

Vonage VoIP - Complete Analysis of Marketing Strategy

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Vonage VoIP – Executive Summary of Marketing Strategy

Vonage is a Voice over Internet Protocol (VoIP) provider. The company offers a replacement to the standard telephone industry for any person or small business with a broadband internet connection. A simple adapter connects the modem to an existing telephone handset.

It is a young, privately held, company, founded in 2001 by Jeffrey Citron and a handful of others with venture capital. It utilizes technology not yet considered mainstream (about 3% global penetration), but it's expected to appeal to the mass market in the next few years paralleling the market penetration of broadband connections. Vonage battles the discontinuous transition chasm because earlier attempts to market this technology had limited success due to reliability concerns.

The product instantly appeals to many market segments including NetGen's, those disaffected with traditional local and long distance phone companies, mobile young families and military populations, and those comfortable with technology. Vonage offers fully featured, consumer controlled packages for a fixed price, generally less than other traditional or wireless service, both of which charge extra for those features. Vonage offers its service directly on its website, through bundled packages with cable, through small telecoms, and very recently through retail outlets.

Vonage faces direct competition from smaller VoIP providers who offer less expensive packages. It also faces indirect competition from deep-rooted traditional telecoms, wireless companies, email and prepaid phone cards.

The most critical external requirement is broadband availability, which is expected to grow very quickly through 2008. This should give Vonage time to develop while the FCC grapples with how to protect the consumer and entrenched owners of landlines. At the time of this report, VoIP transmissions are considered data, and as such are not subjected to traditional voice regulation / taxation, thus giving them a cost advantage. Naturally, those who built the landline connections want compensation for the "last mile", even though Vonage uses the existing public internet for the majority of its voice traffic.

Many multiple system operators (MSO's) have already announced plans to offer VoIP in the next year, and Vonage must maintain its leadership in the VoIP market or seek relationships with the MSO's. They also face competition from foreign companies who are poised to enter the US market.

Vonage must differentiate itself and gain market share - through consumer education, advertising, free trials, continued superior customer service, and innovation - within the telecom industry.

Vonage VoIP

Complete Analysis of Marketing Strategy

Company Description

Vonage enables a technology called Voice over Internet Protocol (VoIP). This means consumers can make and receive telephone calls via their high speed internet connections.

Vonage was founded in 2001, and to date has completed over 130 million calls, serving more than 120,000 telephone lines. Initially the strategy was for Vonage to sell their services to both large corporations which have high speed connections, and to cable companies to resell bundled with services to subscribers. This business model has morphed into the one that Vonage has today focusing on residential and small businesses.

➤ **VoIP**

There are several different types of VoIP, and they are usually lower cost than traditional phone service. There are both software versions and hybrid services such as Vonage.

The software versions include such programs as NetMeeting or Messenger. These programs require a computer with specific hardware requirements, such as a PC microphone and speakers, in order to function. With this type of VoIP, the interface is restricted to those using the same service.

Vonage uses VoIP technology, but provides a traditional telephone interface, so consumers use their own telephones and telephone numbers, and can receive and make calls to anyone that has access to a regular telephone.

➤ **Financing**

Among the founders is Jeffrey Citron (formerly of Datek brokerage services). His previous experience was a major contributing factor to Vonage's ability to raise \$12 million dollars in initial financing entirely from angel investors.¹ Recently, during the 3 months around the start of 2004, Vonage added \$75 million dollars, raising the total amount of investor financing to over \$100 million.² This parallels increases in subscribers.

➤ **Product Offerings**

Vonage has both residential and business plans. Each phone line connection is enabled by an adapter that holds the identity of the phone number. For that reason, it can actually be taken on a road trip and plugged into a hotel's broadband connection, or moved to a new home and plugged into the broadband modem or router.

Residential Offerings

Vonage's residential offerings are essentially the same as traditional phone companies. But the features that are add-on costs with traditional phone services come standard with all Vonage packages, including voice mail, 3 way calling, and caller id (see Table 1 Feature Comparison for features list). Vonage does offer different plans, but these only change the number of minutes and types of minutes that are included. The packages range from \$14.99 for 500 minutes, to \$24.99 for unlimited local calls, and up to the premium package costing \$34.99 with unlimited minutes anywhere in the US or Canada.

