

PROFILE OF IAXIS LTD (IAXIS)¹

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Origins and Development

Iaxis was spun out from Telemonde a company chaired by the notable figure, Kevin Maxwell (son of the late Robert Maxwell) in April 1998.² Iaxis, as with Level 3, was founded by former MFS executives (most prominently, Ray Dutton). Unlike Level 3, however, the company had no intention of building its own network (see strategy section). The parent company, Iaxis BV, is based in Holland.

In January 1999 the company launched in the UK. In April 1999 it changed its name to Iaxis Ltd, a name which Marketing Director, Neil Lawrence, said was intended to move away from the “technicalities of telecoms” and present a “new, innovative” image that was “breaking the mould with what’s gone before”.³ According to Communications week International the change of name was in keeping with a growing trend among telecom operators who were paying much more attention to brand awareness.⁴ Speaking on the issue Iaxis’ Lawrence also stated that:

“Brand and brand values are everything...The values potential customers associate with your brand often mean the difference between whether you get on the shortlist of vendors or not, whether you can charge a premium or must price at a discount”⁵

This focus upon branding now seems rather ironic given that the name Iaxis (like Ionica before it) has become associated with bad management and bankruptcy.

The beginning of the end

After little more than a year Dutton left the company and there was increasing suspicion that it lacked both a coherent strategy and the necessary financial backing to keep it afloat. Ominously, no new press releases were posted on the company’s Web site after June 9, 2000. By now Iaxis seemed to be in deep trouble.

By August 2000 there were tangible signs that Iaxis was having difficulty staying in business. One of its main technology suppliers, Ciena Corp, filed a report with the Securities and Exchange Commission (SEC) in the US in which it indicated that one of its main customers, responsible for 13 percent of its revenues, was having financial

¹ This paper has benefited from funding provided by the Targeted Socio-Economic Research (TSER) Programme of the European Commission (DGXII) under the Fourth Framework Programme, European Commission (Contract no.:SOE1-CT98-1114; Project no: 053).

² Total Telecom (28/9/99)

³ Quoted in Total Telecom (12/4/99)

⁴ Communications week International (10/5/99)

⁵ Quoted in Communications Week International (10/5/99)

difficulties. Ciena later announced that it was writing off the \$28.2 million owed to it by Iaxis, an announcement which led to the temporary suspension of trading in its shares on the Nasdaq exchange.⁶ Ciena's shares later fell by 6 percent on the news.⁷

Iaxis officially filed for bankruptcy in September 2000 and was reported to have net debts of around \$200 million. Later this figure was put at \$270 million.⁸ One of the founders of the company, Ray Dutton, put the events down to management's failure to negotiate with its creditors.⁹

According to Communications Week International Iaxis was approached with a \$850 million offer in July from an unnamed buyer.¹⁰ Its management were inclined to accept but its venture capitalist shareholders refused. With hindsight it was obviously an offer worth accepting. The impression given was that even in winding up the company there were some serious managerial failings.

The failure of the company represented the most notable casualty in the sector since the well publicised demise of Ionica. The company's plight was seen as symptomatic of the sea change which had taken place in investors' attitudes towards the type of broadband strategy adopted by Iaxis. As the Independent put it:

“The Collapse of Iaxis marks something of a watershed in the development of the liberalised telecommunications industry, until recently one of the hottest of hot investment sectors”¹¹

The Guardian saw the company as “...providing another cautionary tale for investors swept up in the now largely dispelled hype which enveloped the sector”.¹²

One of the main creditors was the parent company, Iaxis BV, which was thought to be owed £117 million. It was in no position to attempt to keep its UK affiliate afloat. Its former parent, Telemonde, was also facing financial problems and indicated that it would not be launching a rescue package.

Among potential buyers, one of Iaxis' main clients, Deutsche Telekom, was widely tipped, with the price being estimated at between £20 million to £40 million. Other possible buyers were identified as BT and Flag Telecom.¹³ In all the administrators received 27 expressions of interest in the company.¹⁴

In the end the company was acquired by Dynegy, a US energy company, as part of its expansion into the European telecoms market (see Acquisitions section, below). The company was expected to invest several million pounds in order to complete Iaxis'

⁶ AFX Europe (5/9/2000)

⁷ The Wall Street Journal (6/9/2000)

⁸ Total Telecom (7/11/2000)

⁹ The Independent (7/9/2000)

¹⁰ Communications Week International (25/9/2000)

¹¹ The Independent (7/9/2000)

¹² The Guardian (7/9/2000)

¹³ FT (7/9/2000)

