A Battle Royale—Distribution Partners + Customers Vs. Inmarsat

By Alan Gottlieb, Managing Director, Gottlieb International Group, Inc., and Contributing Editor

Singapore March 15th: Here at the *ACi Maritime Communications Conference*, the clouds of war are gathering. Inmarsat's Distribution Partners (DPs) and customers are rising up in unprecedented fury in response to Inmarsat's recently announced price hikes. Driven by an ill-advised telephone company-like strategy, the communications giant has instituted unexpected dramatic and crippling price increases to its Standard, low use plans. This has sliced the margins of their distributors and has incited customers to action. Time is almost up—as discontent mounts into open revolt, Inmarsat terminals could soon be sinking into the sea.

Led by Adonis Violaris, Director of Telaccount Overseas Ltd., member of Bernhard Schulte Shipmanagement, shipping companies at the Conference broadsided Inmarsat's Michael McNally with a barrage of attacks and threatened to move their business to Iridium and KVH if the price increases are not rescinded. Make no mistake: the opposition is organizing, and boots are on the ground.

In further affirmation of the seriousness of the issue, the Cyprus Shipping Chamber and the German and Hong Kong Ship Owner's association have been directed by their member companies to take the price hike issue to the International Chamber of Shipping reflecting the consequences of what many believe to be an unjustified and ill timed effort to compensate for the strategic errors that have led to the huge recent decline in Inmarsat stock price.

Strategies That Failed

Such blunders are not new to Inmarsat. After spending billions to launch the ***i4*** constellation, billions more are now at risk with the ***Global Xpress*** project, all due to the entrenched monopoly's managers failing to recognize that the world was moving toward a fixed-priced broadband model—until they actually saw the wholesale migration to VSAT systems hitting their bottom line.

Now, this team of managers has placed the Company on a path toward war with the very distribution partners Inmarsat so desperately needs to sustain and grow its business. To

understand the gravity of management's mistakes, one only needs to examine how Inmarsat's new strategy evolved and how it affects their Distribution Partners and customers.

Initiated as a move to shield its distribution from purchase by private equity firms or competitors, the "going direct" strategy was introduced with the purchase of **Stratos** and, later, **Segovia**. DPs, infuriated by what appeared to be a thinly veiled effort to infringe upon their turf and recognizing the trend toward fixed-priced broadband, countered with their own VSAT offerings. During the same period, the availability of over-ocean Ku-band VSAT increased, and to this day, continues to increase. By 2014, nearly 95 percent of the world's shipping routes will have Ku-coverage, thanks to Intelsat's new, ***Global Mobility Network***.

Despite the proliferation of Ku-, Inmarsat still held one card: as ship owners often charter their vessels and never know exactly where there ships need to travel, communications coverage must be global, and VSAT systems occasionally fail. Therefore, the new VSAT services required a backup, and until Inmarsat's recent price increase announcement, ***Fleet Broadband*** (**FB**) was the ideal solution. In the meantime, VSAT's continued pressure on the Inmarsat revenue stream mounted and Inmarsat desperately sought a competitive solution to VSAT. Enter... ***Global Xpress***.

Why Not Ku-Band?

After years of deriding Ku- VSAT as an unreliable substitute for Fleet Broadband due to its Rain Fade characteristics, Inmarsat found itself needing to deploy the very same Ku- technology that it had vigorously opposed. But now, that option was no longer available. The FSS operators had already appropriated the necessary orbital slots.

Inmarsat's i5 satellite

While it may have been possible to negotiate a deal with the FSS operators for Ku-band transponder space or a Hosted Payload arrangement, Inmarsat management decided that, rather than make a humiliating run to its FSS competitors, it would take the only other possible alternative: launch a totally new, Ka-band constellation. Never mind the fact that Ka- is much more sensitive to Rain Fade than Ku-band and requires an even more precise and expensive antenna than Fleet Broadband. With this new strategy, Inmarsat management could position themselves as visionaries rather than be condemned for a lack of foresight and missing the turn in the market.

Since the introduction of the "visionary" inspired Global Xpress service, doubts have begun to emerge among satellite engineering experts as to the viability of Ka- for the "mission critical" maritime applications now being adopted in the rain intensive maritime environment. Given the questionable viability of Global Xpress and the fact that it is unproven, Inmarsat needed a way to assure a distribution path for its new service. This realization resulted in the purchase of **Ship Equip**, an aggressive young company that saw the shift in the market to VSAT and cleverly rode the trend up to $55 Million in Revenue and 1,000+ VSAT installations—all while the managers at Inmarsat were touting the narrow-band virtues of the i4 service and deriding VSAT as unreliable.