Some features that differentiate Vonage from traditional phone services include virtual area codes and multiple numbers attached to your account. For instance, you can have a Miami

¹ <http://siliconalley.venturereporter.net/issues/sar05042001.html>

² <http://www.x-changemag.com/hotnews/42h674450.html>

phone number that rings at your phone in New York. Vonage offers toll free numbers for only \$5/month more.

Business Offerings

There are two small business offerings, one with unlimited minutes for \$50/month, and one with 1,500 minutes for \$40. The business product offering is very similar to the residential offerings, but in addition you get a fax number with the account.

Market Being Served

➤ *Market Characteristics - Voice Communications*

The market for voice communications is large and something most people can easily relate to. It consists of two (or more) people wishing to communicate by voice anytime and with anyone, anywhere. The cell phone markets, the conventional landline markets, and the VoIP markets primarily serve the overall market for voice communications. This huge overall voice communications market is mature and not expected to grow, however the interaction between the smaller cell phone, landline, and VoIP markets are ever-changing, overlapping, and have great potential to displace each other. All services offer voice communication making them each a near-commodity service with the exception of cell phones that also offer users untethered mobility. The end user simply wants clear reliable voice communications at the lowest price possible. Whether the transmission path is over the airways, the internet, copper lines, or fiber optics is unimportant to the end customer.

The VoIP market most directly competes with the conventional landline markets, and to a lesser extent with the cell phone market. Since all methods offer voice communications, it is

important to examine the features which the VoIP market has to offer. This may tell us why Vonage might better satisfy the needs of these various market segments

➤ **MARKET SEGMENTATION**

We identified the following VoIP market segments and how Vonage satisfies their needs:

- **EARLY ADOPTERS** - This market is the first to adopt new technologies. Their purchasing decisions are based more on "wants" than "needs". The growth trend of this market is small. Their needs are being fulfilled because they are always searching out something new.
- **FRUSTRATED TRADITIONALISTS** - This market has had it with the traditional phone companies and their broken promises and misleading advertising. They want a plan they can truly understand. Unfortunately, for the big phone companies, the growth trend in this segment continues to rise as conventional plans become more complex and in many cases misleading. New VoIP customers' needs are fulfilled here because the pricing plan is very straightforward and predictable.
- **ME-TOO TECHNOCRATS** - This market is similar to the early adopters, but they are not necessarily the first to the market. They mostly want things because other people have them. The growth trend for this segment is low because it represents a small fraction of society. This segment's needs are satisfied because they get the new technology they want.
- **COLLEGE STUDENTS** - This segment is mobile and comfortable with computers and advanced technology. Its size is quite large and is replenished every September. It is an extremely important segment due to its size, its young age, and its ability to influence other segments. With the exception of mobility, which cell phones offer, this segment's needs are satisfied because they get the voice communications and internet connectivity they desire.
- **IMPULSE BUYERS** - This segment is relatively small, but still important because it contributes to market growth and does not require extensive additional marketing. This segment is not expected to growth much over time. At least in the short term, this market's needs are satisfied because they "got a deal".

- **WEB ENTHUSIASTS** - This segment loves the web and all things that have to do with it. This segment is of small to medium size, but it very important because it continues to grow. It is also important because it is such a logical fit with what VoIP technology offers - impressive connectivity and integration with the internet.
- **VALUE CUSTOMERS** - This segment wants low cost, but is willing to pay extra for additional functionality. This segment is extremely important because it is large and growing, especially when the economy is not. Their needs are met because VoIP really does offer a lot for the money.
- **BOTTOM FEEDERS** - This segment's over-riding concern is price. This market is small in comparison to Value Customers, and not expected to grow appreciably. Their needs are met because VoIP really does offer the lowest cost.
- **CONNECTED / INTEGRATED MARKET** - This segment is pre-occupied with being connected, often to their customer base. Cost is not a major issue. With globalization and virtual workplaces, this market is of medium size and expected to grow. Their needs are met because of the many connection and integration features associated with up-level VoIP offerings.
- **MOBILE MARKET** - This segment is mobile, as the name implies, and values the ability to remain connected while away. The portability of the of the VoIP adapter box is what differentiates this group from just the connected / integrated group above. With globalization and virtual workplaces, this market is of medium size and not expected to grow appreciably. Their needs are met because they can use their phone anywhere they can get an internet connection, but the real threat comes from cell phones displacing the VoIP market in this segment.
- **MILITARY MARKETS** - This refers more to the service members than the institutions. This segment is large, highly mobile, comfortable with new technologies, would love to keep a common phone number, and they are very familiar with the hassles of changing phone services - especially when stationed overseas. The VoIP growth prospects here are large, because market penetration in this segment is low. This segment's needs would be met, because they really can keep their telephone number and avoid dealing with new phone companies every 2-3 years.