¹⁴ FT (5/11/2000)

network. Iaxis' creditors were likely to receive some payment, although only a fraction of the amount owed.¹⁵

Key Individuals

Ray Dutton

After leaving US operator, MFS, following its take-over by WorldCom, Dutton co-founded and became chairman of European network builder Telemonde Ltd. He was instrumental in the spinning off of Iaxis from Telemonde in 1998 and became the new company's CEO. In December 1999 Dutton stepped down as CEO and left the board in April 2000.¹⁶

His departure from the company was attributable to his failure to secure an additional \$900 million in financing from its backers. He was also reported to have had disagreements over future strategy with the venture capital companies represented on the company's board.¹⁷ In particular it is thought that he failed to win backing for a Mediterranean addition to the Iaxis network. Commenting on the disagreement he later stated that:

“The fact that Iaxis didn't carry out the project has nothing to do with the business case and everything to do with Iaxis's fund-raising plans and strategy focus”¹⁸

Speaking at a conference in 2000 Dutton alluded to his short tenure at Iaxis, arguing that it often made little sense for chief executives to stay with new operators for more than 18 months. In his own words, “it gets too complicated after that”.¹⁹

In June 2000 he founded Fusion Plc, a telecoms investment vehicle. One of the first deals entered into by Fusion involved the construction of a Mediterranean cable network using a submarine ring, a plan which, as noted above, originally formed part of Iaxis' strategy. The project, going under the name Onesea was taken over from Iaxis which was at pains to emphasise that it had no link with the new operation. This distancing was seen as symptomatic of the cool relations between Dutton and his former Iaxis colleagues. Dutton was now in a position to continue with his “dream project”, although using a different corporate vehicle.²⁰

The lack of empathy which Dutton felt for his former Iaxis associates became particularly apparent following the company's demise. In one interview he stated that:

¹⁵ FT (5/11/2000)

¹⁶ Communications Week International (25/9/2000)

¹⁷ Yahoo (UK) Finance (6/9/2000)

¹⁸ Quoted in Total Telecom (2/6/2000)

¹⁹ Quoted in Communications Week International (25/9/2000)

²⁰ Total Telecom (2/6/2000)

"The existing management have made a complete balls-up. It's in such a bad way that I'm not sure how much is rescuable. As an example of incompetent telecoms management, I cannot think of a more extreme example."²¹

In July 2000 he bought troubled UK reseller, Alpha Telecom, intending to turn it into a multi-service voice, data and mobile provider.²² Given his rapid involvement in new projects after leaving Iaxis it is little wonder that he has been described as a "serial telecoms entrepreneur".²³

Kevin Maxwell

The Chairman and Co-founder of Telemonde is the well known corporate figure, Kevin Maxwell. According to the company's web site he:

"has an extensive senior management background in communications and media, including newspapers, on-line publishing and software, in Europe and North America. He has specialised in the telecommunications industry since 1993"

In April 2000 the Guardian reported that Telemonde was also having severe financial difficulties and may be on the point of collapse.²⁴

Michael Neuman

Following the departure of Dutton the position of CEO (and President) was taken by Michael Neuman. Prior to joining Iaxis he was founding director and President and CEO of Bell ExpressVu, a direct-to-home satellite TV company based in Canada.²⁵

Eryl Stafford

The chief technical officer at Iaxis is mentioned here primarily because prior to joining the company he was employed by Ionica as its network design manager. This means he has been implicated in both of the two most dramatic telecoms failures in the UK over the last few years. It will be interesting to see where he goes next.

Investors

In 1999 Iaxis was described as a "closely held company".²⁶ In mid-1999 Communications Week International mentioned the Chiltern Group Plc, as a major

²¹ Quoted in The standard.com (6/9/2000)

²² Total Telecom (20/7/2000)

²³ Total Telecom (20/7/2000)

²⁴ Guardian (4/3/2000)

²⁵ Company Web site

²⁶ Total Telecom (28/9/99)

shareholder.²⁷ Other significant investors were identified as Gilbert Global Equity Partners, Larkfield, GE Capital and Donaldson Lufkin and Jenrette.²⁸

In July 1999 a consortium of investors led by Wynnchurch Capital participated in a second round of equity financing of Iaxis. The investment was needed for the development of the Iaxis network, although no figures were released regarding the amounts involved.²⁹

In September 1999 the Carlyle Group, a US private equity firm, agreed to invest \$350 million in Iaxis.³⁰ Later in the year the company also invested money, together with Iaxis, in a new co-location company, Hubco (see Joint Ventures, below).

