

by [Camille Mendler](#), Enterprise Research, Global Communications and Converged Solutions Vice President, cmendler@yankeegroup.com, 44-20-7307-1085

Teaching an Old Dog New Tricks: Wholesale Transforms



The Bottom Line:	The opportunity to resell expertise and manage other carriers' network operations is transforming the wholesale business of many telecom operators, but they face a fierce and fragmented competitive market.
Key Concepts:	Carrier outsourcing, professional services, managed services, outsourcing
Who Should Read:	CMO and head of business development at telecom operators, equipment vendors and IT services companies

Practice Leader: [Zeus Kerravala](#), Enterprise Research Senior Vice President, zkerravala@yankeegroup.com, 617-598-7235

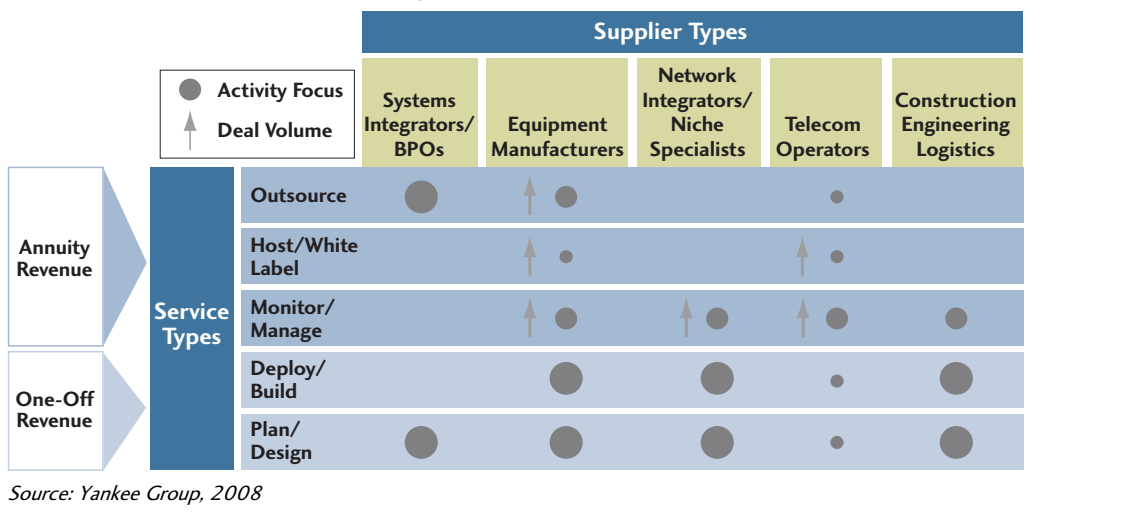
Carrier Outsourcing Injects New Energy and Prospects for Margin Growth into Operators' Wholesale Divisions

Savvy leaders of wholesale divisions are achieving a profound turnaround of their business prospects. They're doing it through the canny repackaging of long-established skills and network assets, and marketing a portfolio of managed and outsourced network and application services coupled with expert consultancy.

It's a bold endeavor on several counts: First, selling an enriched package of value-added services to other telecom operators assumes consultative selling skills that are in short supply. Second, the competitive market for selling professional and managed services into the telecom operator vertical is increasingly saturated, not least with equipment vendors and IT services firms vying for a piece of the action.

Conservatively, Yankee Group estimates that the global market for selling managed network services to fixed and mobile telecom operators will triple during the next 5 years and be worth in excess of \$27 billion by 2012. This represents only a subset of the professional and managed services sold to the telecom operator vertical. Others include IT-centric, business-process centric and logistics services sold on a consultancy and annuity basis (see Exhibit 1). We highlight managed network services, including operations, capacity, hosting and interconnect management, because this is where wholesale divisions are currently most active.

Exhibit 1.
Competitive Landscape for Providing Services to Telecom Operators



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Wholesale Is an Old Dog, but it Is Learning New Tricks

Heading up a wholesale division has not been a good career move in many telecom operators. The business of wholesale—selling excess voice and data capacity and related services to other service providers—experienced lean and painful times during the boom and bust of the late 1990s. Wholesale business models remained stagnant and profit margins thin, and the customer universe was shrinking fast because of M&A and bankruptcy. It's been difficult to find and keep talent willing to take such challenges head-on.

