

IMPACT OF NORTEL'S CHAPTER 11 FILING ON
THE ASIA PACIFIC ENTERPRISE
COMMUNICATIONS MARKET

Asia Pacific Market Insights

Frost & Sullivan's commentary on the Asia Pacific ICT industry, addressing opportunities, best practices, and major events



"We accelerate growth"

Nortel announced on January 14 that it has voluntarily filed for creditor protection under CCAA in Canada and in the US under Chapter 11 of the US Bankruptcy Code, and certain of the Company's EMEA subsidiaries made consequential filings in Europe. Asia, including LG Nortel, CALA, and Nortel Government Solutions business are not included in the creditor protection filing. Nortel is one of the leading vendors in the enterprise communications market globally and in Asia Pacific. This announcement from Nortel is expected to impact the market landscape and the competitive dynamics in the market.

Nortel's Current Position in the Asia Pacific Enterprise Communications Market

Nortel is one of the leading vendors in the enterprise telephony market with over 15 percent market share in Asia Pacific excluding Japan. Nortel is also the market leader in IVR (Interactive Voice Response) solutions in Asia Pacific. Nortel has been growing its enterprise voice business strongly over the last 5-6 quarters on the back of an aggressive and focused migration program. Nortel's UC 1-2-3 program targets its large TDM installed base in the region and offers attractive upgrades to its IP telephony platform. Nortel commands a good position in markets such as Australia, India, Malaysia, China and South Korea however it has been facing tough challenges in markets such as Japan and Thailand. Nortel's customer base is fairly diverse coming from Banks, Government agencies, Universities, Hotels, Telcos, and Manufacturing sectors.

Nortel has had a three-pronged UC approach – Microsoft-Nortel, IBM-Nortel and Nortel-Nortel. On the Microsoft front, the Nortel-Microsoft Innovative Communications Alliance (ICA) had some reasonable success in 2007 and first half of 2008. Success of the ICA, however, has come in pockets and certain markets only. Additionally, Nortel's incremental opportunity on ICA deals is restricted to the telephony upgrade and inter-working licenses, hence the revenue upside for Nortel is limited as it wouldn't be up-selling its own applications such as conferencing or unified messaging.

Nortel had been pushing its IBM alliance recently, and this was a key element of their growth strategy in the UC market. Nortel's ability to have strong and deep relationships with both Microsoft and IBM was certainly a great value proposition. This would help Nortel keep their voice installed base and potentially grow their customer base if their customers chose to move on to the UC roadmap and had one of Microsoft or IBM as their Email and Instant Messaging software provider.

Nortel also positioned a Nortel-on-Nortel UC solution that would address customers who had demand for point solutions such as audio conferencing or mobility. Nortel has also seen some early success with its Agile Communications Environment (ACE) in large accounts such as HSBC.

A critical element of its success has been its channel network in the Asia Pacific region. Nortel has strong channels such as 3D Networks, Alphawest, IBM, HP, HCL, Wipro, Digital China, Radiance Communications, PCCW, Jardine OneSolution, and several others. Nortel has also been seeing good growth on the back of Managed Services offerings from its Service Provider (SP) partners in the region.

Impact on the Enterprise Communications Market in Asia Pacific

Customer Concern – A telephony refresh or upgrade for an enterprise is at least a 5 year investment. Any enterprise deciding to upgrade its communications infrastructure would look for vendors that can offer a strong product portfolio meeting the business needs of the enterprise, good professional services partner to smoothly execute the migration or upgrade project, good post-sales product support & maintenance and a visionary technology roadmap to ensure that the enterprise is partnering with a vendor that is up-to-date and invests in research & development to keep the enterprise at par or ahead of their competition. Faltering on any of these decision considerations would typically lead to loss of the customer.

A major growth driver for the enterprise communications market in Asia Pacific continues to be the migration to IP. Enterprises evaluating their migration typically would have Nortel in their consideration list. The Chapter 11 filing from Nortel will create anxiety in their installed customer base as well as new prospects on the customer support, product maintenance, and technology roadmap that they can expect from Nortel. Speculation around Nortel's future post the Chapter 11 filing is expected to create concern amongst their installed base.

