Analysis - Tip of the Iceberg

By Keith Mallinson Friday, October 3, 2008

Wireless is not immune to the financial turmoil.
It just needs to look below the surface.

Like the rest of the real economy, the wireless sector will be profoundly affected by the troubles in the financial and insurance sectors.

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The wireless industry appears oblivious or in denial about what's happening on Wall Street. It's business as usual with upbeat investment and demand growth expectations.

At the recent CTIA Wireless I.T. and Entertainment show, Leap stated it will double Cricket's covered pops in the coming year and RIM's Co-CEO Jim Balsillie predicted in his keynote speech that the proportion of smartphones would increase from 12.5% to 24% of all phones sold in the United States from 2007 to 2008.

Dow Jones news reporting on Sept. 18 – after the collapse of Lehman Brothers earlier in the week – reveals that Verizon expects to see solid wireless net subscriber growth in the third quarter. At a conference hosted by Goldman Sachs that day, Verizon's COO Dennis Strigl said he sees minor impact from the financial services industry because that sector doesn't contribute a significant amount of revenue.

His boss, Verizon CEO Ivan Seidenberg, was also quoted as saying "[t]his financial crisis hasn't yet translated into fewer companies starting up, less research and development, less marketing."

Member opinion at InMobile, the online community for executives in wireless, is also optimistic. In response to a current poll asking about short-term (1-year) confidence levels in the mobile industry, only about 12% of respondents indicated that the bad news of the economy isn't really taking a significant toll on wireless.

CAUSE & EFFECT

I agree the direct impact from loss of business in the financial and insurance sectors will be slight. This year, there have been about 103,000 jobs lost in the U.S. financial sector and another 50,000 may be looking for work in the months to come, according to an estimate by consultancy Challenger Gray & Christmas.

Even if every one of these job losses represents the loss of a subscriber, it's less than 1% of RIM's 16 million base as the company has expanded and diversified its subscribers. The revenue decline would only be around one-tenth of a percent of the $150 billion market total in U.S. wireless services.

In fact, this is a conservative assessment of direct loss given that mobile devices are regarded as essentials nowadays. While joining the ranks of the unemployed, many will not break their "Crackberry" addiction to e-mail and cell phone usage. They will simply become consumer rather than enterprise server users.

Unfortunately, the direct impact is only the tip of the iceberg: It is the indirect effect of the financial meltdown on the broader economy that matters. Wireless will be significantly affected, as will many other sectors. Prospects for the U.S. economy, already weakened, are worsening as the credit crisis spreads. Wholesale and retail sales, industrial production, employment and personal income have all fallen sharply this year.

FINANCIAL JITTERS

Tight credit and reduced confidence will surely have negative effects on demand. Some people are being forced to spend less following foreclosures and job losses. Others will simply hold back spending on discretionary items such as new phones, enhanced services and many will simply throttle-back on usage.

Qualcomm CEO Paul Jacobs said in a recent interview with CNBC that customers are taking longer to replace their cell phones. These remarks spooked investors, helping drive the company's shares down 3% that day. New phones drive upgrades with additional features and supplementary network service fees. Advertisers will be more cautious and less likely to experiment with the embryonic and largely unproven mobile advertising medium. Carrier capital expenditure plans will be postponed.

Some companies are much better-positioned to weather the storm than others. For example, RIM's focus on the high-growth smartphone segment could still result in strong financial performance, even if the growth rate cools significantly versus its lofty projections.

In contrast, larger players such as Motorola and Nokia that also supply to the mid-range and lower tiers are being significantly squeezed as they attempt to defend their market shares against flat demand and lowering prices. High-growth developing markets abroad will provide some relief.

Shareholders and financiers will become increasingly intolerant of weak financial performance and shy of unproven businesses such as greenfield operations. This will have a polarizing effect. Whereas numerous companies including Sony Ericsson, Palm, Freescale, Nortel, Alcatel-Lucent, Sprint Nextel and Clearwire will struggle to survive, those with robust business models, growing market positions and cash piles including North Americans AT&T and Verizon, RIM, Apple and Qualcomm will use the downturn to rein-in costs and establish even stronger competitive positions.

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