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WEEKLY INSIGHT
KPNQwest collapse provokes an earthquake in the telecom sector
It owned the biggest fibre optic network in Europe and controlled 30% of the European Internet traffic and 10% of the international traffic. But this hasn't been enough to save it from bankruptcy after failing to find buyers for parts of its business.
The announcement provoked panic among both client companies and stock markets. Last Monday the company’s shares fell 71% and during the week there were numerous problems to access some of their clients' websites. Some voices in the industry have described the collapse as a "nightmare" and even as a "September 11th" for the telecom sector.
Despite the present situation, the Dutch network company insists on its idea of finding a buyer for its network. AT&T, Verizon and Telia are among the favourites. (From Financial Times)

Highlights
- Founded in November 1998, KPNQwest has a 25,000 km fibre optic network stretching across 18 countries, from Ireland to Romania and Spain to Finland, and provides service to 100,000 corporate users. Among them, important technology firms (like IBM, Dell, HP, Nokia or Sonera), banks (like Dutch Bank ABN Amro) and services (like the airline company KLM and the consulting firm Cap Gemini).
- The operator was one of the major Internet carriers in the world. Many access providers channelled their...
exit to the Net through its backbone. The traffic has been transferred to KPNQwest's biggest rivals: Cable&Wireless, BT Ignite, France Telecom and Worldcom.

- After raising €1,000 million through an IPO in November 1999, its market valuation shot up to 41,000 million in February the following year.
- The company support net losses of 2,000 million, a heritage from the deployment and maintenance of its underused network which, according to some sources, costs some 500,000 million per day.

**Press Review**

**From The Irish Times**
"Customers will be redistributed among other providers across Europe. Ironically, the glut of capacity-a significant factor in KPNQwest's downfall-may ease the transition.

(...) Founded in November 1998 as a venture between Qwest Communications of the US and KPN, the data carrier was hammered by a slump in demand for the wholesale data capacity."

[Full Story]

**From Reuters**
"Many had thought that KPNQwest could survive the capacity glut in the telecoms market and falling demand for data transfer services that followed the tech boom and bust. Bondholders have already organised a committee to investigate the downfall.

(...) 'What has happened is unbelievable', said Philip Scholte, telecoms analyst at Stroeve brokerage in Amsterdam. 'It's difficult for me to accept that business has deteriorated this badly in only a couple of months.'

(...) Analysts said that one of the crucial problems was the waning support of its main shareholders and customers, Dutch carrier KPN KPN.AS and U.S. local operator Qwest Q.N. Both firms are struggling with their own debt problems."

[Full Story]

**From Forrester**
"Third parties will eagerly snap up choice KPNQwest network assets at fire-sale prices and use them to redeploy the business model without the massive startup costs. And by 2004, pent-up corporate user demand for metro fibre loops and new IP services will convince the capital markets that the telecom industry is worthy of new funding."

[Full Story]

**Commentary by...**
Juan Miguel López, PwC Manager

*Telecom: business is in the extreme*

The business of carriers has seen better moments. Investment has abandoned telecom signal transportation between operators -a mature business with low margins and void possibilities of differentiation- to focus, although without much excitement, on those providers that take advantage of local loop to offer technologies, services and contentwith added value.

Big operators' lines, built years ago by long-distance incumbents such as ATT, Cable & Wireless or MCI-Wordcom, cover today the whole planet, supplying more transport capacity than is needed. Analysts estimate that only 4% of Europe's fibre is really "lit" at present. Even those networks on stream are underused. Overcapacity of networks is still higher in US, where baby bells have covered the country with idle fibre, very costly to deploy and of doubtful profitability.

Big providers believed that the differential value lied in the possession of an enormous web. In the mid-
nineties, the Internet fever was caught by the main operators, who thought they had found extraordinary business opportunities in the growing data traffic. Following their traditional model, they started to wire the world to meet those opportunities.

The volume of transmitted data has increased indeed but not in the expected exponential way. Moreover, today's technology has increased the capacity of the networks considerably: one sole fibre optic cable is now able to channel multiple services.

In this context network redundancy is meaningless, as KPNQwest's failure shows. During its almost four years of existence, this provider felt obliged to lay 25,000 kilometres of fibre optic cable, while its competitors offered an identical service with already deployed networks and, therefore, with more competitive margins. For the moment the investment market is punishing the telecom market, making no distinction between providers that limit themselves to signal transport and those who focus on value added services to end users. The former behave as mere carriers in a saturated market and their only differentiation point is price. The latter, who understand that the telecom business is in the extreme, try to offer value to end users through pay services (specially those delivered by broadband). Gradually investors will better distinguish between the possibilities of both strategies.

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**EBCENTER ARTICLE**

The Internet is threatening the survival of intermediaries
Daniel Albiñana, Research Assistant at EBCenter

The intermediaries who base their business on carrying out transactions that their clients could do free of charge via the Internet are condemned to disappear. [Full Story]

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**REPORTS**

76% of telecom companies feel their shares are undervalued

*Title:* Communicating Value in the Telecommunications Industry

*Source:* PricewaterhouseCoopers

*Date:* 2002

*Abstract:* Seventy-six percent of executives of telecom companies feel their shares are undervalued. That is the major finding of a global survey of telecom company executives, investors and analysts conducted by PwC.

According to the study, only 24% of telecom executives believe their company’s external financial reports are very useful in communicating the value of their organisation. There is a lack of consensus between telecom executives and investors as to which performance measures are critical. Although many factors impact valuation, telecom executives see hidden value that investors and analysts do not. The majority of investors and analysts believe that companies have a great deal of discretion in calculating earnings. PwC experts recommend that telecom companies understand the value drivers that are most critical to the marketplace and develop meaningful reporting metrics that can be consistently reported to the external marketplace.