Since Nortel has filed for Chapter 11 and not Chapter 7, its day-to-day operations including Sales, R&D will continue, however, Nortel would need to undertake a strong communications drive to its customers to educate them on the financial state of the company, future of the company and degree of continued support and roadmap of its product portfolio. Nortel has already undertaken efforts to stay close to its customers and foster confidence in them. Initial reactions from some of the existing Nortel customers are also indicating support for Nortel.

While panic switches from existing customers of Nortel to other vendors is not expected in the near term, a close watch on the financial and business restructuring of Nortel should be top of mind for many Nortel customers. Nortel customers who are now prime for an IP telephony refresh will need to reconsider and get assurances from their system integrator and/or Nortel. Given the current economic climate, evolving unified communications industry and Nortel's announcement, existing customers could have more delays in decision making on their communications infrastructure upgrade. Non-Nortel customers would find it extremely hard to be convinced of choosing Nortel as a preferred telephony or UC vendor, until there is some concrete development on the business restructuring and the future of the company. One can expect higher discounts from Nortel in order to protect its installed base in the near to mid-term.

Channel Vulnerability – While customer concern is a grave challenge for Nortel, maintaining a strong channel network that will help Nortel address its woes in the market by protecting the installed customer base, and building customer confidence to grow Nortel's business is extremely critical. The bankruptcy protection announcement will also make Nortel's key strength in Asia Pacific, their channel network, anxious and vulnerable to poaching from competition.

Channels make a big portion of their revenues from professional services and maintenance services. Nortel has a strong installed base in the region which has given its channel a steady stream of maintenance revenues over the years. With existing customers being anxious and new customer acquisition very challenging, Nortel channels need to consider their growth strategies. The economic crisis is expected to drive down IT budgets and enterprises are likely to delay decisions around infrastructure upgrades and new application adoption. While protecting Nortel's installed base would continue to give the channels a steady stream of services revenues, however, in terms of new customer acquisition, Nortel channels would need to rethink their strategy.

With better incentives and more focus on customer communication, Nortel can help maintain its channel base; however, channel movement can be expected in the medium term.

Competitive Threat – Both the points mentioned above will be aggressively pursued by Nortel's competitors in the market. Campaigns to target Nortel's installed base can be expected in the market. Competition can be expected to indulge in FUD-based (Fear, Uncertainty and Doubt) sales tactics. While Nortel customer base is vulnerable, the entire customer base is not looking for a technology refresh today, and Frost & Sullivan does not expect panic-driven technology decisions in the near term.

The section of Nortel customers that are currently evaluating a technology refresh would be the real addressable market for Nortel's competitors in the immediate term. For such customers, it will be important to offer a viable migration path that will enable a phased movement from Nortel to their telephony solution. Majority of Nortel's upgrade deals are closed-door deals without any competitive bids. As a result of the announcement, many such upgrade deals can now be expected to be

opened up to competitors in the market. Nortel's advantage lies in the fact that customers could reuse a large percentage of the Nortel digital phones reducing the total cost of the technology refresh/upgrade. For competitors to succeed, competitive pricing on products and services (from channel partners) as well as migration roadmap would be essential.

The process of competitive replacement will take some time, giving Nortel the opportunity to go to its installed base and convince them of the future of Nortel, and steps it is taking to incentivize its customers and channels to stay with them during this business and financial restructuring process.

Nortel's Challenge

Nortel's enterprise voice business has been growing steadily over the last year and a half in Asia Pacific. Nortel has a strong voice business in the region and good presence in most of the key markets in Asia Pacific. Nortel has three major areas of strength which are now vulnerable under the uncertainty of Nortel's future given the Chapter 11 filing. The three areas of strength that Nortel needs to focus on are its large installed base, channel partners and alliance partners such as IBM and Microsoft.

Nortel's challenge is to address the uncertainty surrounding the future of the company, and protect its installed base & channels. Aggressive communications initiative needs to be launched that will address customer concerns and channel vulnerability. Technology roadmap and product release announcements need to keep coming regularly to rebuild customer confidence. Restructuring plans & financial state of the company to be shared at the soonest to convince the market that Nortel is progressing towards a sound financial footing.

Frost & Sullivan estimates an opportunity in the order of hundreds of million dollars that exists with Nortel's TDM installed base in the Asia Pacific region alone. This customer base has been a significant growth driver for them, and will be their life line for the next few quarters, until there is concrete restructuring plans and clarity on the future of the company.

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