- FOOT-IN-THE-DOOR MARKET - Vonage will not directly make money in this market, but it gains them a foothold within a market and helps build the necessary consumer awareness to help build the market for VoIP phone service. Even if some of that newly educated market goes to other VoIP providers. One example could be setting up free call centers in a war zone to allow servicemen to call home for free. Or for that matter, free call centers anywhere to introduce people to the technology. This segment will grow as consumer awareness of VoIP increases. Their needs are merely VoIP awareness, which they will get from these demonstrations.
- ELDER CARE MARKET - This segment is where adults are taking care of their aged parents. It is very important for them to be able to check on bills and messages to help them help themselves. Auto payment features, phone number transferability, and ability to easily check their messages are very important to these time strapped caregivers. This segment is expected to grow based solely on demographics. Their needs will be met because it is easy to monitor phone activity.

Table 1 was developed based on known VoIP product features and from Vonage advertising together with our team's best guess at what various segments would find important to them.

Table 1 Feature Comparison

Market Segments													
VONAGE FEATURES / ATTRIBUTES	Early Adopters	Frustrated Traditionalists	Me-too technocrats	College students	Impulse buyers	Indecisive buyers	Web Enthusiasts	Value Customers	Bottom Feeders	Connected / integrated market	Mobile market	Foot-in-the-door	Elder care market
TECHNICAL													
3-way calling	x		x	x						x		x	
Voice mail - phone retrievable			x	x						x	x		x
Voice mail - web retrievable	x			x			x			x	x		
Caller ID		x		x						x			x
Call forwarding	x		x	x						x	x		x
Number portability				x		x				x	x		
Simultaneous ringing	x									x			x
e-mail voice message notification	x		x	x			x			x	x		x
Virtual exchanges	x									x			
FINANCIAL													
Low price				x	x	x		x	x				x
Predictable expenditures		x		x	x	x		x	x				x
Low \$30 startup fee		x		x				x	x				x
Minimal tax burden									x				
Simplified billing - credit card only	x	x					x	x	x				x
ADMINISTRATIVE / OTHER													
Unlimited calling plans	x	x		x		x		x		x			
Limited calling plans		x					x	x					
International calling plans		x											
Real time account management	x						x			x	x		
Number transferability		x					x			x			x
No contract		x			x	x	x			x			
Free adapter rental					x	x				x			x
Free trial period					x	x				x			x
SERVICE													
24 / 7 customer support						x							x
MARKETING													
Refer-a-friend plans			x										
3'd party endorsements (Circuit City)						x							
Special web pop-up enticements					x								
Co-branding with cable companies						x							x

➤ **Market Growth Trends**

The growth trend for both the consumer and residential markets is huge, and Vonage appears to be well positioned to take advantage of that. Broadband internet access, an enabler for this technology, is estimated at around 15%³ penetration in the US. The highest broadband penetration is in South Korea where an amazing 70%³ of all households now have broadband Internet access. As DSL and cable access continues to improve in performance and comes down in price, this key enabling technology will allow the VoIP market to gain greater market penetration.

Another hurdle to overcome is the initial resistance associated with a new technology. The

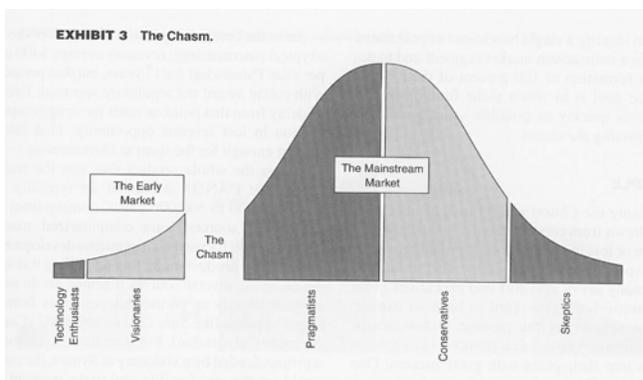


Figure 1 - The Chasm⁴

while the mainstream market is made up of pragmatists, conservatives, and skeptics. As shown in Figure 1, the early market is small relative to the mainstream market. In between those two markets is the discontinuous transition period known as the chasm.⁴ How long the market waits in the chasm before buying varies greatly and is difficult to predict. This can ultimately make

