



Advisory Report

Hosted VoIP Application Servers: On the Ascent or in Decline?



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■ Summary

Observers taking stock of the hosted VoIP and multimedia application server market are being confronted by a number of mixed messages and contradictions. Despite significant indications of a declining market – namely a significant falloff in overall revenue and competitor consolidation – network equipment makers are somehow optimistic about the future. This optimism has taken the form of intensified product development by a handful of competitors, such as Alcatel-Lucent, NSN and Nortel. The future of the product category, however, is marked by several open questions. Will the general acceptance of a horizontal service delivery infrastructure by operators serve as a catalyst to the adoption of VoIP and multimedia hosted application servers? Will operators be able to entice enterprises into incrementally moving to a hosted model by initially offering IP trunking for premises-based PBXs? Can operators make a credible case that a hosted approach to unified communications and fixed mobile convergence is more efficient and effective than a premises-based approach?

■ Current Perspective

The hosted VoIP and multimedia application server market is a head scratcher. Those reading the tea leaves accumulated after nearly ten years of activity in this sector of the VoIP market are likely to arrive at opposing interpretations of what current conditions suggest about the future of the product category. Experts in both camps can be forgiven for their divergent findings, however, as each side is able to point to significant indicators to support their positions.

From a numbers standpoint, the hosted VoIP and multimedia application server market is a glass half empty – rather than half full. Not a particularly lucrative segment to begin with – roughly \$200 million annually, according to Synergy Research Group (SRG) – the market has suffered declines in the past couple of years. Early indications for 2009 point to more of the same. Q1 numbers for the standalone market – \$25 million – are the lowest totals in at least three years, according to SRG. In addition to the less-than-rosy financial

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performance, observers point to the consolidation of competition as another symptom of a market segment in decline. That consolidation is largely a result of a mini-acquisition spree by standalone market leader BroadSoft, which purchased the assets of the former VocalData (from GENBAND) and acquired Sylanro in 2008. Though BroadSoft is supporting the customer bases of the acquired products, chances are the company will eventually amalgamate its stable of application servers into a single platform. Consolidation is rarely an indicator of a market segment on the rise. A final piece of evidence suggesting that the hosted VoIP and multimedia market is in a contraction mode – or at least in a no-growth mode – is the reality that despite a decade of trying to gain ground, the percentage of businesses that rely on premises-based communications equipment, rather than network-based, or hosted, services, has held steady at approximately 90%. (See Figure 1: Reasons to be Optimistic or Pessimistic about Hosted App Server Market for a list of market pros and cons.)

Despite these negative indicators, hope still springs eternal in the hosted VoIP market. It could be a case of misreading the market, but the major – perhaps the only -- indicator suggesting that the hosted VoIP market is on the cusp of a surge is the recent product development activity of some of the world’s largest telecommunications equipment makers. Within the past year, Nokia Siemens Networks (NSN), Alcatel-Lucent and Nortel have intensified development and marketing efforts around standalone SIP-compliant application servers. Alcatel-Lucent’s 5340 Enterprise Communications on Network (5340 ECN) and Nortel’s Adaptive Application Server appear for the first time in the July 2009 update of the Current Analysis Hosted Multimedia Application Server Product Assessments. (A profile of NSN’s hiQ 4200 was added to the product comparison earlier in the year.) A product category that has been dominated for the past ten years by application server specialists, such as BroadSoft, Sylanro, VocalData and Netcentrex (now part of Comverse) is steadily broadening to include products, which have been in the production pipelines for several years, from end-to-end network equipment providers. Assembling solutions quietly over the past year or so, Ericsson is also breaking away from reliance on third-party products, such as BroadSoft’s BroadWorks application server, and is likely to join its rivals in aggressively marketing an application server for business and/or residential VoIP deployments in the near future.

Figure 1: Reasons to be Optimistic or Pessimistic about Hosted App Server Market

Reasons to be Optimistic	Reasons to be Pessimistic
SIP business trunking services seen as a potential catalyst to incrementally move enterprises with PBXs to a hosted model	The overall IP-PBX market is experiencing consistent growth
Growing complexity of enterprise communications, such as mobility extensions and unified communications, will convince enterprises to offload this chore to a third party	The overall hosted VoIP application server market has been in decline for the past couple of years
Acceptance of horizontally optimized service delivery layer establishing standalone application server as essential component of infrastructure	Standalone players are disappearing and competitive consolidation is rarely a sign of a market on the rise
Applications and, hence, application servers are increasingly seen as a major driver of IMS adoption	After nearly ten years of trying, operators have not been able to entice more than 10% or so of the enterprise market to move to hosted communications services
Global recession will motivate enterprises on cost-savings mission to experiment with hosted services	IP-PBXs are steadily taking on UC and mobility features demonstrating that the growing complexity of enterprise communications systems is not overwhelming enterprise support staffs

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Why the sudden surge in a product category that appears to be contracting? Equipment makers aren't exactly effusive on the topic – most likely to avoid looking foolish if their recent efforts fail to bear fruit – but the general acceptance of a horizontally-oriented service delivery infrastructure is a major factor for the current application server revival. As operators begin to implement service oriented architecture (SOA) and other IT-oriented technologies, as well as architectural models such as IMS and SDP, the role of the standalone application server becomes increasingly important to the overall service creation and delivery process. In fact, most network equipment makers have adopted an application server-optimized business model for marketing their IMS-based equipment. Several equipment makers, most recently Comverse, which introduced a core IMS portfolio at the end of 2008, are increasingly responding to RFPs that call for an end-to-end solution designed to deliver a specific service or multiple services. In this scenario, equipment suppliers are spotlighting their application servers as the centerpiece of a comprehensive equipment bundle that includes IMS-based session control and/or session management functionality. In the case of Nortel, the company's IMS portfolio is now headlined by the Adaptive Application Engine, which Nortel is pairing with IMS-based session control equipment from third parties. Nortel took the opposite tack as Comverse by pulling the plug – at least temporarily – on development of an IMS core portfolio and leaning the full weight of its IMS strategy on its application server.

