Let's go round again

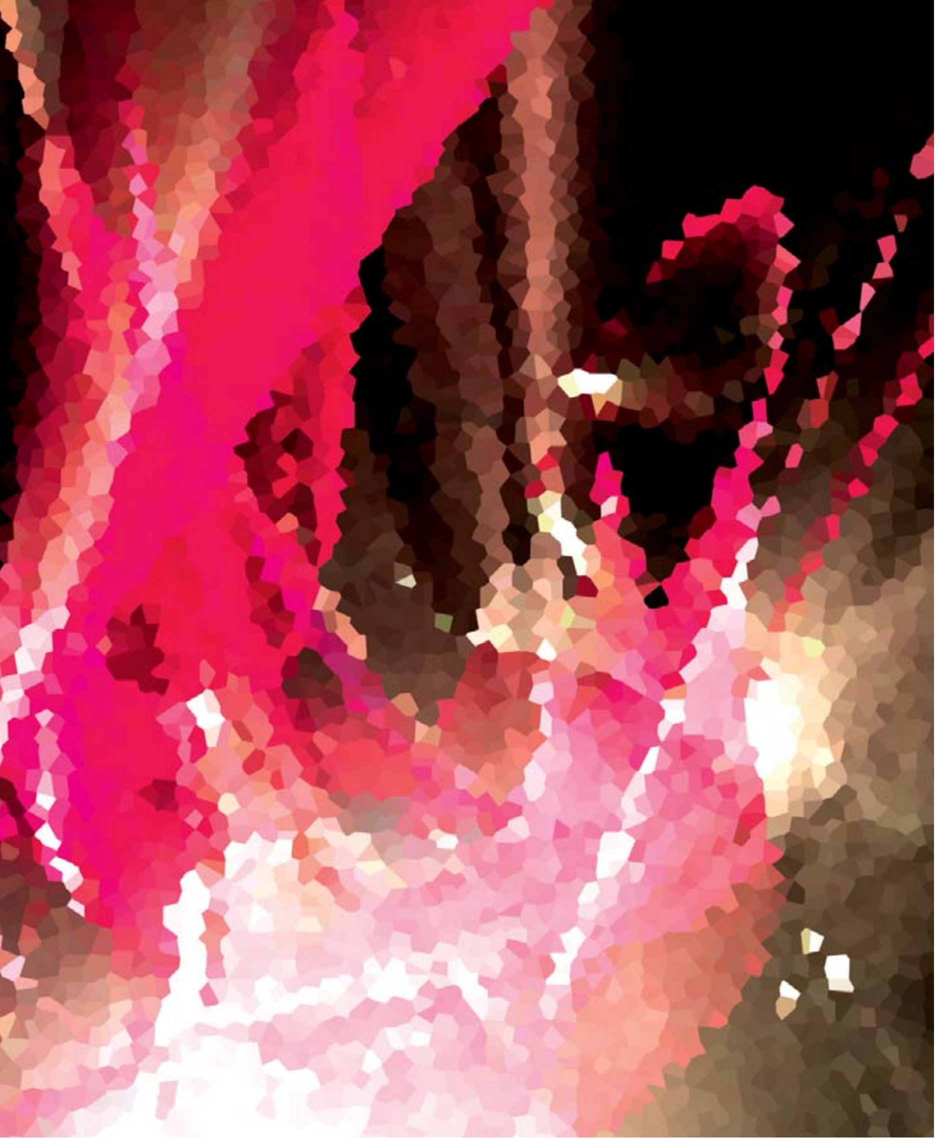
COULD THE INDUSTRY BE ABOUT TO SEE THE RETURN OF BANDWIDTH TRADING? CAROLINE CHAPPELL ASSESSES WHETHER BANDWIDTH TRADING COULD PROVE TO BE DIFFERENT THIS TIME AROUND

Bandwidth and voice minutes can be measured like oil, grain or gold. There are continual fluctuations in supply and demand that affect their price and they are bought and sold as standardised commodities. Why then, "has there been no significant change in the way the telecoms market operates since the 1970s?," asks Lawry Trevor-Deutsch, president of new voice trading exchange at Nytex. Proponents of voice and bandwidth trading have long pointed to huge inefficiencies in a market where prices continue to be agreed between individual parties rather than set by a transparent cross-market mechanism and where the lack of standard commercial agreements and trading platforms prevent large numbers of carriers doing business with one another. Lawry-Deutsch comments: "The industry still has a chaotic system of exchange for over 200 billion minutes of traffic a year based on individual closed contracts with large variances in price and quality."

Detractors argue that bandwidth and voice trading have already been tried, in the heady pre dotcom bust days of the late 1990s. They failed to deliver on their promise of revolutionising market efficiency

From the West Coast ...