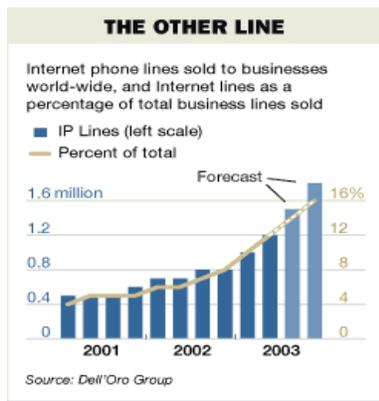
Technology Adoption Life Cycle was developed in the 1950s to show how communities respond to discontinuous innovations. It classifies the overall market for a new product or technology into two main groups - the early market and the mainstream market. The early market is made up of enthusiasts and visionaries,

³ Sheng, Ellen. "Cable Companies Expect Internet to Drive Growth", The Wall Street Journal (October 17, 2003).

⁴ Burgelman, R.A., Maidique, M.A., and Wheelwright, S.C., *Early Market Adopters (2001)*. Strategic Management of Technical Innovation. United States: McGraw Hill.

or break an innovation and at times, their companies. VoIP has a global market penetration of around 3%, and is now in the visionary stage. Pragmatists are not quite ready to replace their traditional phones. The VoIP industry now offers an adapter, which allows users to use their traditional telephones. This should help reduce the time spent in the chasm by easing the customers' transition. The bottom line is that the growth opportunities are huge, but predicting exactly when they will occur is difficult.

VoIP is growing faster in the business market, as VoIP companies have smoothed out customer service and billing, and added features such as caller ID and call waiting. They also



have made it possible for businesses to add VoIP in stages rather than rip out their entire phone systems. World-wide spending on Internet telephone systems by businesses is expected to exceed \$1 billion this year, more than double last year's total, according to Dell'Oro Group, a research firm in Redwood City, Calif. That represents nearly 20% of world-wide business spending on phone systems.⁵

Figure 2 - Internal Phone Lines⁵

Competitive Analysis

➤ Vonage Competitive Strategy

Vonage appears to be making a strong appeal to household and small business phone usage. In addition Vonage has publicly announced its intention to acquire Cable lines, "We'd

⁵ Grant, Peter and Latour, Almar. "Battered Telecoms Face New Challenge: Internet Calling" The Wall Street Journal (October 9, 2003).

love to crack a top-10 cable operator this year." Vonage CFO John Rego told analysts at Oppenheimer & Co.'s VoIP (define) conference in Boston Tuesday.⁶

"Circuit City's national rollout of Vonage's service is evidence of the transformation of the telecommunications industry and the need to make broadband telephony more readily available to the general consumer market," says Matthew Deatruck, vice president of retail channel sales for Vonage.⁷

Verizon, MCI, AT&T, SBC, Time Warner, Sprint and the Baby Bells are landline competitors in the expanding VoIP market. Cable providers are also expanding their VoIP products; Cox Communications and Comcast Corp are major Cable VoIP players.

Vonage competes as a privately held startup. Voice Plus and Packet 8 are also low overhead companies. The small, low overhead providers trade off their lower breakeven price advantage with the larger corporations' massive infrastructure advantages. The small providers pay a fee to local phone companies to route their data through. These connections are charged at local call rates even though the data stream could initiate from 6,000 miles away.

➤ **Direct VOIP Competition**

Least Expensive

SKYPE offers free software download of Peer-to-Peer communications. Using a PC headset you can talk to other PC users with similar hardware/software. This requires that you know the IP address of the person you wish to call, and whether or not they are on-line.

Deneg GmbH has announced a free service similar to SKYPE, however they have formed a registry of users and an on-line status for each ID. There are obvious privacy issues here.

⁶ Colin C. Haley, Vonage Goes Courting For Cable, March 10, 2004, <http://www.internetnews.com/infra/article.php/3323971>

⁷ Vonage and Circuit City Team, www.xchange.com, 3/5/2004

Inexpensive

DSLi, a Florida provider in the Miami area code offers a “call-out only” VoIP service for \$10.00 a month. All incoming calls are routed to an answering service. This service is only available in the Miami area, and uses a standard phone plus an adapter (additional fee).

US & Canada Service

Vonage has a \$14.99 service package including 500 minutes for calls throughout the U.S. and Canada. You must buy the modem interface from Vonage for about \$40 including shipping.

