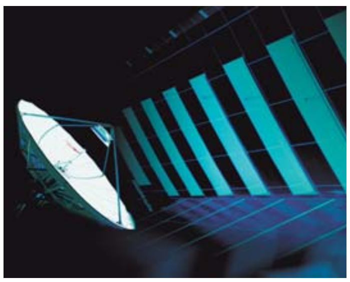
Competition or Conflict?

Managing the Partnership Between Teleports and Satellite Carriers



How successful "co-opetition" between teleport operators and satellite carriers can drive the growth of the business.

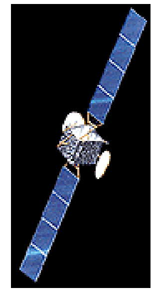
June 25, 2009

World Teleport Association

www.worldteleport.org

Made Possible by the Support of WTA's Industry Patrons:

Introduction



Teleports act as the "meet me" points for multiple transmission paths: satellite, optical fiber, microwave and increasingly IP-based WiFi or WiMax. They do not own or operate satellites, but satellite transmission is typically their major focus and the characteristic that distinguishes them from other service providers. Like carriers, they benefit from growth in satellite applications and suffer when satellite utilization falls.

In a word, teleport operators and satellite carriers are *interdependent*. Success in satellite communications depends on having in-orbit assets in the right regions with the right technology to meet customer needs – as well as on having access points on the ground with integrated service capabilities that add value to the basic bent-pipe circuit. Some of those access points are the property of customers; all satellite carriers provide direct service to broadcast, business and government customers that operate their own ground segment. But according to research by WTA, nearly 25% of satellite communications revenues move through the accounts of teleport operators, which makes them a vital channel to market for carriers.

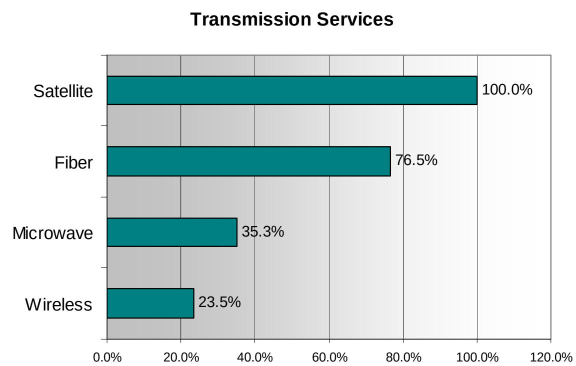
The Traditional Market

Prior to 2000, the interests of teleports and satellite carriers were well aligned. Most satellite carriers depended on independent teleport operators to provide ground access and specialized services to customers not operating their own teleports. (Carriers also operated their own teleports for telemetry, tracking & control, but this had no commercial impact.)

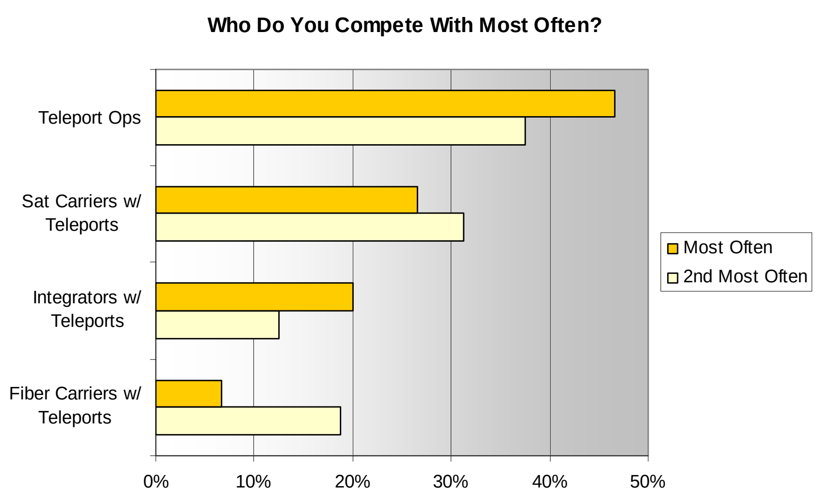
In the new century, however, satellite carriers took advantage of market downturns – and resulting low acquisition prices – to acquire teleports and gradually integrated the ground facilities into their operations. Today, the world's largest satellite carriers – Intelsat, SES, Eutelsat and others – operate teleports in multiple locations and find themselves in a position to compete directly with teleport operators that are also their valued customers and strategic partners. This represents channel conflict between the role of the carrier as supplier of a vital service to teleport operators and their role as potential competitors in providing integrated services to the same customers.