VANCOUVER



during the early years of this decade. Of those early exchanges, few now survive. As a new generation of trading exchanges begin to open their doors, will they fare any better than defunct ventures? Can they overcome the deep-seated prejudice against trading that persists in the market or displace the trading platforms that the largest voice carriers have set up for themselves? Is anything really different this time around?

A RASH OF DEBUTANTES

The answer to this question is yes, according to those founding a rash of new trading platforms which are making their debut this year. Andreas Hipp, CEO at Epsilon, observes that the main reason Enron's attempt to establish bandwidth trading failed was the lack of connectivity between carriers at the time. "Enron was pushing for huge cross-connects at pooling points to support on-demand bandwidth at a time when everyone was running patch cables in telehouses and it took 15 to 20 days to set up an interconnection," Hipp says. "This was not an acceptable timescale to support a tradeable unit." Also, there was less standardisation, so depending on geographic location, the attributes of a tradeable product were different. "People thought their bandwidth was better because they had bought certain boxes and had better quality of service but today, IP bandwidth is a commodity," Hipp adds.

Epsilon is reviving Enron's idea of pooling points, with carriers paying Epsilon a port fee to be pre-connected into Epsilon's equipment and trading platform so that they can quickly agree to supply or buy amounts of capacity. Epsilon is going a step further than companies with "meet-me" hubs that support carrier interconnectivity, like Telx or Ancotel, but not as far as Arbinet in providing a "middleman" trading service. Although Epsilon will facilitate the buying and selling of bandwidth, it will not underwrite trades. Its port fee business model is seen as more in tune with the times than the high subscription fees trading exchanges have traditionally charged. Significantly lower charges associated with bandwidth and voice trading is a key change that will drive uptake this time, the new entrants suggest.

ONLINE ESCROW

Meanwhile new online escrow companies like Vertecto believe they will make it easier for carriers to do business with each other through exchanges. Vertecto, for which Hunter Newby, formerly of Telx, is an evangelist, has set up a transaction clearing house backed by Wells Fargo bank, which it believes brings to the market a number of innovations. These include standard terms and agreements, the ability to transact in five currencies across 33 countries, very low transaction fees underpinned by high levels of process automation and the connection with Wells Fargo, which will hold payments in escrow until both

to the East Coast …

HALIFAX

transacting parties are satisfied with their trade. Jeff Ellentuck, CEO of Vertecto, is in discussions with at least one company which, like Epsilon, has the ability to connect large numbers of carriers but lacks a financial protection and deal-making component. Ellentuck sees Vertecto enabling such companies to become trading platforms, much as Paypal provides e-commerce facilities to third parties, though Vertecto offers considerably more safeguards. "There is no reason why a small company should be disadvantaged by a large one or vice versa," Ellentuck says. "A carrier the size of AT&T can take advantage of routes offered by smaller companies and small carriers can get fair access to new buyers."

New facilities like Vertecto's may well guard against "the fringe of the voice market which is awash with characters

NYTEX – AN ONLINE STOCK EXCHANGE

Nytex aims to be an independent clearing house for voice minutes, acting as an online stock exchange that sets market prices for minutes across any route in the world based on supply and demand at a reference quality. The market price will fluctuate due to market forces such as cable cuts or new competition entering a particular country market, but it will be available to all rather than negotiated among the few. In four months of beta testing, carriers have traded 100 million minutes across its platform, Nytex says, and two major European carriers are early customers on the live exchange.

Nytex has devised an algorithm that creates the market price by blending all supply routes to individual destinations. The algorithm automatically directs a buyer's traffic to a destination along the cheapest route that can provide the reference quality. If the amount of traffic starts to choke the route and quality falls, the algorithm fails over, continuously adjusting the routing to a second or more routes, and the price naturally drifts higher as demand rises. Prices on the exchange are updated every 60 seconds in response to trading activity. Buyers put a ceiling on the price they are prepared to pay for termination and all the while the market price remains below this, they have the opportunity to save money.

There are no upfront fees for joining Nytex – the exchange rolls any clearing fees into the market price – so buyers and sellers can opt in or out whenever it suits them. In a blended model, buyers don't have visibility of who delivers their traffic but Nytex's Lawry Trevor-Deutsch maintains that the model "will always come out with a better price and higher quality than a buyer can get from one individual seller". Any carrier can sell on the exchange as long as they provide the right quality, levelling the playing field for smaller carriers. Trevor-Deutsch says the losers in the market will be traffic aggregators, whose infrastructure will no longer be needed to transit traffic or to take on the risk of matching buyers with smaller sellers.