Packet 8, (also 8X8) starts at \$19.95 for U.S. and Canada with unlimited minutes.

Hardware fee varies on package deals but is similar to Vonage.

Galaxywire has Continental U.S. Unlimited Plan for \$19.95 a month with a \$20.00 startup fee plus a charge of \$8.95 for shipping and handling of the phone interface modem.

VoicePlus offers unlimited local (Canada & U.S.) access for \$20.00 a month plus a one time hardware charge.

Unlimited International Service

Cablevision, Optimum Voice, Vonage, and others have single household prices of approximately \$35.00 a month plus various specials on hardware interface and installation ranging from \$20.00 to \$99.00. As with DSL and Cable access there will inevitably be variations to gain market share; for example, “\$26.95 for the first 6 months with subsequent pricing dependent on area”.

“Meta Group Vice President David Willis said a theoretical bottom for unlimited local and long-distance VoIP dialing is about \$22 a month, based on estimated expenses.”⁸

Basic small business plans

Vonage small business basic packages start at \$39.99 with a 1500-minute limit and additional minutes at \$.039 per minute. Each additional phone connection is \$12.00. The small business unlimited plan starts at \$49.99; there is no limit on minutes per month.

Indirect competitors to both VoIP and Vonage

- Traditional landline telephones based on conventional switching technology - to the end consumer these offer the identical service without the inconvenience of:
 - Connection to a broadband connection
 - Loss of phone service during a power outage
 - Sacrificing 911 services
 - The small decrease in voice quality of VoIP as compared to traditional land-line phones
- Cell phones - these devices are often used instead of non-mobile "landlines" just to use up all those extra "night and weekend" minutes. Invariably though, the voice quality of cell phones is not up to par with VOIP and certainly not up to par with conventional land line phones.
- E-mail - the goal of a phone conversation is communication. To that end, e-mail is an indirect competitor to VoIP.
- Phone cards - these too, allow for portable voice communication, similar to VoIP. In fact most of these cards use VoIP technologies.

⁸ Ben Charny, *VoIP providers face price war*, CNET News, November 4, 2003, <http://news.com.com/2100-7352-5101663.html>

Risks Associated with Competition

Vonage can provide consumers who have broadband internet connections unlimited local and long distance calling for \$34.99 a month throughout North America; \$15 to \$25 cheaper than Verizon's comparable Freedom bundle (depending on state).

The FCC has not released rules concerning whether, or how, to regulate new VoIP. Currently the mandated reliability costs of local landlines and the 911 required services put the Baby Bells at a cost disadvantage. Conceivably, future FCC rulings could spread this cost to all VoIP providers.

As providers compete, the profit margins will slim, ultimately threatening the survival of higher cost structure companies. The huge Telecommunications investments made during the late 1990's assure that connectivity costs will remain low for the next decade.

Old fashion land line connections still have superior reliability as they are self powered. The entire VoIP network is power dependant. Even if the user has reliable backup power, there is no guarantee that power is provided throughout the connectivity path. Many households will keep standard phone lines regardless of price advantage. These standard phones will remain as competition until the reliability of the Digital data path is equal to that of standard wire.

Environment Analysis for Vonage VoIP

➤ *Broadband Internet Environment*

Vonage depends on the public internet and existing broadband access which is proliferating exponentially. In April of 2002, less than 16 million US households subscribed to broadband

internet service. In October of 2003 it was up to 19 million.⁹ Forrester research predicts there will be 60 million, more than half of all US households, by the end of 2006.¹⁰

➤ **VoIP Telephone Environment**

Acceptance of VoIP in general has gained ground. Yankee Group senior analyst Zeus Kerravala told TechNewsWorld that VoIP technology is "here to stay."¹¹ Vonage's CEO Jeffrey Citron expects mass conversion to VoIP in 2005-2006. Broadband Daily research predicts that VoIP will reach 17.48 million households by the end of 2008, or about 15%.

Telecom and cable companies are getting ready to roll out VoIP and already use it for long distance international calls and cheap prepaid phone cards. In the month of March 2004, five major cable companies announced plans to roll out VoIP within a year. They join four other large and small multiple system operators (MSO's). "All future market development will be VoIP," Barber, VP of Telephony for Charter Cable said. "It's more efficient and more cost-effective." In fact, he estimates that IP telephony generally is "about 30% cheaper than a constant bit-rate solution (circuit-switched service)."¹²

VoIP already has large acceptance in Asia and Europe, and foreign companies are poised to enter the US VoIP market if US companies don't.

