

The Telecom Industry Will Survive Despite Crisis

Bob Hafner, David Neil, Jay E. Pultz

Accounting questions and other bad news have hit many telecommunications carriers and equipment vendors lately. Some individual players may succumb, and the crisis will test the nerve of enterprises.

NEWS ANALYSIS

Event

On 12 February 2001, Cable and Wireless announced that it had booked as revenue the total value of lease agreements with other carriers for using its capacity although some of the leases run for 20 years. Other bad news has come out in the space of a few days:

- U.S. authorities are probing Global Crossing's accounting practices, which could delay or derail its bankruptcy settlement.
- Qwest Communications International came under scrutiny for an off-the-balance-sheet partnership with KMC Telecom Holdings that may have boosted Qwest's earnings artificially.
- KPNQwest said 15 percent of its revenue comes from capacity-swapping agreements with other carriers.
- Nortel Networks said it may miss its 1Q02 earnings targets because carriers continue to limit spending.
- Qualcomm's share price fell amid concerns about its accounting practices.
- Standard and Poor's lowered WorldCom's rating because slack revenue and earnings growth will make it more difficult for WorldCom to repay its debt.
- Carrier1 International, a European wholesale carrier, filed for bankruptcy, and its stock was delisted.
- Optus, Australia's second-largest carrier, restated its earnings for 2001 after authorities investigated its accounting practices.

Analysis

The outlook at first seems dismal for the global telecom industry. The above list of recent developments is only partial, nor does it reflect persistent troubles such as the ongoing struggles of Lucent Technologies or Cisco Systems' sluggish network service provider (NSP) business. This incredible spasm of bad news follows on 2001, one of the worst years ever for the telecom industry, which saw revenue growth stall, competition intensify and carriers bend under enormous debt loads. Gartner believes that some NSPs, at least, aggressively reported revenue to present the best possible face to investors. In the wake of Enron's collapse, these practices have come under harsher scrutiny than ever, and investors may punish stocks on the mere suspicion of irregularities.

Although the reputation of the industry has suffered damage that will last a long time, the telecom market won't collapse. Carriers that expanded rapidly in the late 1990s spent 2001 working out from under their debt, with some success. Revenue growth won't pick up speed very quickly, but the worst declines are probably over. Many carriers have begun to develop value-added services with higher profit margins and the potential for faster growth. Finally, when the smoke clears, a few carriers will have suffered serious damage; most will survive. In fact, some consolidation will make the survivors stronger, depending on the carrier and segment.

Enterprises should not let the scandals and disasters distract them; rather, they should analyze the health of carriers individually. This assessment should include an extra close look at financial reports but should also reflect the maturity of efforts to reduce debt and reignite revenue growth.

Analytical Sources: Bob Hafner, Jay Pultz and David Neil, Enterprise Network Strategies

Need to Know: Reference Material and Recommended Reading

- “Investigations Put Global Crossing Restructuring in Doubt” (FT-15-5015). Even if these inquiries do not derail the proposed settlement, they could delay it well beyond August 2002. **By Jay Pultz, David Neil and Jean-Claude Delcroix**
- “AT&T Isn't First With 'Managed' Services But May Have an Edge” (FT-15-3727). The new services represent good steps toward developing incremental revenue streams beyond voice and data transport. **By Jay Pultz**

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