Buying A Distribution Channel

Recognizing that much of their business had been built upon the uncharacteristically high demand for VSAT in the Norwegian region, Ship Equip's insightful managers and investors recognized that the market that had produced their stunning rise was becoming saturated. The "low hanging fruit" had been "picked" and now Ship Equip would face a rapidly growing army of competitors in markets less receptive to the purchase of VSAT services. It was time to cash out. To do it they needed a buyer with a less savvy view of the shifts in the market. Enter Inmarsat, a company who so desperately needed a channel to launch its Global Xpress service that it was prepared to pay far more than anyone else, despite the fact that Ship Equip has likely seen an end to rapidly accelerating growth.

After spending nearly $159 million for the Company, Inmarsat management slowly began to realize that this new channel might not be enough to assure success. Inmarsat developed a new tactic to "strong arm" its distributors and customers to purchase Global Xpress: a new hybrid Ku- and L-band service called ***Xpress Link,*** featuring an upgrade path to Global Xpress and combined with a dramatic price rise on its low usage Standard Plan Fleet Broadband products.

Inmarsat packaged its own service, Xpress Link, which consisted of Ku-band with an FB back up with unlimited Fleet Broadband as part of the package. The Company then instituted its new FB pricing strategy aimed specifically at competing DPs that sell VSAT, hiking the retail price of the basic Standard package by more than 200 percent, and by 40 percent on the larger Standard packages, up to 50 Megabytes with all-voice charged extra.

The supposition is that Inmarsat assumed that by making it uneconomic for its competitors to use FB as a backup service, and then giving that service away as part of the new Xpress Link service, it could force its customers to buy into its upcoming Global Xpress service; thus disregarding the potential effects of the price rise on its own loyal DPs as well as a large market of other low-end users in the fishing and bulk carrier vessel segments that might never upgrade to a VSAT service. To understand the effect of this move on the DPs, one needs to understand how the wholesale pricing structure of the service has been altered by the price increases.

While the end-users seldom pay the suggested retail price, the real news is the dealer cost for the Standard Package goes up from $35 to $100. This slashes dealer margins on long term contracts and places dealers in the awkward position of having to raise prices to their customers or take a huge hit on margins—an especially delicate situation inasmuch as distributors have many contracts in place with a locked-in, three-year duration. Those distributors fortunate enough to have the contractual flexibility to pass along the price rises to clients are facing an unprecedented level of resistance from those customers.

Adding to the furor over the increases was the effective date of the price rises. The changes go into effect May 1st, right in the middle of the shipping industry's budget year, thereby confronting the shipping community with an unbudgeted and dramatic price rise.

Gottlieb On Maritime...

Rupert Pearce, Inmarsat's CEO, summed up his new strategy, "Because VSAT isn't global, VSAT isn't resilient, VSAT does crash when in adverse weather conditions. And VSAT above all was not built for maritime, unlike Global Xpress. They've appropriated the edge of beam coverage around the world of Ku-band networks. So ship owners have to have Fleet Broadband alongside it. Well guess what, it's just become uneconomic for VSAT operators to do that. So they're going to have to suck it up or move to Xpress Link."

Pearce's tirade rhetoric as well as his ill-informed understanding of the market is stunning. Not only are Ku-band VSAT providers not relying on the edge of Ku- satellite beams—the major ocean routes are now completely covered by Ku—the higher frequency of his proposed Global Xpress is much more vulnerable to adverse weather conditions than proven Ku-band VSAT. Furthermore, his inflammatory and arrogant attitude, totally inappropriate for the CEO of a large, publicly held company, as well as his outrageously misleading commentary, will, no doubt, further contribute to the vast rift forming between Inmarsat and its once loyal and supportive network of distributors and customers. How the new policy will affect each segment of the market is telling and bodes ominously for Company as well as personal futures.

DPs In Revolt

For those DPs selling VSAT, the Inmarsat policy markets a bitter assault on their businesses for the following reasons:

1. As provider of Ku- VSAT services, most of the DPs buy their own bulk bandwidth from satellite operators, manage and repackage it for SPs and end-user customers. This gives them the flexibility to allocate bandwidth as they see fit to maximize the profitability of their services. With Xpress Link and Global Xpress, this advantage disappears, and they become only commissioned sales agents receiving a 17 percent commission;

2. We understand from our sources that Inmarsat intends to provide the complete service potentially eliminating value-added packages that enhance differentiation between the providers including installation, repair, software and support thereby eliminating the opportunity for DPs to increase their margins by selling these services. This renders obsolete any third party value-adds, including software that, in some cases, has cost DPs million of dollars to develop;

3. They are rumored to demand that DPs must agree to sell only Inmarsat services;

4. Inmarsat, not the DPs or SPs, will own the customer;

5. Inmarsat will compete directly with its DPs with both channels under *Frank Coles*, the new president of maritime, a dubious distinction that gives little comfort to the DP Community that the channels will be managed independently;

6. Finally, we hear that Inmarsat is now offering to install Xpress Link services with no upfront payment from the customer—a desperation based practice further inflaming competing DP partners;

7. All of this is in addition to the dramatic wholesale price rises discussed previously. The net affect of such policies can only cause a stampede of DPs moving away from Inmarsat to Iridium as a Ku-band Back Up and to **KVH Industries**, a firm that has cleverly developed the ultimate alternative for VSAT communication, the ***V11***, a service that does not use, or need, Inmarsat.