In October 2008, WTA surveyed the senior executives of independent teleport operators in the Americas, Europe and Asia. The goal of the survey was to identify how the changing competitive dynamics of the business were affecting them and how their companies were evolving in response. WTA published the results of the survey in an October 2008 report titled *New Services, New Markets, New Competition*. It is available free to WTA members and for sale to non-members.

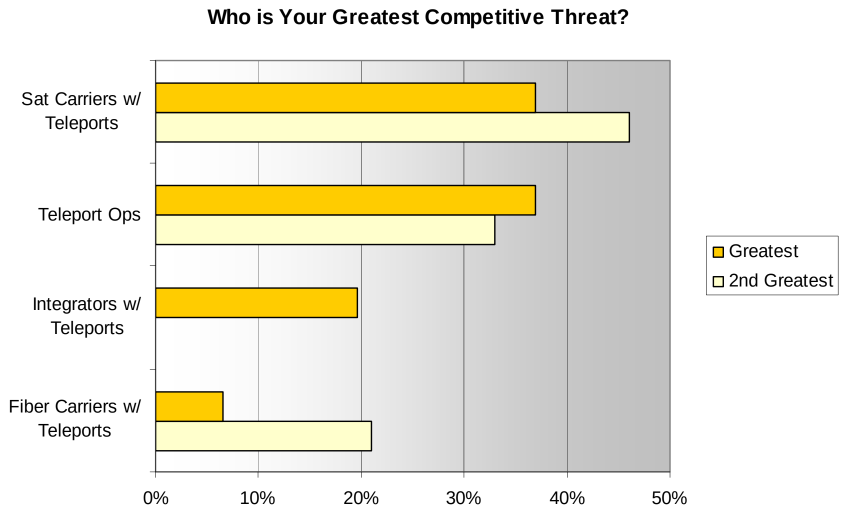
The Issue of Channel Conflict



The report showed that teleport operators took the issue of channel conflict seriously. One hundred percent of teleports surveyed use satellite as a transmission path, compared with 76% for optical fiber and 35% for microwave. But when asked what kind of company they compete with most often, 27% of respondents cited satellite carriers owning their own teleports as their most frequent competition today, compared with 47% citing other teleport operators.



The survey went on to ask independent operators what kind of company they considered their greatest competitive threat. Here, opinions were even stronger: satellite carriers were ranked as the greatest competitive threat by over 35% of respondents and the second greatest competitive threat by over 45%. These rankings suggest that there a wide gap may have opened between how teleport operators and satellite carriers view their partnership.



To help address the issue, WTA organized a Member Forum in March during SATELLITE 2009 in Washington DC, hosted by the Paul-Hastings law firm. Nearly 40 senior executives with teleport operators and satellite carriers attended. It was the industry's first open exchange of views on the topic and proved a valuable experience for all involved. The purpose of this white paper is to offer a balanced presentation of the issues raised and recommend ways to better manage the vital strategic partnership between teleport operators and satellite carriers as they strive to deliver innovative, cost-effective services to customers.

What is Channel Conflict?

Channel conflict is present in nearly every industry on earth, and companies have developed many strategies for managing it to the benefit of the broader market. That was the how Michael Cohen, a PaulHastings attorney and expert on competition law, introduced the topic to the WTA member executives gathered at his firm's Washington office on March 23.

He explained that channel conflict takes place *within* brands ("intra-brand") when dealers, distributors and retailers compete with each other on the price of the same product. This is the oldest form of channel conflict, and industries have developed many ways to deal with it.


Michael Cohen, Partner, PaulHastings

- Suppliers set retail prices and require distributors to adopt them, or publish "manufacturer's suggested retail prices" to reduce the scope for price-cutting.
- Suppliers define sales territories and authorize only one distributor to carry their products in each territory.
- Suppliers segment customers based on type (national vs. local) or purchasing method (retail vs. mail or online) and assign each to a different distribution channel.