In March 2000 a consortium led by Bain Capital invested \$66 million in Iaxis in the form of convertible preferred shares.³¹ Less than six months later the company was in administration.

After the collapse of Iaxis in the UK, Dutton continued to hold a 20 percent share in the parent company, Iaxis BV.³² By this stage, however, his main interests lay elsewhere.

Acquisitions, Joint Ventures and Main Suppliers

Acquisitions

In November 2000 Iaxis was itself bought by Dynegy Connect, the telecoms arm of Dynegy, a US energy company. Dynegy Connect was only formed in September 2000 through the \$188 million purchase of Extant, a privately held US communications group. Telstra, Australia's largest telecoms company, had a 20 percent stake in Dynegy Connect.

The purchase was seen as a cost effective way for the company to establish a pan-European network. As part of the deal Dynegy Connect would also take Iaxis' stake in DigiPlex (see below).³³ Later it was announced that Iaxis' assets would be rolled into a new company, Dynegy Europe Communications (DEC). The deal was done for a "nominal consideration", with \$40 million being set aside for Iaxis' creditors.³⁴ The new company was to be headed by Matt Epling, formerly managing director of Europe for Extant. DEC, he said, would use the same trading strategies that the parent group had originally used to sell electricity and gas. In doing so, he argued, it would become "the wholesale communications provider of choice throughout Europe".³⁵ This ambition was remarkably similar to that often expressed by Iaxis.

²⁷ Communications Week International (6/9/99)

²⁸ FT (5/11/2000)

²⁹ Iaxis Press Release (9/7/99)

³⁰ FT (18/9/99)

³¹ FT (5/11/2000)

³² FT (7/9/2000)

³³ FT (5/11/2000)

³⁴ Total Telecom (7/11/2000)

³⁵ Quoted in Total Telecom (7/11/2000)

Joint Ventures

In December 1999 Iaxis announced it had taken a 15 percent trade investment in a new company, Hubco SA, alongside The Carlyle Group, Providence Equity Partners and Carrier 1. Through the investment Iaxis was to offer co-location facilities in 25 sites across Europe.³⁶ The company later changed its name to DigiPlex.³⁷

Main Suppliers

In addition to Ciena, Iaxis also relied upon Nortel and Jupiter Networks for its network equipment. All of these well known companies are likely to have suffered some degree of financial exposure to Iaxis' cessation of its operations. In the case of Ciena, in particular, the collapse of Iaxis represented an indication of the dangers involved in having a new start-up operator as one of its main customers.

Network

In mid 1999 the Iaxis network known as *iaxisenroute* was lit, coinciding approximately with the launch of Viatel's European network. While Viatel invested around \$1.04 billion, however, Iaxis spent only around \$156 million.³⁸ This was due to its decision to lease rather than build, relying primarily upon dark fibre sold by utility companies.

The Iaxis network initially linked London, Brussels, Amsterdam, Rotterdam, Dusseldorf, Frankfurt, Strasburg and Paris.³⁹ This first phase of the network stretched for 3,000km. Stage two (scheduled for the end of 1999) was set to add another 5,000km taking in eight German regional cities, as well as Zurich, Geneva, Lyon and Milan. Stage three was scheduled to include Madrid, Barcelona, Valencia, Bordeaux and Vienna.⁴⁰ In total the company's land network was scheduled to span 12,000km by early 2000.⁴¹

A key feature of the network was that it was to use WDM technology developed by Ciena, which can carry 96 wavelengths on a single fibre. Commenting on this, Ray Dutton, Chairman of Iaxis stated that:

“By using WDM technology, Iaxis customers can obtain total control over an entire channel of bandwidth without the cost and complexity of building their own networks”⁴²

³⁶ Company Press Release (1/12/99)

³⁷ Independent on Sunday (14/5/2000)

³⁸ Total telecom (1/7/99)

³⁹ Techweb.com (29/9/99)

⁴⁰ Company Press Release (29/10/99)

⁴¹ Company Press Release (10/11/99)

⁴² Quoted in Total Telecom (1/7/99)

The potential of WDM to dramatically change the supply-side of the data market was recognised by Telecommunications Online which commented that, “If deregulation is creating a river of bandwidth in Europe, new fibre-optic technology could turn it into a torrent”.⁴³ Total Telecom also emphasised the centrality of the WDM technology to the strategy pursued by Iaxis, stating that:

“...were it not for WDM’s inherent ability to turn a single fibre into a substantial network, the Iaxis game plan would be impossible”.⁴⁴