Yet many wholesale divisions have continued to exist. That's partly because they still bring in valuable cash to fuel overall operations, and partly because their existence (specifically within incumbent operators) is strictly regulated. What's now changed is that a handful of innovators are on a determined offensive. Leaders such as Srinath Narasimhan, managing director of Tata Communications (formerly VSNL), Karsten Lereuth, president of BT Global Telecom Markets, and Daniel Kurgan, chief executive officer of Belgacom International Carrier Services (ICS), are allied in a disruptive new vision of wholesale:

- **Tata Communications**, one of very few operators to remain successful and grow in global wholesale in recent years, has established VGSL—a division dedicated to offering professional and managed services to other operators. It is tapping into the expertise of Tata Consultancy Services to boost its IT-centric capabilities, and that of its domestic operations including Tata Indicom to resell specific technical competence in key areas including WiMAX network builds. Considerable new investments in global submarine cable assets are also aimed to bolster its position in providing managed network services globally to enterprises and carriers.
- **BT Global Telecom Markets**, part of BT Global Services, is marketing BT Group's deep expertise in next-generation networks and services through its 21CN Operator Services, leveraging its Telconsult consultancy practice as part of its service wrap, and winning consultancy deals with operators including Turk Telekom. Its UK-based sister division, BT Wholesale, has already generated £1 billion (US\$2.02 billion) in managed network and white-labeled services with customers including Orange, T-Mobile, Virgin Media and Vodafone.
- **Belgacom ICS** is banking on its global voice and mobility expertise and associated infrastructure, targeting emerging market operators in particular. The company's managed interconnect, billing and security service wrap has won various clients including a landmark deal with South Africa's MTN Group, which owns mobile operations across 21 African and Middle Eastern countries.

Emerging Markets Drive Activity

Emerging markets are providing fertile ground for carrier-to-carrier outsourcing and associated consulting services. Bharti Airtel's \$2 billion outsourcing services deal with Ericsson is a case in point. Yankee Group identifies the Middle East and Africa, Southeast Asia and parts of Latin America as priority regions for carrier outsourcing and associated services. Opportunities also exist in Central and Eastern Europe among operators that still lack direct investment from an experienced foreign operator to help them grow.

In emerging markets, operators rarely have time to fine-tune capex planning and opex control to consider how to deal with future revenue permutations. They live in the now, and fulfilling explosive subscriber growth—particularly in the context of mobile—dominates what they do. This leads to capex and opex patterns that are distinctly different from those of peers in developed markets. Consider China, where the capex-to-revenue ratio among fixed-line operators can exceed 30%, compared with operators in developed markets, where the capex ratio is 18% or less. Operators that have lived through the experience of building next-generation networks in competitive markets have valuable expertise to share with such service providers in both building networks and improving time-to-market for new services.

But in our view, opex management is really where mobile and fixed operators in emerging markets are storing up future problems. This is where the logic for third-party professional and managed services is particularly strong. For example, managing network operations can represent half of the opex budget for fixed-line operators in emerging markets, and they often shortchange much-needed forward investments in customer care, sales and marketing. The same problem applies among mobile operators where control over opex is also poor or neglected. Again, operators with demonstrable best practice expertise have an opportunity to sell these skills and take on the management of selected technical operations such as network operations centers, interconnect management and aspects of billing and purchasing. Reducing opex by up to 30% is the type of carrot that outsourcing selected operations can offer, according to Yankee Group operator interviews.

Competition Is Fierce in the Carrier Outsourcing Space

Wholesalers are not alone in recognizing that operators need help to become more agile and efficient. The competitive landscape is highly fragmented. Heavyweight competition is already in place globally from vendors such as Alcatel-Lucent, Ericsson and Nokia Siemens Networks, as well as business and IT-centric firms such as Accenture, HP and IBM. Worth noting is the rising profile of Indian companies in the competitive mix. Business process and IT services firms such as HCL, Patni and Wipro are expanding internationally, while network integrators such as Tech Mahindra and GTL are also serious players. Niche players include i-conX (interconnect billing and settlement), Global Capacity (supply chain management), Global Network Operations (NOC management) and Relacom (installation and maintenance services).

