

The Line Is Dead: The Future of Telephone, Cable and Wireless Communications

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Back in the day, irritated parents once asked, “Do you have stock in the phone company?” when their teenagers talked for hours on their household landlines. Now, as teenagers and their parents both rely on cell phones and computers instead of landlines to communicate, individuals who really do hold stock in wired telecommunications (“telecom”) carriers need to brace themselves for the industry’s rapid and permanent decline.



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For most people, it is no surprise that the wired telecom industry is shrinking. What has shocked consumers and industry experts alike is how completely and quickly it seems the industry will disappear. Revenue has

been dropping at an annual rate of 7.5 percent since 2006, according to market research firm IBISWorld, and it is expected to continue falling at a similar rate during the next five years. By 2016, IBISWorld predicts that the industry will be 31.3 percent smaller in terms of revenue than it is today.

The shift has been so precipitous that in 2005, the Federal Communications Commission (FCC) launched an investigation into the sharp drop in wire/landline service in parts of the country. In 1996, 97 percent of U.S. households had a landline phone, compared with only 75 percent today. Craig Moffett, vice president and senior analyst of U.S. telecommunications, cable and satellite at Sanford C. Bernstein & Co., recently said that he expects that number to drop to just 36 percent by 2015.¹ An August 2009 *The Economist* article in noted that if the current decline in landlines continues, the last cord of an American landline may be cut as soon as 2025.²

The “Great Recession” accelerated and contributed to this “cord cutting,” according to Stéphane Téral of Infonetics

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Research. The convenience of portable devices combined with unemployed and underemployed consumers’ desire to save money inspired many people to cancel their landline services and turn solely to cellular networks to meet their communication needs.

As subscribers departed from traditional wired telecom companies, so did the income those companies needed to improve and maintain their wireline infrastructure. It became increasingly harder for wired telecom companies to improve their fixed-line networks or

extend their networks to underserved parts of the nation. Forced to provide the same services with less revenue, companies had to severely reduce headcounts to survive, leaving fewer employees to do the same amount of work. All of these factors accelerated the decline of traditional wired carriers while simultaneously improving the market share of their wireless competitors.

While the major wired carriers—Verizon, Qwest and AT&T—claim to have anticipated this shift that was exacerbated by the Great Recession and either heavily invested in wireless technology or shed their wireline holdings, other, smaller telecoms did not have wireless holdings on which to rely. According to *The Economist*, Fairpoint, a buyer of Verizon’s telecom assets, is struggling, and other telecoms, including Las Vegas-based CommPartners Holdings, Hawaiian Telecom and Freedom Communications USA have filed for chapter 11 over the past few years. Other struggling, small telecoms have been acquired by larger firms in recent years: Comcast’s acquisition

of Cimco and Level 3’s acquisition of competitor Global Crossing are just a few examples that underscore the trend of bankruptcies and consolidations in the once-fragmented telecom industry. Similar findings can be found within the Canadian telecom market.

This overarching trend toward convergence in the telecom industry will have a pronounced impact on wired carriers. The rise of the Internet has turned previously unrelated industries, particularly cable television providers, into powerful competitors. In the fight for broadband customers, cable companies have the advantage of being able to provide consumers with bundled groups of services, including video, phone, Internet and, sometimes, even Voice over Internet Protocol (VoIP). According to Leichtman Research Group, this has resulted in cable companies controlling a larger share of the broadband market and consequently adding subscribers more quickly than

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traditional telecom providers. Cable has now reached a tipping point, particularly because until the last decade, wired telecom owned the “last mile” of connectivity into consumers’ homes. Because of the influx of cable providers offering bundled services, telecoms can no longer protect this last line of defense.

Cable is also better poised to take the lead in the next round of industry convergence as the boundary between content and distribution collapses. Comcast’s recent acquisition of the majority stake in NBC Universal was a landmark event. By creating what Comcast chief executive Brian Roberts called “the ideal entertainment and distribution company,” Comcast has conquered that important metaphorical “last-mile” connectivity with consumers. The result is that wired carriers will soon be relegated to those rural areas where the literal “last mile” matters more than the metaphorical one. In preparation, large telecom companies, including industry giants AT&T and Verizon, have already begun to sell off their wireline segments to smaller

¹ *The Media Financial Manager Magazine*.

² “America Loses Its Landlines,” *The Economist*, Aug. 13, 2009.

regional companies in remote places where cable has not yet arrived.

Despite all of these factors, the most obvious cause of the decline of the wireline telecom industry is substitution. Customers are increasingly turning to other industries—namely wireless communications, cable and Internet phone companies—for the services their wired carriers once provided them. As wireless carriers have achieved substantial economies of scale, they have been able to significantly drop their prices, making it feasible for even the most price-sensitive customers to use cell phones as their primary (or only) form of voice communication. This phenomenon has granted these customers their own acronym: cell phone onlys, or CPOs. It has been less than a decade since the wireless industry really took off, and already wireless subscribers outnumber wireline subscribers two-to-one, according to IBISWorld.