With the assistance of this technology even a small operator such as Iaxis could conceivably set itself up as a serious pan-European operator. Communications Week International saw things in a similar light, stating that:

“It is the massive capacity of its WDM systems...that allows it to tackle the carriers’ carrier market with just one fiber”.⁴⁵

From its beginnings the company was focussed on the carriers’ carrier market – supplying capacity from STM-1 upwards from any point to any point on its network. Its strategy was based upon leasing single pairs of fibres (one for transmission in each direction) from various facilities-based companies. One of the company’s early innovations on its network was to allow its customers to switch their point-to-point capacity to keep up with new market opportunities. Commenting upon this built-in flexibility, Ray Dutton commented that “The service is the equivalent of owning a lease on a flat that is portable across every city throughout Europe”.⁴⁶

In October 1999 Iaxis announced the construction of a 10,000km subsea cable system in the Mediterranean at a cost of \$900 million.⁴⁷ This represented a departure for the company which had shown itself reluctant to build its own facilities. Perhaps on this occasion it would have argued that it had no alternative but to build, due to the lack of available dark fibre. As it turned out Iaxis changed its strategy and abandoned the Mediterranean link. This went against the business instincts of Dutton and contributed to the termination of his links with the company.

In April 2000 the company announced it would be expanding its network by a further 2000 km as it moved into Scandinavia. By this stage Iaxis was suggesting that its global network (including undersea fibre) stretched 90,000km.⁴⁸

At the time of the company’s collapse in September 2000 the FT valued the Iaxis network at \$200 million.⁴⁹ Again this was only a fraction of the amount spent by its “fresh build” rivals such as Viatel and KPN Qwest. The fact that the company could compete with such a budget network must have been cause for concern for these rivals. As it turned out, however, whatever the network strategy of Iaxis, it did not

⁴³ Telecommunications Online (June 1999)

⁴⁴ Total Telecom (1/7/99)

⁴⁵ Communications Week International (4/10/99)

⁴⁶ Company Press Release (19/4/99)

⁴⁷ Total Telecom (12/10/99)

⁴⁸ PR Newswire (27/4/2000)

⁴⁹ FT (7/9/2000)

stay in business for long enough to prove whether it really was feasible to be an international network operator without first laying a desiccated network.

Addressable Market

Market Size

In 1999 the value the global communications market was put at £438 billion per year. Of this, Europe accounted for 31 percent, the U.S. for 27 percent and Japan for 12 percent.⁵⁰ The long-distance market in Europe has been estimated at \$200 billion a year compared with \$160 billion for the U.S..⁵¹

Credit Suisse First Boston suggested that the European telecoms market was growing at around 11 percent a year (comprising of volume growth of 17 to 18 percent and price deflation of 6 to 7 percent). It calculated that the market would grow from \$194 billion in 1999 to \$413 billion by 2005.⁵² Virtually all of this growth was projected to come from data and mobile traffic with voice traffic growing just enough to offset predicted price declines.

According to industry sources the European long-distance market for voice services is the largest in the world, with 43 percent of international calling volume originating in Europe.⁵³ One of Iaxis' main competitors, Viatel, has put the size of the traditional long distance and international market in Europe at \$220 billion a year.⁵⁴ Again the primary area of growth is identified as the digital communications sector, with the company stating that, "the communications industry is expecting unparalleled growth in data in the near term".⁵⁵

Data networking and the Internet, in particular, are seen as the main generators of future expansion. Traditional telephony, suggests Viatel, will soon be "dwarfed" by this emerging market sector.⁵⁶ By 2001, suggests Viatel, Internet services in Europe will be worth \$100 billion, with annual growth of around 60 percent. On-line sales in Europe, it suggests, are set to grow from less than \$1 billion in 1998 to over \$64 billion by 2001. This growth will be attributable, in part, to the increase in the number of Europeans "on-line", a number forecast to rise from 22 million in 1998 to almost 70 million in 2002.⁵⁷

This growth of data in Europe is a reflection of an identical trend at the global scale. Credit Suisse First Boston estimate that by 2005, 85 percent of all telecom traffic will consist of data.⁵⁸ Applications outsourcing is part of this growing data market.