Do operators have a differentiated offer against these competitors? Based on the results of mobile and fixed operator interviews carried out in 2006 and 2007, Yankee Group believes that there is a perceived level of trust in operators as third-party service providers—particularly Tier 1 incumbent operators—that allows them to bid credibly for service contracts. Differentiators lie largely in their business and operational expertise that is believed to contribute to accelerated time-to-market for customers—be it in the area of operating multiple bilateral relationships for interconnect, settlement or peering; the management of multiple vendors in building and operating next-generation networks; or the ability to white label and host a given service for a swift and capex-light rollout.

Predictions

- **Emerging markets will drive carrier outsourcing opportunities, but often with new types of customers.** Between 2007 and 2012, carrier outsourcing deal flow will accelerate in the Middle East, Africa and Southeast Asia—particularly where markets are liberalizing. New customer targets may also come from nontraditional sources such as utilities, industrial conglomerates, municipalities and private equity firms with aspirations to develop telecom revenue. Examples include Orange’s build-operate-transfer network deal with OYAK, the Turkish Army’s pension fund, and also the country’s third-largest conglomerate. Such nontraditional clients also continue to blur lines between carriers’ wholesale and enterprise sales activities.
- **Wholesale divisions are writing their own obituaries, whether they are successful or not.** If wholesale divisions engage with customers much as enterprise divisions engage with theirs, the rationale to keep such divisions structurally separate is weakened—particularly for non-regulated international wholesale activities. The endgame could be that wholesale is subsumed into an enterprise division. Ultimately, wholesale salespeople may report into a group that includes other teams focusing on discrete verticals such as manufacturing and financial services. In fact, this could be a positive development as wholesale divisions with growing outsourcing practices need better access to subject matter experts and resources often found in enterprise divisions to close deals.
- **Some wholesale divisions will cease to exist.** If a given wholesale division can’t or won’t transform, a strong logic exists to outsource or sell non-core functions to a third party—enabling focus on priority customers. Examples include KPN’s decision to merge its international wholesale voice business into iBasis, which has created a global VoIP giant. Another example is Swisscom, which refocused on domestic retail IP-centric services. It decided to merge its international fixed-line carrier division with Belgacom (with Belgacom acting as prime), and to partner with virtual network operator Vanco to provide international connectivity services to its multinational enterprise customers.

The winners will be those that transform or bow out gracefully from wholesale service provision. Losers will be those that believe that what’s happening is just wholesale by another name and don’t change what they do.

Recommendations

- **Change financial reporting for wholesale operations to reflect the shift in tactics.** The emerging contribution of wholesale to what’s often termed “new wave” revenue generation in some operators should be better recognized. Currently, wholesale revenue reporting reflects—in perception and currently in fact—the sale of legacy, commoditized services such as connectivity or minutes. And yet it’s equally important to indicate to the financial community that even in divisions that are perceived to be selling legacy products and services, transformation is under way and new wave revenue is growing. Forward bookings of deals with next-generation wholesale elements should gain better visibility, just as they do when blue chip enterprises are the customers.
- **Invest in sales expertise if you’re serious about carrier outsourcing.** As enterprise divisions have found, selling consultancy, managed and outsourced services requires considerable sales skills. Wholesalers have discovered a lifeline in new services, but they’ve got to be able to sell them. Investment in sales training is a highly strategic expenditure.

- **Develop strategic partnerships with equipment or services vendors.** Investigate cross-functional alliances, since most players in the carrier outsourcing space are experts in only one area (e.g., networks, IT or business processes) while operators may issue RFPs for more holistic transformation projects. Several pairings of complementary skills and geographical footprints have already occurred including Accenture and Telcordia (business support and OSS) as well as Patni and Sitronics (combining OSS skills, and Eastern Europe and Middle Eastern footprints).