Another plausible explanation for optimism around the application server market is that application servers are also increasingly taking on functions and capabilities, such as supplying Web services APIs and handling mobility management, that are gaining in importance to operators as strategic differentiators and potential sources of new revenue. Equipment makers also see the potential for SIP-based application servers that deliver voice and multimedia functionality to begin to grab a share of the enterprise market. Though large enterprises aren't expected to toss out premises-based gear in favor of hosted services in the near future, equipment makers see an opportunity to gain some traction with enterprises through business trunking services, which enable enterprises to trade in TDM trunks to legacy or IP-PBXs for IP-based connections. In addition to leveraging the SIP-based application servers to establish IP-based business trunks to the enterprises, operators are looking to introduce enterprises to multimedia and unified communications services that can be delivered from the hosted application server. Once enterprises have tasted of hosted multimedia nectar, some operators believe, business customers will begin to develop an appetite for a full-blown hosted model.

Though the past couple of years have not produced any solid evidence to support the theory, operators and makers of hosted application servers still harbor optimism that the growing sophistication and complexity of enterprise communications will eventually lead enterprises to off-load responsibility to network operators. Proponents of this theory argue that the introduction of mobility and unified communications (UC) will push larger enterprises past the threshold they have set for dedicating resources to maintaining a communications system. An offshoot of this theory is that the global recession will serve as a catalyst for enterprises to begin to experiment with hosted services as a cost-reduction exercise.

Given the recent declines and consolidation in the hosted multimedia application server market, equipment makers that are putting additional resources into the segment in anticipation of a surge in popularity are taking something of a risk. Should the segment catch fire in the next year or two, however, equipment makers want to make sure they are in a position to cash in on the opportunity.

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Recommended Actions

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Recommended Vendor Actions

- Though large enterprises represent the most lucrative opportunity for services based on hosted VoIP and multimedia application servers, the sweet spot of the business market remains the SMB segment. Accordingly, equipment suppliers need to continue to optimize feature sets and functionality toward that portion of the market.
- Hosted VoIP and multimedia application server makers should continue to make these products the focal points of their IMS strategies. Operators have indicated that they will not adopt IMS in a significant manner unless the move to an IMS-based infrastructure is accompanied by the immediate availability of revenue-generating services. Equipment makers should optimize their application servers to deliver targeted services and augment their products with tightly integrated IMS functionality.
- As application servers take on more and more functionality that is crucial to an operator's ability to differentiate its services from competitors' offerings, the application server will be viewed by operators as a critical part of their service delivery infrastructures. Equipment makers should continue to add support for Web services and mobility to their respective products.
- Despite some optimism pointing to a potential surge in the hosted application server market, equipment makers must not take too many risks by throwing excessive resources into product development. Given the negative indicators in the application server market – declining revenue and competitor consolidation – network equipment makers should proceed with development efforts cautiously.
- Equipping hosted application servers with VPN and SIP trunking capabilities makes good sense for network equipment providers. Embracing SIP trunking offers several benefits. For starters, it provides a feature upgrade that equipment makers can offer to existing customers. In addition, it enables operators to sell services to enterprises that are using premises-based equipment. Finally, a SIP trunking services provides operators with an opportunity to begin to entice enterprises to a full-blown hosted model by dangling network-oriented and multimedia features before them.

Recommended User Actions

- If the global recession is to provide operators with the opportunity to highlight the perceived cost-advantages of a hosted solution, operators will need to take advantage of this unfortunate window in the next year or so. Recessions do not last forever and if operators plan to push a hosted message to enterprises during these trying times they should focus a campaign in that direction before the end of 2009.
- Though it might mean cannibalizing sales of ISDN connections, operators that haven't already done so should begin to offer enterprises SIP business trunking connections to their corporate PBXs. Moving to IP trunking is a "no brainer" for most enterprises and if operators do not offer an alternative to PRI lines, customers will find an operator that does.
- Operators should treat SIP business trunks as hosted "starter kits," as IP trunking can later be augmented with multimedia services delivered off of a VoIP application server or network-based services, such as a corporate dialing plan that extends to satellite offices and mobile phones. After "hooking" enterprises on IP trunks, operators should incrementally begin to offer related services.

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- Operators should look to leverage VoIP application servers for as many services as possible. For example, several application servers on the market are capable of doing double-duty in both enterprise and residential environments. Mobile operators in particular should insist that a SIP-based application server is compatible with the Rich Communications Suite (RCS) project.
- Operators need to back up claims that the growing complexity and strategic relevance of enterprise communications require that businesses move to a hosted model to gain the greatest performance and price efficiencies. Operators need to demonstrate, for example, that the enterprise is not the most productive venue for fixed mobile convergence (FMC) solutions and that it makes the most sense if fixed and mobile services are intermingled in the cloud rather than in the enterprise.