The Bandwidth Desk

New Revenue Streams? Yessiree!

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InvisibleHand Networks CEO James Brown was enthused after returning from the recent day-long Tarifica Pricing Congress in London. “I was in the unfortunate position of speaking last. But everyone stayed, and I was in the very fortunate position of being the only person who could give them good news,” he says.

The good news centers on the firm’s Merkato automated transaction platform, a technology that he says allows the bandwidth business to price in a differentiated way, to extract value from mission-critical applications and draw revenue from those willing to pass to each other.

“The big question was how do we get revenue from those peering relationships and leverage the value that underlies the concept of the Internet itself?” Brown asks.

The concept of making money through peering arrangements was a big hit for two reasons. First, the two sides of the arrangement, regardless of size, perceive there’s more value to be gained there. “We offer the ability to say in real time exactly what traffic you want to pass onto your network and what you’re willing to pay,” he says. Merkato enables wholesale players to bid that out to several similar players in five-minute increments. Goodbye to long-term contracts, lengthy negotiations and the sizeable administrative costs familiar to those who’ve negotiated the old-fashioned way.

Second reason: Carriers are looking for a way to measure and monitor- and to distance themselves from regulators. “Global Crossing and the like have spent more time in Washington than they would like, trying to explain what a peering or transit relationship looks like and how you put that on the books from an accounting perspective,” he says. ”People start digging through that when you go through Chapter 11. How much traffic did you pass to AT&T and how much did you get for it? It makes you look kind of foolish when you shrug your shoulders and say, `I don’t know.’”

From Brown’s point of view, Merkato offers an efficient way to clean up the books. Knowing what you are paying for a particular service gets costs in line, and the peering arrangement creates a new revenue source from a natural exchange point.

But brown’s concept requires a behavioral and cultural change in the business. For one, the carrier employees who negotiate peering arrangements will find themselves biding and selling on a computer rather than face-to-face. But those who handle the P&L duties at carriers are excited to change their behavior he says. “It gives them a tangible way to put their costs in line, understand what those are, price accordingly- and drive revenue.”

Like many exchange boosters in the past, Brown sees education as a major part of his Merkato sales pitch. The firm’s StreamingHand exchange (www.streaminghand.com) proves the technology worked in a viable commercial environment. It also demonstrates that customers were willing to change their behavior to garner savings on bandwidth costs, he says. What’s more, it allows customers to be more flexible and nimble in their own business plans because they can get bandwidth on demand at a decent price.

“Service providers themselves, by using our software, can gain massive efficiencies which they may or may not choose to pass on to their customers. The empirical data we got from StreamingHand after 12 months of operation was that you can increase revenues upward of 45 percent, increase gross margins five-fold and save customers an average of 30 percent relative to their 95th percentile pricing methods today.” In short: flexibility and increased revenue.

“The IP service providers have been dying to sell something other than pipes. They want to sell solutions,” he says. “But the CFO keeps slapping them on the hand until they can prove the ROI is months or years rather than decades.”

Brown adds that carriers, exchanges and colo facilities can use Merkato to maximize use of existing infrastructure, so the deployment cost is in the tens of thousands of dollars. Various software licensing models also offer incremental investment, whether per-transaction, per seat or per capacity.

The InvisibleHand chief heard a few thought-provoking comments at the conference. Those at the meeting frequently heard the opinion that Chapter 11 and consolidation are the only avenues to a market turnaround. But Brown cites Moore’s “other” law-that you never emerge from a recession with the same products. That goes for Chapter 11 too, he says. “There’s no way the capital markets are going to allow people who got themselves into trouble with a particular business model to reorganize, annoy their creditors, then come out and do the same thing. The fact that two or four people own the network as opposed to five or 10 doesn’t really change that, short of government regulation which no one wants.”

Wholesale carriers are coming around to understanding trading, he says. The last wave of it was incorrect because its biggest proponent, Enron, was essentially trying to create its own network to trade – and squeezing other wholesale carriers in the process. The new effort is more focused on neutral enabling technology. Brown also saw a growing acknowledgement that peering, exchange and collocation facilities do offer a chance to rationalize carrier business. (Eighty percent of Internet traffic flows through such a facility.)

Trading IP flow rather than circuits is far more appealing to wholesale carriers, he says. “The more liquidity in the market, the better,” but IP connectivity trading allows even the smallest player to buy bandwidth on demand. That wasn’t possible in the circuit-based model.

Brown predicts some interesting surges in the telecom market over the next six months. Exchanges, collocation and hosting facilities are essentially buyers in what’s now a buyer’s market. “In the short term, I think they’ll negotiate the old-fashioned way for wholesale prices on bandwidth, then arbitrage it with our software. With StreamingHand, our gross margin jus on bandwidth, excluding SG&A, overhead and so on, is 200 to 300 percent on average. That’s a huge margin,” he says. “Unfortunately, the service providers can’t move fast enough right now to take advantage of that.”

But hosting providers can – and they will figure out that they can buy bandwidth for orders of magnitude lower than they can sell it. Colo and exchange facilities will figure out they can provide value-added service to bandwidth buyers, which in turn will bring the carriers to the market.

“Suddenly there’s a new revenue source and the facility is more sticky in terms of customer churn that it ever was before. To the extent they can be first movers, they can steal traffic and customers away from others,” he says. “They are well positioned to do this in a way service providers are not.”

At the conference, Brown sensed that carriers are ready to move through exchange and colocation facilities. InvisibleHand has closed deals with Telehouse and other major houses that say their carrier customers see potential to derive more revenue by increasing capacity utilization on an existing pipe – and to add class-of-service offerings at a variety of prices.

“Suddenly [carriers] have additional revenue that falls directly to the bottom line without changing the business model or shaking up the corporate structure. They’re simply offering what they already have, which previously they couldn’t get money for.”

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