⁵⁰ Observer (17/10/99)

⁵¹ Business Communications Review (July 1999)

⁵² Credit Suisse First Boston, Viatel Research Note (21/9/99)

⁵³ Viatel SEC Form10k, 1998, p2

⁵⁴ Viatel Annual Report, 1998, p5

⁵⁵ Viatel SEC Form10k, 1998, p6

⁵⁶ Viatel Annual Report, 1998, p9

⁵⁷ Ibid p9

⁵⁸ Credit Suisse First Boston, op cit

Durlacher Research (London) predict that in Europe it will grow from \$14 million in 1999 to \$1.5 billion by the end of 2004.⁵⁹

As a carriers' carrier Iaxis was primarily involved in leasing out capacity on its network to other carriers. Lehman Brothers referred to figures from Global Crossing which valued total capacity sales in Europe in 1999 at \$1.8 billion rising to an estimated \$4 billion by 2004.⁶⁰

Target Market

Iaxis originally emphasised that it had no retail division and was concentrating purely upon wholesale backbone provision. It aimed to supply the capacity needs of ISPs and ASPs, tier one telecom operators, new carriers, systems integrators, resellers and mobile operators.⁶¹

Iaxis claimed that its "wholesale only" strategy helped it differentiate itself from other wholesalers who also had an eye on the final customer. By adopting this approach it sought to introduce the principles of "openness and honesty" into what it called the "notoriously cagey wholesale telecoms industry".⁶² Towards the end of the company's life, however, there were suggestions that it was losing its wholesale focus and beginning to look at the final consumer. In Dutton's words the new management began marketing "close to the end customer".⁶³ This naturally had the potential to bring it into conflict with its wholesale customer base.

Iaxis was also developing a number of "carrier hotels" which provided operational accommodation to house equipment such as routers and web servers for ISPs and other operators in need of co-location facilities.

Main Customers

Among its customers were COLT and Carrier 1.⁶⁴ In September 1999 Deutsche Telekom announced that it had also taken part of Iaxis' pan-European network. Tom McGlew, Chief Operating Officer at Iaxis, claimed that, "It's the first time a managed optical network has been sold to a major carrier".⁶⁵ The deal was over a period of 10 years and was valued at \$50 million.⁶⁶ Other prominent customers included Telenor, Via NetWorks and Lanz.⁶⁷

⁵⁹ quoted in Tele.com (25/10/99)

⁶⁰ Ibid

⁶¹ Company Press Release (29/11/99)

⁶² Company Press Release (22/10/99)

⁶³ Quoted in Communications Week International (25/9/2000)

⁶⁴ FT (18/9/99)

⁶⁵ Techweb.com (29/9/99)

⁶⁶ Total Telecom (28/9/99)

⁶⁷ PR Newswire, (18/5/2000)

Company Data

Debts

The company was not in existence for long enough for the usual time series data, consisting of data such as turnover and profits, to be available. Unfortunately the main data for which the company will be remembered will be that relating to its debts at the time of its collapse.

Upon filing for administration the company was reported to have debts amounting to \$200 million. Later there were estimates which put the figure as high as \$300 million.

Employees

At the time of its collapse the company was reported to employ around 130 people. Of these, 90 lost their jobs when the company went into administration.⁶⁸ The remainder (mainly network engineers) were retained by the new owners.

Stock Market Performance

Iaxis originally scheduled an IPO for 1999, but later chose to postpone its flotation until early 2000. This date was also later put forward, this time to the second half of the year, as the company succeeded in bringing on board a new private equity partner in the form of Bain Capital. Despite its British origins the company indicated that the most likely market for its flotation would be Nasdaq or the Neuer Markt. At the time the company was thought to have a floatation value of over \$1 billion.⁶⁹

Speaking of the second postponement of the IPO, Tom McGlew, Chief Operating Officer, stated that:

“We decided against it because timing is of the essence. We’ve been able to continue build this business on the basis of actually looking again at increasing the equity and coming to high-yield debt at a point of our choosing”⁷⁰

As well as the postponed IPOs the company also cancelled a road show in June 1999, designed to raise money on the high-yield debt market. According to Communications Week International had the company moved ahead with either its IPO or its high yield plans then it is very probable that it would have stayed afloat.⁷¹ Again Dutton is quite outspoken on the policy of the company he left behind, stating that:

“When we (Iaxis) were working towards an IPO (last year) Iaxis was valued at £1.2 billion, but in the nine months since I left they have managed to eliminate

⁶⁸ The Standard.com (6/9/2000)

⁶⁹ The Scotsman (16/3/2000)

⁷⁰ Quoted in The Scotsman (16/3/2000)

⁷¹ Communications Week International (25/9/2000)

that worth. There are some valuable assets in the Dutch holding company but the network assets have been withered away. It's pathetic"⁷²

