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Strategic determinants of reseller profitability in the US wireline telecommunications 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. Using data gathered from 12 US toll resellers for the 6-year period from 1992 to 1997 the present study provides an empirical analysis of associations between 15 strategy variables and two profitability measures of such resellers. 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. Statistical 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 $ sales, and (6) a higher costs of service share of total operating costs. 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 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. © 2002 Elsevier Science B.V. All rights reserved.

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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. Especially in the end consumer markets for wireline telephony services, so-called 'switch-based' and 'switchless resellers' can contribute to price aggressive telephony service offers tailored to the needs of specific customer segments (Fontenay et al., 1987; Beard et al., 1998). *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 and distribution and billing and 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 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 call minutes in Germany. However, 3 years after the opening of the German telephony market the future of resellers is 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.

One approach to shed an empirical light on this question is to study 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