Companies that become more transparent and do a better job of reporting on key value drivers will receive real benefits, according to the perceptions of the marketplace. [Full Story]

**Content Industry Outlook**

*Title:* Outlook 2002: Issues in The Information Marketplace

*Source:* Outsell

*Date:* December 2001
Abstract: This year the content industry will converge and engage in interdependent relationships. That is the opinion of the research firm, Outsell, that has elaborated a survey reviewing the trends for digital content in 2002. Experts forecast that as information professionals continue to deploy more and more digital content, they find themselves looking for help from vendors that just haven't arrived. The survey also states that digitisation of content does not mean that physical space will lose its importance in this industry. However, as digital space changes so will physical space. Legal rights and relationships in the industry will continue to be important, but some of the solutions to legal conflicts and contractual relationships will regain a measure of common sense. According to the Outsell experts, buyers are increasingly concerned that their content deployment practices are consistent with their contractual obligations and copyright law. [Full Story] (A free subscription is required)

Entertainment and Media Industry will reach $ 1.4 trillion
Title: Global Entertainment and Media Outlook: 2002-2006
Source: PricewaterhouseCoopers
Date: May 2002
Abstract: According to PwC forecasts, the entertainment and media industry will continue to grow, reaching $1.4 trillion by 2006, for an annual growth rate of 5.2%. The majority of the growth will be driven by the digital distribution of content, aided by raising broadband penetration in the home (35 million broadband households by 2006).
Most vulnerable to piracy, file sharing and unauthorised use, recorded music will be the slowest-growing segment, averaging only a 1.6% annual gain. Spending on recorded music will increase from $36 billion in 2001 to $39 billion in 2006. The home video market is booming due to the popularity of DVDs, although piracy will hinder growth. Filmed entertainment will expand at a 5.7% compound annual rate, increasing from $59 billion in 2001 to $79 billion in 2006.
Digital distribution will develop slowly but will begin to have an impact on the market in 2006. Internet advertising and access spending will be the fastest-growing segment over the next five years, expanding by 12.1% on a compound annual basis and totalling $94 billion in 2006, up from $53 billion in 2001. [Full Story]

COMPANIES
World Cup ticket fiasco
Users can only buy World Cup tickets through the Internet, but it is collapsed. So thousands of tickets have been unsold for first-round matches in both South Korea and Japan. It seems that ticket sale problems are leaving many empty seats and $770,000 of losses are expected for each match. From Financial Times. [Full Story]

HP to stop making e-business software
Hewlett-Packard plans to stop making e-business software after the products failed to catch on in the lucrative field. The company has suffered heavy losses with its own e-business software and will now partner with other software companies to offer HP customers the programs they need to take their business to the Web. According to Gartner analyst Mark Driver, "HP acquired good technology, but it was a cultural mismatch: a hardware company trying to drive out software infrastructure." From ZDNet. [Full Story]

Macromedia and Jakob Nielsen agreement
The Web design guru Jakob Nielsen will collaborate with Macromedia to expand the role of Flash. Nielsen, one of the most prominent critics of the company’s Flash software for Web animation, is the author of the essay Flash: 99% Bad, where he argued that Flash-based multimedia typically makes Web sites harder to
navigate and distracts from the site's real message. Nielsen and his consulting firm, Nielsen Norman Group, will work with Macromedia to develop guidelines for creating practical, easy-to-use Web applications with the new version of Flash. From News.com. [Full Story]

WE RECOMMEND
What hinders digital cinema?
With the May release of George Lucas's *Star Wars: Attack of the Clones*, the spotlight is again focused on the promise of digital cinema, a new technology which stores video and audio as digital data so that it can be manipulated and transmitted electronically.

Studios could save more than $1 billion and theatres would not have to be constrained by the number of prints they have because they could instantly access a digital movie with any projector linked to their server, and simultaneously increase the number of screens showing it.

However, the studios and theatre owners aren't hooked on digital. Their major argument is that, with 36,000 screens in the U.S., it could **cost $5 billion to $7 billion** to upgrade the entire infrastructure. Plus, in contrast to digital music, there isn't a customer base clamouring for digital cinema.

There are other obstacles to digital. It's not clear yet which of the competing technological specifications will become the **standard** for digital cinema. In addition, the thought of operating **two different distribution systems** for a period of time is not particularly palatable. And, most serious of all, the studios are fearful that distributing their films over computer networks will lead to **piracy**. From Strategy+Business. [Full Story]

Strategy for a turbulent world
Globalisation and technology are sweeping away the market and industry structures that have historically defined the nature of competition. That makes it impossible to predict, with any confidence, which markets a company will be serving or how its industry will be structured—even a few years hence. The result is an economic environment that is rich in opportunity but also marked by a substantial increase in awareness of risk and aversion to it.

McKinsey recommends that CEO's think about corporate strategy as a portfolio of initiatives intended to achieve favourable outcomes for the entire enterprise. There are three distinct elements to a portfolio-of-initiatives approach. First, it entails a **disciplined search**, based on familiarity, to discover and create initiatives that provide disproportionately high rewards for the risks taken. Second, it involves a dynamic continuous effort to manage the portfolio of initiatives resulting from this search process and the use of time-management and portfolio theory to overcome unavoidable risks due to complexity and uncertainty. Finally, it calls for a **flexible and evolutionary approach** that lets "natural selection" rather than vision determine where, how, and when to compete. It may be useful to examine each of these elements in greater detail. From *McKinsey Quarterly*. [Full Story]

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