Strategy

Buying not Building

While sharing a common heritage with companies such as Level 3, Iaxis took a very different approach to its network provision – preferring to lease from third parties rather than build from scratch. Julian de Bosdari, the Business Development Director of Telemonde (Iaxis' original parent company) summed up the company's philosophy stating:

“We don't put spades in the ground...We search for fibre that is already there, and buy it or take an IRU on it”⁷³

Referring to the company's corporate relative, MFS, he went on to state that:

“The only reason MFS ever built anything was because it couldn't buy it. Our mission is to make it easy to buy infrastructure rather than build it. Most of the carriers will simply be buying it from other people”.⁷⁴

The company maintained that with the rush to lay fibre across Europe there was no shortage of willing suppliers. According to Camile Mendler, Business Development Manager at Iaxis:

“It is possible there will be a glut of fibre. Supply will follow demand for telecoms capacity. We can upgrade as we go along, so why should we spend more than we need to at the moment”.⁷⁵

Talking about the companies who have perused the “build” strategy Mendler stated that:

“I feel sorry for some of our competitors who are building massive fibre networks. You loose a year or so if you dig it in, while we're in operation now. And the march of WDM technology is so rapid”⁷⁶

Total Telecom called this approach a “lean and mean” strategy and it was one which contrasted fundamentally with the “build it and they will come” approach of the network constructors.⁷⁷ The “lean” approach has also been adopted by a number of other prominent telecom operators. Fibernet, for example, is adopting this “minimalist” sort of build strategy. Charles McGregor, Chairman of Fibernet stated that:

⁷² Quoted in Total Telecom (5/9/2000). Parenthesis in the original.

⁷³ Quoted in Network Week (11/2/99)

⁷⁴ quoted in Ibid

⁷⁵ Quoted in Total Telecom (1/7/99)

⁷⁶ Quoted in Total Telecom (1/7/99))

⁷⁷ Total Telecom (1/7/99)

“So long as you can light the fibre, there are people digging it everywhere in Europe...you’ve got to sell all that capacity and there isn’t the demand at the moment. Our network is so inexpensive”⁷⁸

McGregor also made the point that the idea that Europe is going to follow the US model of demand growth was to overlook the fact that cross-border traffic on this side of the Atlantic will be hampered by the existence of numerous different languages. For that reason Fibernet has focused more on a nation-centric, rather than cross-border, strategy.⁷⁹

With Iaxis going into administration in September 2000, McGregor was less keen to draw parallels between the two companies, not least since Fibernet’s share price was also under severe pressure. Now emphasising the differences between the companies (in particular Fibernet’s “local” approach) he stated that:

“They are pan-European operators just selling bandwidth...Fibernet uses local networks, has denser points of presence and offers more services to companies”.⁸⁰

Hermes Railtel has also sided with the “minimalists”. Jan Loeber, MD of Hermes, stated that:

“In the long-term the economics fiercely favour a strategy that combines DWDM with a fibre-lean network. If you have 48 fibre pairs in the ground it’ll probably be three or four years before you go beyond lighting the second fibre pair. In the meantime what are you going to do with the others? By installing a massive amount of fibre you’re dooming yourself to being in the real-estate business selling at low margins”.⁸¹

At the other extreme the “builders” such as Viatel, Level 3 and Global Crossing are scathing about the “leasers” strategy, claiming that as demand for data explodes across Europe, network ownership will be the only way to secure quality and continuity of service and to maintain margins as prices go ever lower. This approach, however, is itself a radical departure within the telecoms industry. As Dr Barry Flannigan at Ovum put it:

“these companies are betting large amounts of money that an excess of capacity will spur-on demand. This marks a real discontinuity in the telecoms market – a shift from demand-side to supply-side economics. In other words, we are moving from a business model where bandwidth is scarce to one where bandwidth is plentiful. This development threatens to invert all the traditional pricing models”.⁸²

⁷⁸ Quoted in Total Telecom (1/7/99)

⁷⁹ Telecommunications online (June 1999)

⁸⁰ Quoted in The Independent (24/11/2000)

⁸¹ Quoted in Total Telecom (1/7/99)

⁸² Quoted in Total Telecom (1/7/99)

The “leasers” are currently keeping to the sidelines of the construction frenzy and seizing the cheap capacity opportunities offered by the new model. If the “builders” are correct and the future belongs to the network owners then one consolation for the non-builders may be that the amount they actually gambled was fairly low. The builders, on the other hand, are backing their strategy with considerable capital investment.

