1997 Trends
CLECS ON THE ROAD TO DIVERSIFICATION

By Richard G. Tomlinson and Terrence L. Barnich

Here's a prognostication for the new year: In 1997 CLEC revenues will grow, the universe of market players expand, services deepen and strategies grow at an explosive rate. That is, of course, if the core industry trend toward vertical convergence of CLEC local switched services with long distance services that has been taking place for the last two years gives way to horizontal diversification into wider combinations of telecommunications and telecommunications-related services. Early indications, from industry leaders as well as newer entrants, suggest that horizontal diversification, with its positive effects on revenue and business expansion, will be the most important trend for the CLEC industry in 1997.

The Antecedents for Expansion

The CLEC industry was born of the economic distortions caused by federal and state regulatory telecommunications policies. Competitive access providers (“CAPS”), predecessors to the CLECs, owed their business viability almost solely to the ability to respond to regulatory stimuli. However, CLECs will ultimately prosper only if they navigate the transition from surviving by responding to regulatory inducements to thriving by anticipating marketplace incentives. That is not to say that regulatory drivers will quickly wither away as economic factors.

Indeed, the passage of the Telecommunications Act of 1996 has built into it certain protections that will insulate the CLECs from the immediate threat of being swamped by much larger capitalized telecommunications competitors. Restrictions against in-region bundling of local and long distance services by the Regional Bell Operating Companies (RBOCs) and the temporary prohibitions on joint local-long distance marketing imposed on AT&T, MCI and Sprint have given the CLECs a three to four year regulatory head start in being first to market their integrated services.

At this early stage in the transition, the opportunities to exploit the local switched services market opened by the passage of the Telecommunications Act and the state initiatives responding to emerging competition cannot be understated. However, there are significant core market drivers accelerating the development and evolution of these opportunities that the CLECs are already leveraging into profitable lines of business.

Core Drivers

First is the development of business applications for use by the Internet. This has produced an anticipatory thirst for bandwidth as well as created an engine to overlay the public circuit switched network by various competitive packet switched networks. For the CLECs this presents a whole new world of opportunities to provide fiber transport, packet switching, Internet access and data services.

Second is the reality of the convergence of local and long distance services into the provision of a geographic indifferent package of end-to-end telecommunications services. As alluded to above, the paradigm shift from the monopoly model to the competitive marketplace embodied by federal and state regulatory changes has given the CLECs a near blank sheet in which to make the local-long distance convergence a reality. Third, persistent technology evolution will permit the opportunistic CLECs the ability to be first to market a large basket of integrated vertical client-server and network-based business applications. Furthermore, in the quest for profit margins, nimble CLECs will continue to migrate the reach of competitive services down the customer class food chain.
from business applications to home based business markets and the residential market. And along the way, they will serve various government markets such as distance learning and medical health-care.

**Growth by Diversification**

While internal growth of CLEC companies has been strong in the pursuit of conventional lines of business and whereas, growth will continue to be robust as a result of these more nascent opportunities, explosive growth is coming through diversification by way of acquisitions and mergers that accelerate the ability of CLECs to exploit the newly available markets. In this quest, CLEC companies are traveling divergent paths in discovering new approaches and creative service combinations to satisfy customer demands.

MFS is the industry exemplar in this regard. With the acquisition of Internet provider UUNET, MFS was poised, for a short period, to transform itself from a predominately "network services" provider to a "data services" provider. And then again, with the WorldCom merger, it has acquired a global long distance footprint, thus taking a giant step toward becoming a total service competitive communications company.

Teleport, by contrast, has followed a more conventional growth strategy based upon voice-oriented services. Offering dedicated and switched telephone business services, it has sustained respectable growth by maintaining a more purest CLEC business. ICG, which until recently stayed with a carriers' carrier approach, has expanded into enhanced voice and interactive voice offerings through a series of acquisitions.

Intermedia Communications, which operated for several years as a one-state GAP in Florida, has employed frame relay data offerings as its initial expansion vehicle throughout the Eastern United States. This, coupled with the acquisition of frame relay provider EMI Communications, gave its revenue spectrum a strong data focus. Intermedia continues its data strategy, but is now adding more networks in other states and is deploying a significant number of central office switches.

McLeod Inc., which began its operations as a Centrex reseller, is now deploying and operating its own switch-es and is migrating out of its Iowa base to deploy more fiber networks. The 1996 acquisition of directory publisher TelecomUSA Publishing has given McLeod a unique revenue profile.

GST Telecom, with a broad initiatives from network operations to switch manufacturing, is strongly participating in the long distance business through its acquisition of long distance resellers.

Brooks Fiber Properties has a well-balanced revenue profile, combining facilities-based CLEC operations with the acquisition of long distance resellers.

In addition to these more established CLECs, there is an ever emerging wave of new companies today based primarily on reselling CLEC and interexchange carrier (IXC) local and long distance service. Many of these new carriers will use their resale revenues to finance a migration to facilities-based operations. Close behind are a gaggle of wireless and video oriented competitors. In all, 1997 will surely be punctuated by the introduction of an exhausting list of entrepreneurs seeking creative ways to enter the expanding communications market.

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