The KVH V11—Inmarsat Not Needed

This very clever service targets Inmarsat's core market, the lucrative large fleets of Tankers and Containerships. KVH's timely response features a unique 1m antenna that combines C- and Ku-band into one complete package. Using Spread Spectrum technology, the service will deliver relatively unlimited fixed price, high speed broadband at up to 1 Megabits per second speeds (or metered, if desired), and will be available this summer.

Due to the fact that both services are on a single antenna, KVH will offer Iridium as a backup in the unlikely case that the system requires remote diagnostics or service over a satellite link. In our view, this service is a major advance over the ***V7*** offering much better coverage and a backup C- service that is for all intents and purposes, as rain immune as Inmarsat's Fleet Broadband.

The likely end result of the Inmarsat policy is that its major DPs will be aggressively pushing ***OpenPort*** services and in parallel will seek their own C-band Back Up alternatives. Other DPs and resellers will rush to KVH. We also believe that this potentially market moving service is the forerunner of other C-band based back up solutions, all of which may have a potentially devastating affect on Inmarsat's market share.

For the end users that already have FB terminals, the affect of the price changes is far reaching.

Slamming The Shipping Customers

While Inmarsat has lowered its prices slightly on the SCAP offerings in a further effort to compete against VSAT, its management has failed to recognize that a large segment of the market (*i.e.,* Bulk Carriers and some Container Vessels and Fishing Vessels) does not have sufficient data requirements or communications budgets to afford the SCAP or VSAT and, therefore, will be adversely penalized by these unjustified price hikes to FB and F55 and F77 prices.

For these, and other small vessel segments, reeling from low freight rates and struggling to survive, the effect of the 40 percent plus price hikes on the "Standard" plan is significant. The fact that Inmarsat, who is currently making a profit, would hike prices to users in a time of economic trouble is astounding.

In response, and in addition to the actions underway by the Cyprus and German shipping communities, the Greek IT Managers in Europe are starting to build up an alliance against Inmarsat pricing. **A.M.M.I.TE.C.**, the *Greek Association of Maritime Managers in Information Technology & Communications*, is actively involved in these efforts and is seeking the participation of similar shipping organizations around the Globe. In addition, rumors abound that anti-competitive legal action is under consideration including taking the case to the European Commission.

Given the fact that Inmarsat has sold thousands of Fleet F77 and FB terminals based on the data and voice rates available at the time of purchase, ship owners not protected by long term contracts with DPs are now faced with the choice of either pushing these terminals into the sea, paying significantly higher prices for the same service, or purchasing OpenPort terminals, or heading over to KVH. We expect the Inmarsat price hike issue will soon explode onto the floor of maritime organizations and courtrooms around the world.

In Conclusion

Inmarsat is under enormous pressure. Its "go direct" strategy has infuriated its once loyal distribution partners and is pushing them to alternative suppliers and competitive technologies. The viability of its highly touted Global Xpress for maritime applications is being questioned. A new wave of Ka- competitors threatens to create over capacity in the Middle East, a market Inmarsat management projected to be a major new source of revenue for Ka-band, and Global Xpress is unlikely to be widely adopted by the major trans-Atlantic and Pacific Carriers due to insufficient capacity on high demand trans oceanic routes. Finally, the lucrative revenue stream from **LightSquared** is ending.

Ultimately, we believe that shareholders and the Inmarsat Board will recognize that management's misunderstanding of the market and its customers has submerged the communications giant in a toxic brew of circumstances, and will act to terminate this bizarre strategy that ultimately threatens the long term viability of Inmarsat.

About the author
Mr. Gottlieb is Managing Director of Gottlieb International Group Inc. Established in 2001; his firm, located in Washington D.C., is a recognized global authority on the use of VSAT on Commercial Vessels. His firm provides Market research, Business Development and Sales Training in Maritime and Oil & Gas Satellite Communication Markets. Major clients include Satellite Operators, Equipment Manufacturers, VSAT Vendors and Private Equity firms. His publications include Buying VSAT, The First Independent Guide, and numerous articles published in SatMagazine, Digital Ship and other publications. He is a frequent speaker at Digital Ship, ACi Conferences, Riviera Marine maritime satellite conferences and Orange Business Live.

Editor's Note
The Battle of the Saintes, painted by *Thomas Mitchell*, was fought between the British and the French fleets in 1872 as a part of the conflict that occurred after the rebellion in the-then 13 colonies. These naval engagements took place, starting on April 9th, with the decisive action fought on April 12th. The name Saintes comes from a group of islands located between *Guadeloupe* and *Dominica* in the West Indies. (Image courtesy of the ***History of the Sailing Warship in the Marine Art*** website at ***http://www.sailingwarship.com).***