With the demise of Iaxis it may be postulated that the “builders” have won the argument. However, whatever Iaxis’ problems, there is no by no means certain that its failure to build its own network was its main weakness. Had it done so it may well have simply run out money earlier. In any case a number of Iaxis’ competitors, including GTS, Viatel and Jazztel are also now looking vulnerable, indicating that corporate survival has more to do with access to finance rather than a company’s network orientation.

Outsourcing via a hub network

Iaxis was also active in the creation of an outsourcing business at the carrier level, whereby the company offered other carriers services such as network monitoring and maintenance. The rationale behind this was that once an operator, such as Iaxis, had set up its own network it could then use its knowledge to offer a profitable service to new arrivals. According to Neil Lawrence, marketing Director at Iaxis:

“There is great potential for outsourcing the network...If we can go to a new carrier interested in realising opportunities in Europe and say here’s the solution in a box, then we’ve got a killer proposition”⁸³

In order to offer this outsourcing service Iaxis announced that it would be opening a series of “telehouses” (also known as “carrier hotels”) across Europe under the name *iaxishub*. By the end of 2000 the company aimed to have 11 such facilities, enabling other carriers to outsource the bulk of their international links and communications equipment.⁸⁴ Speaking of the outsourcing strategy Dutton, stated that:

“There is a massive, massive shortage of facilities in Europe...In many ways it’s more important than fiber. It is the one thing that will most hold up the development of Internet services in Europe”⁸⁵

The company projected revenues of \$1.1 billion from the carrier hotel business in five years compared with \$1.5 billion from network leasing and managed bandwidth services on the company’s “enroute” network.⁸⁶ In March 2000 the company expanded its out-sourcing and co-location activities in announcing that it would be launching 19 new Net Centres across Europe, involving a total investment of over \$200 million.⁸⁷

⁸³ Quoted in Telecommunications Online (August 1999)

⁸⁴ Techweb.com (29/9/99)

⁸⁵ Quoted in Communications Week International (6/9/99)

⁸⁶ Communications Week International (6/9/99)

⁸⁷ PR Newswire (9/3/2000)

Apart from the profit available from providing co-hosting facilities, network operators such as Iaxis also hoped to increase their network traffic by developing relationships with their “guest” operators. The same point was made by Charles McGregor of Fibernet (also in the co-location business), who stated that:

“The main driver isn’t to make money out of providing buildings and space, it is to encourage people to use our 4,000km network”⁸⁸

Competitors

A good idea of Iaxis’ main competitors can be gleaned from Telemonde’s (its former parent company), submission to the SEC in which, in addition to Iaxis, it specified the following competitors in the international communications bandwidth market: Gemini, MCI WorldCom, GTS, Level 3, Viatel, KPN Qwest, Global Crossing and numerous arbitrage operators and brokers such as Transglobal Network Services and Band X.⁸⁹

In terms of Iaxis’ co-location business, one of its main competitors in the UK was identified as Global Switch, which had plans to open 20 co-location sites.⁹⁰ Other rivals have been identified as TeleCity and IX Europe.⁹¹ Such services are also provided within Europe by Level 3, KPNQwest and Fibernet.

Other Threats

Given that Iaxis has now ceased trading it makes little sense to look at any threats to its operations. Instead a retrospective approach will be adopted here in order to assess why the company failed to stay afloat.

Bandwidth Glut

For many observers the failure of Iaxis can be seen as confirmation of the bandwidth glut thesis. With the rapid application of new digital technologies the shortfall in data transmission capacity across Europe and between Europe and the U.S is being quickly addressed. With the proliferation of new entrants laying their own network the prospect of over supply has become a reality. This was recognised by the FT which stated that:

"if the growth in data fails to match the growth in capacity, further consolidation will leave a few large groups fighting over distinctly thin pickings"⁹²

In early 1999 GTS pointed out that it had sunk enough fibre cabling across Europe to carry 20 times the total current traffic across the continent. The FT picked up on the

⁸⁸ Quoted in FT (15/3/2000)

⁸⁹ Telemonde, Form 10k, 7/7/2000, SEC

⁹⁰ Independent on Sunday (14/5/2000)

⁹¹ FT (30/10/2000)

⁹² FT (9/12/98)

inherent danger within this emphasis upon capacity, pointing out that GTS was only one of a dozen operations constructing state of the art pan-European networks. The consultancy, Analysys, put the number of telecom firms across Europe which intended to create their own facilities at around 140.⁹³ Such a proliferation, suggested the FT, "will see the death or withdrawal of some of the weaker operators, particularly among the later entrants".⁹⁴ As one of the smaller, late arrivals on the scene, Iaxis was just the type of company to which the FT seemed to be alluding.