The impact of these CPO customers is affecting a variety of vertical industries, including business, government and nonprofit organizations. Because wireless customers are charged for receiving calls as well as making them, it is illegal for telemarketers and political pollsters to call cellular customers, making them more difficult to reach for marketing, survey and political purposes. Telemarketing companies, political campaigns, universities seeking donations and other organizations who wish to reach these consumers must budget for all calls to cell phones to be twice as expensive as dialing a landline.

Other unforeseen consequences of the nationwide shift to CPOs involve the public-service sector, since call tracing for first responders was designed to work with landlines. In more advanced markets, emergency services are learning to utilize GPS tracking and transponder notification to isolate an emergency wireless call within 20 feet, but particularly in urban settings, 20 feet is not specific enough. The technological advances needed to provide more specific call-tracing services to aid in first response care—known as Public Safety Answering Points—are expensive and funded by U.S. taxpayers. The U.S. Association of Public Safety Communication Officials has repeatedly warned that current levels of funding cannot keep up with the program's capital costs as more and more people use cell phones rather than landlines to make emergency calls.

Furthermore, the government-imposed cross subsidy on wirelines is predicted to be increased as the number of wirelines, and subsequently the surcharge revenue from those wirelines, decreases. It is feasible to speculate that the taxes and fees for wireless and broadband connections will increase as a result.

VoIP also poses an increasing threat to wired carriers. VoIP services transmit voice information as data packets, allowing calls to be made more cost-effectively, especially over long distances and internationally. Because of quality issues, subscriber rates are still fairly low, but as the technology improves, VoIP will offer a clear, less-expensive alternative to wireline service. In fact, IBISWorld predicts that the number of VoIP subscribers will double during the next five years.

VoIP software applications require only a WiFi connection to make calls through what is known as an Unlicensed Mobile Access (UMA) phone. Originally available through Apple using the applications iCall and Fring, which allow an iPod Touch, iPad or Apple laptop to become “telephones,” the technology has spread to other carriers to help cover dead spots in cellular coverage. This technology is now available as a hybrid platform on Android and Blackberry devices, and its popularity is expected to grow.

An offshoot of UMA technology, Skype, has attracted 405 million customers worldwide during the past six years, according to the same *Economist* article. Both a service provider of VoIP and a developer of the software application, Skype has been called a model for future communications. While some VoIP companies, such as Vonage, charge consumers to make calls (albeit at rates cheaper than traditional wireline companies), others, such as Truphone and Skype, do not charge customers for basic calls.

In the cutthroat market of telecommunications when the price cannot go any lower than free, the only avenue for competition is service and availability. As both service and availability rapidly improve, Skype and similar telecom companies will tighten their nooses around the traditional wireline industry.

However, it is important to note that these major advances in communications technology have not necessarily translated to increased profits. According to analyst firm

Sanford C. Bernstein & Co., two of the major wireless carriers, AT&T and Verizon, have “not been able to generate returns in excess of the cost of capital in the past decade. Worse, neither [one of them] has even seen an improvement in [its] below-the-cost-of-capital returns. This poor showing occurred during a decade that saw an unprecedented bonanza of telecommunications services.” Both companies have seen their stock prices fall between 22 and 25 percent during the last 10 years.

The fall of wired carriers will have far-reaching consequences for related industries. Phone line construction and repair companies will virtually disappear, as will their supply chains. Printers and marketers of telephone directories also risk becoming obsolete, unless they can change their product to remain relevant to mainly CPO individuals.

Furthermore, media companies of all sorts are struggling with the move into the digital era. While more cable-delivered outlets for media companies to reach consumers are anticipated, mergers such as Comcast and NBC demonstrate that not everyone will be able to access the media that essentially will control the “last-mile” entrance to consumers’ homes.

Since cell phones now serve as consumers’ cameras, computers and televisions, and in many areas of the world, the “last mile” moves when the consumer does. This becomes even more important because despite reductions in wireline usage, the telecom industry is still inexorably intertwined with the cable and wireless industries. Phones and other Internet-connected devices must link back to wired networks for capacity purposes. Because they can handle large amounts of data, cable networks are well suited to “backhaul” wireless traffic and provide supplemental wireless coverage for mobile carriers. Cox Communications has provided this backhaul service for almost a decade, and other cable providers, such as Comcast, Time Warner, Cablevision Systems and Bright House Networks, are trying to get a piece of the pie.

While wireless carriers have also been struggling to make a consistent profit, the cable companies offering data storage, transmission and support for those carriers have been able to invest in their network (*e.g.*, helping to build

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the nationwide 4G system, using their expertise in moving, storing and packing multimedia traffic). Because the three largest wireless carriers are still heavily invested in wired carriers, the three are still dependent on each other—at least for now.

Given the rapid advance and evolution of technology, it is hard to predict exactly what the telecom industry of the future will look like, but it is clear that it will be very different from the way it looked 20 or 30 years ago. Phones will still ring and people will still talk

to one another, but the wired carriers, the titans of the industry for decades, will be gone. Instead of “Ma Bell” of the past, it will be the cable companies, Internet phone companies and wireless carriers that will dictate the industry’s path forward. ■

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