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Strategic Determinants of Reseller Profitability in the US Wireline Telekommunications Market

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Abstract

Resellers of wireline telecommunications services are firms buying transmission or switched minutes capacity from facility-based backbone and local loop carriers to „refine“ these raw supplies by introducing their own pricing schemes and sometimes by running own network nodes to switch leased capacity. They market these „refined“ offerings then under their own brand and on their own account to end customers. From a telecommunications policy perspective, there is general consensus that the existence of resellers is helpful in stimulating competition on formerly monopolistic service markets. From the perspective of the individual resellers, there are, however, almost no empirically substantiated insights on strategy variables contributing significantly to resellers‘ profitability and long-term survival. Therefore, the present study provided an empirical analysis of associations between 15 strategy variables and 2 measures of profitability using data gathered from 12 US toll resellers for the 6-year-period from 1992 to 1997.

During the study years the sample reported an average sales margin of –7.81% and a return on total capital mean of –9.96%. However, inter-firm profitability differences were very large with a subsample of 3 resellers (Excel, Tel-Save, Total Tel) being quite successful and another subsample of 3 corporations (Equalnet, FaxSav, Group Long Distance) being rather unsuccessful. Mean comparison and regression analyses revealed that more profitable resellers displayed (1) a lower share of medium-sized business customers, (2) a lower service portfolio concentration, (3) a higher degree of horizontal service diversification, (4) a focus on fewer sales channels, (5) fewer customer complaints per million dollar sales, and (6) a higher costs of service share of total operating costs. Overall, empirical findings are interpreted to support a life-cycle concept of wireline toll resellers. This means that only those firms immediately using cash-flows generated from basic long distance service resale for a cost-conscious expansion of activities into related services (e.g. value-added services, customized applications) in a first step and for a roll-out of facility-based carrier operations in a second step seem to be on the road toward longer-term prosperity.

Key words: Business strategy, resale, service diversification, toll resellers, US long distance telephony market.

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1. Study background and objective

In the transformation of telecommunications markets from monopolistic to competitive structures market entry of firms following a reseller business model regularly stimulates competition. This applies to the ”International Simple Resale” of leased lines in cross-border carriers’ carrier markets, in which resellers bypass the ”Accounting Rate System” supported by incumbent carriers with significant market power (Cave, 1995; OECD, 1997; Cave and Waverman, 1999). Further, it holds for reselling in end customer markets for mobile cellular telephony services, in which ”airtime resellers” accelerated the diffusion of reasonably priced mobile services (Kruse, 1995; Burton et al., 1999). In the end consumer markets for wireline telephony services so-called ”switch-based” and ”switchless resellers” can contribute also to telephony service offers tailored to the needs of specific customer segments (Fontenay et al., 1987; Beard et al., 1998; Dreyer, 1999). *Switch-based* resellers procure transmission capacities from backbone and local loop carriers on favorable wholesale conditions, “refine” their supply goods with their own switches to telephony services and market these then under their own brand and on their own account to end customers. Alternatively, *switchless* resellers just bring telephony or leased line traffic coming from a large number of their end customers to the network of one or more facility-based operators who usually grant them favorable quantity-discounted call charges. Both switch-based and switchless resellers do not invest as carriers do in an own infrastructure of transmission lines. Therefore, they can focus their investments on marketing & distribution and billing & customer care. A consequence of this business approach is that investment requirements and barriers to entry in the resale market are much lower than they are in the traditional facility-based carrier arena. However, resellers are heavily dependent on a regulatory regime which enforces carriers to provide resellers with access to their network at competitive cost-based procurement charges.

One recent example of a market where wireline resellers were extraordinarily successful in selling mass market fixed telephony services is Germany. There, diverse switch-based and switchless resellers such as *Mobilcom*, *TelDaFax*, Tele 2 or *Mox Telecom* led a price war in 1998 – the first year after complete market opening for competition. This quickly resulted in market share losses for the incumbent and sharp drops in long distance call charges (Brunekreeft and Gross, 2000; RegTP, 1999).

The resellers' success was reflected at the end of the second competition year in a market share of alternative telephone companies amounting to more than 40% of daily long distance calls minutes in Germany. However, three years after the opening of the German telephony market the future of resellers is seen to be uncertain. Productive efficiency increases of the incumbent and of large alternative carriers and more demanding customer requirements in terms of quality and diversity of telephone services raise the question as to whether wireline resellers in Germany and other countries are too disadvantaged with regard to size and resources to be able to survive competition in the long run.[1]

One approach to shed an empirical light on this question is to study at firms in markets which can look back on a longer history of reseller competition in wireline telecommunications services. In these markets it is possible to explore empirically strategy differences between profitable and unprofitable resellers to obtain an understanding of strategy variables contributing to resellers' long-term economic success (i.e., to identifiy critical success factors of resellers; see Leidecker and Bruno, 1984). The present study's objective is to provide such an empirical analysis of critical success factors using data gathered from 12 resellers of long distance telephony services in the US over the 6-year-period from 1992 to 1997.

To portray the context of our research, section 2 develops a brief profile of competition developments in the US long distance reseller market from the mid 70s to the mid 90s. Then, to acquire an understanding of potential determinants of reseller profitability, in section 3 we review previous empirical work on strategic critical success factors of facilities-based carriers and resellers in fixed line telecommunications services markets. Section 4 describes methods and results of our empirical study of 15 potential profitability determinants of US resellers. Finally, section 5 discusses implications following from our empirical findings for business strategies of resellers in other competitive telephony markets outside the US and for future research on reseller business strategies.

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1 In the liberalized European *mobile cellular* telephony market similar developments are apparent for several years. Cf. Garrard, 1998; Helme, 1997; Kruse, 1995.