The FT later confirmed its view that the company's collapse was essentially down to the changing economics of the industry. In particular it suggested that the company ran into difficulties because wholesale prices fell so fast during its initial network construction phase that it could not raise additional finance for the remainder of its network.⁹⁵ Falling prices meant that in the eyes of its financial backers an expanded broadband network did not look like a wise investment.

This focus upon the basic economics of the industry was also apparent in Ovum's post mortem on Iaxis, in the course of which it stated that:

"With all these new networks there has been a step change in supply without an equivalent step change in demand...It won't be the last casualty along the way",⁹⁶

While Iaxis' policy of leasing its network rather than building it seemed like a sensible business proposition, the rapidly changing economic conditions of the industry acted to undermine its strategy. As the company pointed out, it was easy to buy capacity so why build a network? The problem was that while it was easy to buy it was not so easy to sell. With prices dropping rapidly then Iaxis' suppliers could subsequently undercut it as they competed for the same wholesale customers. Given the company's limited financial backing it was in no condition to deal with such intense competition and the cycle of falling prices for any period of time.

Changing Investment Environment and Internal Weaknesses

With the growing prospect of a bandwidth glut in the course of 2000 investors began to desert companies which had once been heavily backed. This contributed to Iaxis' inability to get its IPO off the ground and ultimately to its failure to secure additional finance from its existing investors. The mood of the market had turned against the likes of Iaxis. Saeed Baradar, a telecoms analyst at Bear Stearns, focused upon the importance of such market sentiment in the demise of Iaxis. This factor also has the potential to undermine the ambitions of other operators within the sector (as Ovum's "casualty" comments above clearly show). As Baradar puts it:

"Obviously this is not good news for providers of Pan-European capacity such as Viatel or inter-route 21, but it should highlight the value of a strong distribution network, an integrated value added service portfolio, a large

⁹³ FT 17/3/98)

⁹⁴ FT (18/3/99)

⁹⁵ FT (6/9/2000)

⁹⁶ Quoted in Communications Week International (25/9/2000)

customer base, and a strong balance sheet, such as those possessed by KPNQwest and Colt Telecom⁹⁷

Implicit in these comments are that Iaxis lacked many of the features such as value added services and a strong balance sheet which may have made its business plan more robust. The FT took a similar tack in highlighting the other flaws which made Iaxis' plight all the more inevitable. Among the factors mentioned were:

- the company was hesitant about its IPO, leaving it short of funds to ride out its difficulties
- managers were divided over strategy, leaving a gap between the business plan and marketing strategy
- there were questions about the quality of service – despite the rhetoric on this score from the company
- the company remained focussed at the commodity end of the market, leaving it fully exposed to price falls⁹⁸

Compounding all these difficulties was the acrimonious departure of Iaxis' founder Ray Dutton. Having such a conspicuous individual as a critic of the company was unlikely to have made its attempts to raise additional funds any easier.

Problems with the Network

According to some observers Iaxis' problems were essentially grounded in its network. Michael Mahoney, CEO and President at Viatel was scathing in criticising Iaxis' attempts to put together an essentially inferior network. In explaining himself he also takes a swipe at rival GTS, arguing that:

“Instead of building a state-of-the-art network with the right economics they tried to build the GTS network...I always thought it would end in receivership. It was clear they weren't building a real company”⁹⁹

Interestingly both Viatel and GTS are among the companies most frequently mentioned as the next most probable broadband casualty. Certainly the dramatic falls in both their share prices during 2000 would indicate that there are many investors who believe they will share the fate of Iaxis.

The standard.com also focussed upon the Iaxis network, blaming its failure on its inability to move the network into areas not covered by rivals.¹⁰⁰ This was very much the conclusion of former CEO Ray Dutton who saw this as being more important than the pure price of bandwidth. As he put it:

⁹⁷ Quoted in Yahoo (UK) Finance (6/9/2000)

⁹⁸ FT (11/9/2000)

⁹⁹ Quoted in Communications Week International (25/9/2000)

¹⁰⁰ The standard.com (6/9/2000)

"The intention was to stay ahead of the Global Crossings , Level 3s and KPN Qwests and go into places they weren't going. But the network didn't expand from where it was last November. Falling prices is not the issue"¹⁰¹

In particular Dutton felt the company should have moved ahead with its plans for a Mediterranean network. Now that he is continuing this strategy using a new corporate vehicle it should eventually be possible to assess whether Iaxis' withdrawal from the project represented yet another strategic error.

¹⁰¹ Quoted in Yahoo (UK) Finance (6/9/2000)