Channel conflict also takes place *between* brands ("inter-brand"), which requires greater ingenuity to manage. Mr. Cohen described a case in which the printer manufacturer **Hewlett-Packard** sold its printers and ink through the **Staples** chain in the US. Seeing an opportunity, Staples created its own "private-label" brand of ink cartridge and sold it at a substantial discount to the HP brand. It was highly profitable for Staples but made a big dent in HP's sales. Because Staples was such a major channel, HP negotiated with the chain and reached agreement to make Staples an exclusive distribution partner in exchange for having Staples drop its private-label produce. The decision wound up in court, where a judge upheld the exclusive deal as reasonable.

In another IT-sector deal, **Dell Computer** found itself in conflict between direct sales to consumers and distribution to retailers. Dell prefers to sell direct, custom-building each computer in a process that made it one of the world's largest PC manufacturers. But it also depends on retail chains like **Best Buy** in the US to sell its hardware. To resolve the conflict, Dell reached agreement with Best Buy to offer hardware-software combinations through the retailer that were unavailable through its telephone or online sales.

These examples show that inter-brand channel conflict is both highly likely and manageable. It requires both sides of the conflict to have a clear understanding of their long-term interests and find innovative ways to collaborate in serving the needs of customers.

Viewpoints: Competition or Conflict?

The Member Forum offered attendees panel discussions among teleport operators, satellite carriers, and a roundtable discussion involving the entire audience. Attendees heard a wide range of views, and WTA has gathered additional comments and viewpoints in one-on-one discussions since the Forum. The main points of agreement and contention are described below.

Inter-Brand Conflict

A number of top teleport executives believe that channel conflict is real and threatens the growth of their businesses. The core issue for them is the control that satellite carriers have over the pricing of transponder capacity. Carriers have the potential to use this power in one of two ways:

- Offering customers bandwidth at a price that undercuts the teleport operator's ability to resell bandwidth as part of a total solution
- Offering customers a bundled solution including teleport facilities and services as well as bandwidth at a price that undercuts the teleport operator's ability to sell any service whatsoever

According to these executives, the latter approach constitutes an attack on the core value proposition of the teleport, based on the following reasoning.

When carriers offer teleport services in addition to bandwidth, they have the opportunity to discount the price of those services to zero, if need be, to win the far more lucrative, higher-margin satellite capacity deal. The value of those services – turnaround, format conversion, post-production, routing and switching, network management, systems integration and so on – is the core of the teleport business. No teleport can stay in business by discounting those services too steeply in order to win business from other teleport operators. But satellite carriers have that opportunity, because of the high margins (before capex) produced by transponder leasing.

Panelists

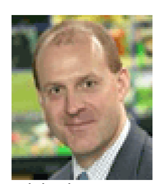
Andreas Georghiou, CEO, Spacenet

Gary Hatch, President, ATCi

David Hershberg, Chairman & CEO, Globecomm Systems

Bryan McGuirk, President, Media & Enterprises Services, SES AMERICOM

Rick Mortellaro, Vice President, International Sales, Telesat



Nick Thompson, Managing Director, Arqiva Satellites & Media

Pricing Bandwidth and Services

Satellite carriers point out that the pricing of bandwidth is complex. At the most basic level, pricing is determined by volume, with big buyers receiving more attractive pricing, whether they are broadcasters, governments or teleport operators. A small independent teleport operator may find that, when it tries to sell a bundled service-plus-bandwidth solution to a big customer, the carrier offers a better price to the customer than to the operator. In such a case, the carrier may not be competing unfairly with the teleport operator but merely providing a bigger customer with bigger discounts.

Carrier reject suggestions that they would agree to lose money on teleport services in order to win transponder deals. They insist that, as a matter of good business practice, every element in their value chain – transponder capacity, teleport facilities, engineering talent and technical operations – has to pay its own way. Independent teleports also provide a cost-free "on-ramp" to their satellites, which is why they are such an attractive channel partner for satellite carriers.

