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EXPERT ANALYSIS FOR SERVICE PROVIDERS

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Moving closer to the Promised Land

The way to a new communications landscape is clear - less regulation and more innovation

June 1, 2002
By: Krish Prabhu
America's Network

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Those who guide our national telecommunications policy need to stop living in the past. Blunt words, no doubt. As we survey the carnage in the telecom marketplace and the emotion-laden gridlock over policy in Washington - and contemplate the Promised Land that was to have been delivered by the Internet - we see that there must be a better way.

The continued progress of the Internet, driven hitherto with very little governmental regulatory involvement, is now increasingly dependent on our national telecom regulatory policy. Advances in technology have moved so rapidly and unexpectedly that the Internet is bursting the fixed barriers of our old voice network and its regulatory superstructure.

Consumer broadband Internet access: Still a long way to go

We thus desperately need a better regulatory framework. Yet the battle lines for establishing such a new framework remain those that were drawn in 1984 in the post-divestiture era of voice services.

We see them every day in the continued recriminations and tussles between interexchange carriers (IXCs), incumbent local exchange carriers (ILECs) and the competitive LECs (CLECs). We can also see that many of the mechanisms in the Telecommunications Act of 1996 just didn't work.

Not so sure

The overall result has been considerable investment uncertainty. That uncertainty has forced innovators and their investors to the sidelines, bringing communications innovation to a near-halt.

Between 1994 and 2001, venture capitalists financed telecom innovation at a level approximately equal to the combined research and development budgets of the major telecom equipment suppliers. Over the last few quarters, however, venture capital investment in telecom has fallen to a tenth of that; and it isn't because of lack of funds - nearly $78 billion of committed capital remains uninvested. Venture capitalists typically invest in a technology two to four years before the technology comes to the market. Without knowing what the new telecom regulation will shape up to be, and without a clear picture of what types of capital expenditures service providers likely will make, it is very difficult for venture capitalists to place their technology bets.

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Implementing innovation

How do we create a new communications framework that ends uncertainty and encourages competition, innovation and growth?

Our first principle, if we have learned anything from the past 20 years, should be the recognition that technology, when given a chance, always outstrips legislation.

Exhibit A is copper-to-the-customer. Where it once dominated access, it is rapidly ceding to cable, wireless and satellite technologies. Our firm's view, for example, is that over the next 10 years, most voice traffic will migrate to wireless.

For regulators, this means that access to copper need no longer be guaranteed to all players. Instead, regulators must now make sure that no one medium has a preferred position over another.

Our second principle is that trying to establish and then enforce artificial barriers and relationships in the name of equity almost always distorts the market and hinders innovation.

For example, the local-vs.-long distance distinction is highly artificial and has resulted in years of fruitless debate between IXCs and ILECs over who has the right to do what.

The arrival of multiple access technologies gives us a golden opportunity to end the debate. If ILECs want to compete for long-distance business, they should be allowed. If IXCs want local access, they can turn to cable, satellite or wireless technologies.

Similarly, expecting service providers to share their networks and effectively compete has not proved out because one can't bludgeon competitors into cooperating. While CLECs have found it difficult to achieve economics of scale, ILECs have stopped investing in upgrading their networks, not knowing whether they can reap adequate benefits from the fruits of their capital expenditure.

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Given our national track record of micromanaging telecom policy, to the detriment of progress, it is almost certainly better to err on the side of less rather than more regulation.

And this leads to our third principle, namely, that government is far better at promoting goals than dictating solutions.

At present, our overriding goal should be universal, ubiquitous broadband access. We have an ample precedent for setting such a goal: the efforts to extend telephone service to all citizens during the 1930s. And we undoubtedly have sufficient incentives in our arsenal to achieve it. We should only take care that they be clear, simple and broad - such as tax incentives for carriers who bring broadband access to a very high percentage of their customers.

Promoting such a goal within the context of a new framework for carrier competition would enable the nation to maintain and even expand its global lead in communications technology and its applications. The overall economic impact would be, in fact, seismic. With uncertainty removed and appropriate targeted incentives in place, investors would provide ample capital for full telecom expansion and innovation. We venture capitalists would start investing our $78 billion, and the Internet would finally be allowed to reach its full potential.

A better way

In viewing the Internet's realizable potential, we investors start with the premise that the Internet can do anything better and cheaper than existing phone networks, content broadcast networks or library information networks. It is better because you can access it wherever you are and whenever you want to and because it comes with unrivaled search engines. Universal broadband access to the Internet can provide Internet content suppliers with a reach to a global audience at all times of the day. In addition, by creating closed and open user groups with adequate security and protection, the Internet can also facilitate appropriate work share environments transcending all space and time restrictions.

A proper framework will encourage significant investment in the buildout of underlying infrastructure, as market demand and supply create natural forces of

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propulsion. Venture investment will aggressively move into all relevant technology areas - intelligent peripheral devices, sophisticated home networking gear, public networking infrastructure, content storage and retrieval, search accelerators, software, and enhanced customized applications.

Overall, we see three clear trends that would receive increased impetus as the Internet starts to achieve its potential:

1. An upgrade of the nation's communications infrastructure from narrowband to broadband, with fixed networks feeding last-hop wireless 3G and Wi-Fi networks. The upgrade of fixed networks will enable us to realize the full bandwidth potential of optical fiber, coaxial cable and twisted pair copper.
2. Content providers will decouple themselves almost entirely from their respective media. Instead of developing cable content and paying cable operators to deliver it, content providers of all sorts will put their product on Web servers and make it accessible to multiple carriers. In fact, we expect broadcasters eventually to shift transmission en masse to Web servers. This would expand their reach to international audiences and would also free wireless spectrum. The unbundling of content from medium might offer the further benefit of allowing service providers to "rebundle" customized content for individual or group distribution.
3. A range of application service models will emerge based on a flexible rental-subscription model. Users will retrieve what they want, when they want it and pay for it appropriately. New service models will tie viewers, advertisers, and content much more closely than ever. For business customers, appropriate service models will facilitate the sharing of the Internet infrastructure for work-share groups in a virtual private environment, thus overcoming space and time restrictions.

These trends and others like them are there for us to exploit - if we choose to. The risk that the technology will somehow fail to deliver seems to me to be remote. The only real risk will be the investment risk at a micro-level. (Will this management team work? Is that a proper business model?) Venture capitalists routinely accept such risks as an inherent part of their day-to-day management activity. Raising and investing money in developing the right ideas is what we do best, but we cannot do it in an environment of regulatory uncertainty.

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