Nytex will benefit from partnering with exchanges that already have interconnection and settlement capabilities rather than having to build out Epsilon-style pooling points to underpin its trading platform or to take on settlement risk. Many industry watchers believe that the writing is on the wall for the fee-based model, so having Nytex as a partner, able to provide an alternative trading model, would make sense for exchanges that want to be at the leading edge. Nytex would also bring to a partner the ability to trade in euros as well as dollars, hedging against exchange rate fluctuations through Cambridge Mercantile. The hedging is invisible to buyers and sellers but means all settlements are fixed at the time of trade.

Trevor-Deutsch believes that Nytex will be a disruptive platform in the industry but one that will be a force for good. "A country can go online in our public exchange and see their communications traffic as a resource that can be traded for cash," he points out. "Once you equate telco minutes to a commodity, you have a new ability to underwrite it and trade it as a natural resource – this will open up a whole new opportunity for companies and countries," he says. ■

and places
in between ...

"It took 15 to 20 days to set up an interconnection – not an acceptable timescale for a tradeable product"

ANDREAS HIPP
CEO, EPSILON

of dubious reputation," according to Richard Elliott, founder of the world's first bandwidth exchange, Band-X, and now managing director of Apollo-SCS. The lack of trust in the market and of sufficiently robust escrow mechanisms to overcome this has meant that there is little appetite for major carriers to trade with companies beyond their known customer base.

Instead, carriers that want to participate in an efficient commodity market for voice minutes have set up their own, closed voice trading exchanges: Deutsche Telekom ICSS and Qwest are examples. They were joined at the beginning of January 2009 by Verizon International Partner Solutions (VIPS), which has brought together the buy and sell side of its international voice business.

"This is becoming a spot market – it's extremely dynamic and competitive and needs to be transacted in a trading environment," points out Carl Roberts VP of International Partner Solutions, Verizon Business. As a result of moving to a trading model, currently servicing around 30 key customer accounts worldwide, VIPS has seen the carrier gain market share and it will continue to improve its service through greater automation and new function.

MARKET SCEPTICISM

Elliott is sceptical about the need for a more developed or replacement exchange for wholesale voice in a declining market, though Nytex's Trevor-Deutsch (see opposite) disagrees. However, Elliott is even more unconvinced that bandwidth trading will make a successful comeback. "Bandwidth as a growing form of commodity has the ability to fascinate the financial market beyond its ability to be traded," Elliott says. "The problem with bandwidth is that it's not a finite commodity like oil or gold. There is no limited supply in forms of bandwidth that make it practical to trade in. The price of bandwidth is volatile in one direction – downwards – so you lose the fear and greed factors that are a vital combination for most markets. The kinds of financial instruments that are traded in other commodity markets are vastly more likely to emerge as a result of upward spikes in pricing. Long-haul pieces of bandwidth, which are the bits of the network that can technically be bought and sold, are continually falling in price. The real value in the market are the local tails that can't be traded."

Roberts agrees that there is no market for traded bandwidth, especially given the current direction of the industry. "Bandwidth is a different animal from voice. If you are looking for a cheap piece of connectivity, trading might work," he says. "Increasingly, though, customers are looking for managed services requiring specific quality of service and SLAs. They want solutions delivered over bandwidth rather than raw bandwidth itself. A number of carriers are now outsourcing their voice businesses and instead are focussing on data and IP services. These will be their sweet spots and competitive differentiators, especially in the enterprise space. These services revolve around bandwidth, so bandwidth is becoming the carriers' crown jewels. Carriers will want to control it to guarantee end-to-end service levels and it won't be possible to trade 'pure' bandwidth. Equally, if you buy bandwidth from an exchange, this won't give you the level of security you need to talk to customers about end-to-end quality of service."

BANDWIDTH SWAPS

If carriers are hostile to the concept of bandwidth trading, they have steered even clearer of the idea of bandwidth swaps. However, a founder of Flag Telecom, Neil Tagore, is reviving this once-discredited idea, setting up a "carrier-neutral advertising platform for swapping opportunities" with his latest venture, Buysell Bandwidth. Tagore claims around 80 carriers subscribe to his portal, although since they arrange the swaps with each other, he has no visibility into just how much business is being conducted. Like Hipp and Trevor-Deutsch, Tagore knows that a significant amount of market education will be needed to persuade carriers to look at, let alone explore, the new opportunities and benefits they maintain their ventures can unleash. Whether Epsilon, Nytex et al will successfully educate a large enough population to make their numbers add up – especially as the new entrants emphasise the fact that they have low-cost business models, which will require scale to work – remains to be seen.

All are trying to rationalise the telecoms market for the good of the industry. However, given the potential of supposedly rational markets to go awry, demonstrated all too clearly over the past year, carriers would be forgiven for wanting their voice and bandwidth markets to remain relatively irrational on the grounds that if they ain't broke, why fix them? ■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