When carriers do operate their own teleports, according to one satellite executive at the Forum, they do it for three reasons:

a) To increase cost effectiveness on outsourced services

b) To achieve control, flexibility and reactivity in re-allocating space capacity in a context of capacity crunch

c) To provide services where the ground technology is an integral part of the service itself, as in the case of fully integrated applications such as satellite Internet or mobile services.

In any case, the amount of money carriers can make from teleport services is minor compared with the margins on transponder leasing. It is precisely this fact, however, that can motivate carriers to underprice teleport services, according to some teleport executives.

Despite the differing points of view, all attendees at the Forum agreed that bandwidth pricing becomes a particular issue between teleports and carriers in soft markets. When there is too much idle capacity available, according to teleport operators, enterprising carrier sales representatives offer deep discounts to the operator's customers in an attempt to win business away. Carrier executives had their own stories of teleport operators, faced with paying for capacity they do not currently need, who try to undercut the retail prices of the very carrier whose capacity they are selling. When it occurs, this kind of cut-throat competition damages opportunities for everyone in the market.

Increasing Customer Value

Teleport operators and satellite carriers agree that increasing the value they provide to customers is the key to long-term success. Teleport operators concerned about competition from satellite carriers cite value as their only meaningful defense. Years ago, teleport operators could profit by offering basic transport services, but those days are long gone. Today, successful teleport operators integrate technology, manage networks, provide format conversion and content hosting and perform a range of customized services.

One teleport executive at the Forum reported that customers who had long bought their own space segment were now asking his company to manage their networks and optimize their bandwidth across multiple carriers. He cited it as an example of a value that no individual carrier could offer. Whether competing against carriers or other teleport operators, said a teleport CEO, "If you're not offering a lot of value-add, you might as well not try to compete. The teleport has to be the place where the value is added to the satellite circuit."

Satellite carriers concur on the necessity to constantly boost the value of customer solutions. The needs of customers are evolving at high speed. Those customers do not care who owns the elements of the solution or how they are assembled, as long as the end-result is cost-effective and of high quality. One value offered by carriers that operate their own teleports is global reach with a dependably high quality of service from end to end. Another is the ability to integrate solutions that are intrinsically dependent on a particular satellite or group of satellites. One carrier cited a service in which it provides a satellite TV multiplex in MPEG-4 using its own teleports as gateways. In the US, the satellite TV companies DirecTV and Echostar have long provided the only gateway to their transponder capacity through a similar multiplex, and this carrier is replicating the model on its spacecraft. In the process, it is gaining a great deal of spectrum efficiency but may be eliminating opportunities for independent teleport operators to uplink TV programs.

Yet even carrier-controlled services may not be monolithic. One satellite carrier has chosen to originate and control its Ka-band operations from its own facilities, but it has gateway relationships with independent operators in multiple countries. Eight out of ten of its gateways are hosted and operated through third-party teleports.

Partnership Models

In a business where available customers number in the hundreds rather than thousands, teleport operators themselves can be important customers that generate from tens to hundreds of millions of dollars in transponder leasing revenue. Not surprisingly, carriers are keenly aware of the potential for conflict with their channel partners and are working, each in their own way, to manage the issue.

Some carriers prefer to deal with possible channel conflict on a case-by-case basis. Through meetings with individual teleport operators and customer events, they listen to feedback and suggest solutions to specific problems.

For others, concerns about channel conflict have spurred a broader review of business strategy. Two of the world's largest satellite carriers, which either built or bought teleport operations in the past decades, have recently decided to sell off or close their non-TT&C teleports and conduct most of their transmission business through teleport partners. They negotiate straightforward commercial arrangements with teleport operators that set clear rules for customer development and management as well as predictable pricing.

Collaboration on Technology Adoption

One area in which business practice differs sharply between satellite carriers and teleport operators is in technology R&D. Carriers make long-term investments in technology and R&D as part of the +20 month development cycle of most satellites. Teleport operators, on the other hand, typically invest only based on immediate customer requirements.

Attendees at the Forum suggested that there may be opportunities for teleport operators to step up in terms of helping to develop and pilot new technologies where the payoff is both longer-term and more speculative than they are used to. In return, carriers might provide revenue-sharing opportunities in those technologies as well as involving teleport operators more closely in their technology roadmaps.

