. Many of these providers are smaller entities serving small markets. Table 1 below shows the top five cable and telecom service providers as a point of reference.

**Table 1: Top Five Cablecos and Telcos (By Revenue)**

<b>Cable System Operators</b>	<b>Telcos</b>
Comcast	AT&T
Time Warner Cable	Verizon
Cox Communications	Qwest
Cablevision	CenturyTel-EMBARQ
Charter Communications	Windstream

While the top five service providers under each heading represent the lion's share of the market, each "Tier 2" provider, be it cable or telco, has similar opportunities and market decisions before them.

**So, Who's Going to Win This Thing?**

Each side has a number of strengths to be effective competitors and gain market share in the other's core markets. Unfortunately for them, they also have counterbalancing weaknesses that mitigate any advantages provided them by their core strengths. However, neither side has an Achilles's heal. Table 2 summarizes the salient characteristics of each group so that readers can assess for themselves who they see coming out on top. We offer our thoughts after this table.

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**Table 2: Sizing Up the Competition -  
Comparing Strengths and Weaknesses**

	<b>Cable TV Service Providers</b>	<b>Telecom Carriers (ILECs)</b>
<b>Overall Financial Strength</b>	Cable companies have carried significant debt loads in the past; While the balances sheets have been cleaned up, some are currently struggling (see Charter)	Telecom carriers have a strong history of maintaining their financial health and strength. Even in the current economic conditions we are in, AT&T and Verizon, for instance, have been very profitable and will continue to be so.
<b>Customer Bases</b>	Consumers; Very small businesses (less than 20 employees); Venturing upmarket into larger business segments with Ethernet; Wireless carrier for backhaul services	Consumers; Small/mid-sized businesses; Large enterprises, including multi-nationals; Governmental and Educational Institutions; Wholesale customers (ISPs, other carriers).
<b>Service “Stickiness”</b>	High: Video entertainment services have, in the past, been relatively “sticky.” Much has been made of “triple play” offerings, and adding voice and data services to the existing video offerings have created a bundle that has significantly helped cable companies in the residential market.	Moderate: Long-term industry trend is decline in access lines, which is ILECs’ core service. Business users too have been willing to switch service providers from ILECs, such as AT&T, to emerging competitive providers, such as CLECs and, increasing Fixed Wireless providers.
<b>Network Presence</b>	Predominantly residential focused; <i>Expanding</i> presence in business districts.	Near ubiquitous in-region; Fiber network in business districts; Global presence for some.
<b>Physical Media</b>	Coaxial cable (“coax”); Fiber optic cable; Hybrid fiber/coax.	Fiber optic cable; Twisted copper pairs.
<b>Network Advantages</b>	Typically, larger data carrying capacity than telco copper plant (e.g., versus DSL); Engineered for greater forward-path throughput, enabling faster downstream data speeds; DOCSIS 3.0 being deployed.	Over-engineered SONET infrastructure ensures millisecond-level failover redundancy for 5-nines uptime; Within incumbent territory, connectivity is in place to all residences and commercial buildings; Densest fiber network assets in the industry are ILECs’ in central business districts.
<b>Major Strengths</b>	Core competency and customer reputation as “video entertainment distributors”; In majority of markets, offer the fastest downstream data speeds (cable modem vs. DSL); Investments in network upgrades completed earlier in decade.	Breadth and depth of network; Quality of service and quality of networks; Intangibles in large enterprise segment: reputation, customer relationships, global experience
<b>Major Weaknesses</b>	Generally lag far behind in business market segments: customer care and service track records will initially hinder entry into the business market; Each operator is landlocked within its own system “clusters”; Lack a lasting, successful wireless play.	FTTx buildouts carry significant risks; Unproven in video entertainment services; Burden of maintaining legacy infrastructure built for services now in decline; Engaging in multi-front competitive wars in the residential, SMB, Enterprise, and Government services markets may expose telco flanks resulting in unexpected losses.

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success (and misses) of each side. Further technological advances, regulatory climates, the economy, and a host of other variables will come into play to further shape the voice, video and data markets. However, we're not going to hide behind that to avoid offering our prognostications. So, in a nutshell, here they are.

As we noted previously, cable companies have much more to gain in the battle we've delineated. However, they also have much more to lose. Cable companies continue to adapt and are becoming sophisticated competitors in telecom markets. We believe that their current forays into "edge" business markets will be successful and they will experience significant market share growth in this market. On the residential side, competition from the telcos is coming, and when it arrives, it will be formidable. By that time, however, cable companies will have strengthened their hold on the residential customer base. All of this, however, can fall apart if cable companies don't fully embrace the importance of customer care.

Telcos, on the other hand, have deep resources with which to defend their markets and simultaneously offer video services that strike at cable's core. The video market, though, is a nuanced one that involves more than customers. Telcos will have to recognize and navigate these nuances, which will serve more or less as speed bumps, not show stoppers. The telcos cannot afford to underestimate cable providers' capabilities and they must develop increasingly deeper understandings of the competitive and market trends occurring in each of their market segments. Finding increasingly effective ways to keep their fingers on the market's pulse will be the most important action the telcos can take in the face of further competition.



The cross-market battle that is heating up will not be quickly or easily decided. Both cable TV carriers and the established telecommunications carriers are marketplace savvy and technologically adept, making the market developments now unfolding that much more intriguing and well worth watching.