One attendee, a teleport and technology veteran, cautioned that lack of innovative technology is not the issue. There are a large number of exceptional technology vendors in the market producing innovations at high speed. The challenge is adoption: figuring out how to use the new technology to improve the customer experience and lower costs. With their common interest in identifying and serving customer needs, he said, teleport operators and carriers have a chance to develop productive partnerships in this area to support future growth.

Recommendations

Satellite carriers need to sell capacity in both soft and hard markets. Teleports need to sell the technical, operational and management value they can bring to complex communications solutions that involve satellite. They are joined in a partnership in which teleports act as significant customers as well as channels to market for satellite carriers, carriers provide an essential service to teleport operators, and both sometimes find themselves in direct competition.

Based on discussions at the Member Forum and subsequent feedback from throughout the industry, WTA offers the following recommendations for the relationship between teleports and carriers:

- **Sharing Risks and Rewards.** The commercial partnership between teleports and carriers work best when both are willing to share risk and reward. Satellite carriers take risks placing satellites in orbit and introducing new kinds of services. Teleports take risks acquiring new antennas to access satellites they do not yet serve, and bundling technology and ground assets to develop new services. Flexible pricing terms during the start-up phase of a new satellite or service can allow both parties to reduce their upfront risks in return for sharing the upside of a successful service. The opportunity to partner on technology adoption (see page 10) may be another such opportunity.
- **Clear and Consistent Policy on Commercial Terms and Pricing.** The best way to deal with channel conflict is for carriers and teleports to agree on clear and consistent commercial terms and transparent pricing based on volume. This requires a level of trust in the partnership and typifies successful efforts to manage conflict. Such policies will allow teleport operators and carriers to compete, where necessary, on value, location, and market access.
- **Creating Partnerships at the Sales Level.** Whether dictated by policy or occurring on the fly, channel conflict comes down to the sales relationship between teleports and carriers. Whatever policies are put in place, the sales executives of carriers and teleports must not only be trained in what the policy is but be motivated to view the other side as a genuine partner in success.

Growing the Pie

In a sense, channel conflict, when it occurs, represents a missed opportunity. The satellite industry as a whole currently receives about

1% of global telecommunications services spending. The real opportunity available to teleports and carriers, working together, is to grow that market share. This will only happen if satellite can move out of its current silo and integrate its extraordinary capabilities firmly into the networks and applications used by the majority of the world's customers. This will take strong and innovative collaboration by all sectors of the satellite business.

The need for continued innovation in the sky and on the ground is enormous, and long-term success depends on letting innovators thrive. Many of those innovators will be small, entrepreneurial companies that identify new niches and exploit technologies in new ways. One Member Forum attendees expressed concern that, if the biggest companies use their market power to drive out small operators, the pace of innovation will slow. This is only one potential outcome of failure to manage the commercial tensions that can lead to channel conflict. Since commercial teleports entered the market in the 1970s, their operators have forged productive partnerships with satellite carriers in both good times and bad. Even in today's strange mix of tight capacity and strong demand in the face of global recession, they will surely do so again.

Next Steps

The goal of this white paper has been to air the issues surrounding concerns about channel conflict in a fair and balanced way. By alerting both teleport operators and carriers to the seriousness of concerns in the market, we hope to encourage dialogue on how best to balance competition and cooperation so as to better serve the evolving needs of customers.

To manage this effort for the Association, WTA has formed a Carrier Relations working group that includes representatives from teleport operators and satellite carriers. The working group oversaw development of this document and will monitor the industry's progress on resolving this issue. WTA members are invited to comment at any time by sending an email to rbell@worldteleport.org.

About the World Teleport Association

Since 1985, the World Teleport Association (WTA) has been the only trade association that focuses on the business of satellit communications from the ground up. At the core of its membership are the world's most innovative operators of teleports, from independents to multinationals, niche service providers to global carriers. WTA is dedicated to advocating for the interests of teleport operators in the global telecommunications market and promoting excellence in teleport business practice, technology and operations. Companies that do business with teleports also find that WTA is the best investment they can make to open new channels to the industry.

World Teleport Association
+1 212-825-0218 FAX: +1 212-825-0075 www.worldteleport.org