➤ **Established Landline Environment**

The public is willing to accept lesser quality and reliability for better value, unlimited long distance, and free features. Residential use of landline long distance service has declined from 97 minutes per month to 52 minutes per month between 1998 and 2003. At the same time,

⁹ <http://www.cedmagazine.com/cedailydirect/0204/cedaily020423.htm>

¹⁰ <http://www.forrester.com/ER/Research/Brief/0.1317.17219.00.html>

¹¹ Jay Lyman, Vonage, TI Team On VoIP Chips And Software, TechWorldNews, January 12, 2004

¹² Alan Breznick. *More Major MSOs Unveil VoIP Rollout Plans Charter, Rogers, Mediacom & RCN All Target Major Service Launches*, Cable Datacom News, March 1, 2004

residential wireless usage increased from four minutes per month to 34 minutes per month. This migration will continue as wireless providers gain a larger share. Residential customers are using the free nights and weekends to make their long distance calls and they are willing to substitute wireless services for landline services. If they choose to replace all their telephone service with wireless phones, this will drive the wireless long distance usage still higher despite the lower quality and reliability of wireless.¹³

➤ **Regulatory Environment**

On February 12, 2004, the FCC deemed VoIP to be packet data on the internet, and therefore an unregulated information service, not a regulated voice service. On the same day, it declared it would begin to examine its' role regarding this “new environment of increased consumer choice and what it can best do to meet its role of safeguarding the public interest.”¹⁴

Michael Powell wrote that he expects problems related to the migration “from the monopoly analog world to the competitive new digital world of communications” will be solved by the VoIP Summit Solutions meetings that the commission will hold. The Internet Policy Working Group will “identify, evaluate and address policy issues that will arise as telecommunications services move to Internet-based platforms.”¹⁵ They acknowledge that customers are substituting IP-enabled services for traditional telecommunications services and networks, and hope to determine the rate and extent customers will use VoIP based services instead of circuit-switched telephony. They realize that this migration will fundamentally change consumers' use of services because consumers like the power to customize the services

¹³The Insight Research Corp, <http://www.insight-corp.com/reports/wimpact.asp>

¹⁴http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-243868A1.doc

¹⁵Federal Communications Commission, NOTICE OF PROPOSED RULEMAKING, released March 10, 2004, <http://www.fcc.gov/voip/>, visited 3/23/04

they use, and “will choose these services from an unprecedented range of service providers and platforms.”¹⁶

U.S. phone companies pay roughly \$25 billion in fees each year to send traffic over other companies' networks.¹⁷ At issue is how to fund universal service, rural access, 911 assistance, and expensive building of land lines. The universal service fee is intended to support telephone infrastructure in all parts of the country and subsidize services such as high speed internet access for schools. VoIP providers, and ultimately their customers are not required to pay these fees, giving them a distinct pricing advantage for now.

Vonage's CEO Jeffrey Citron and Bryan Wiener, president of VoIP for Net2Phone Global Services are not afraid of the power of the entrenched landline companies and believe service providers won't be able to prevent them from using existing infrastructure because market conditions and the history of telecom law has been to prevent discrimination against free traffic.¹⁸

AT&T and Vonage have proactively and aggressively brought these issues to the FCC theorizing that the public internet should remain unregulated. Sprint believes that since real-time voice services are being offered for a fee, they should fall under telecommunications guidelines and therefore should make contributions to the Universal Service Fund, access charges (if the calls originate or terminate on the public switched network) and 911, and CALEA (Communications Assistance for Law Enforcement) obligations.

Compensation is at the heart of the debate. According to Wanda Montano of Charlotte-based USLEC, “We need intercarrier compensation rules that are independent of the technology

¹⁶ http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-04-28A1.pdf, visited 3/23/04

¹⁷ WSJ 10/9/03

¹⁸ Broadband Daily, VoIP Pure-Plays in for the Long Haul, March 4, 2004

used to deliver the services. Once those rules are developed and become effective, then new applications and new technology can flourish without regard to decades old compensation structures.”¹⁹

There is no doubt that the public internet uses networks provided by voice communications companies. All VoIP providers, whether originating from their own networks or as Vonage does, on public networks riding on existing broadband connections, should feel responsible for maintaining this network and the services not provided through the Universal Access Fees through some sort of regulatory remuneration. But it is difficult to determine how Universal Access Fees would be assessed since we can't know where the call originated. Considering foreign exchange codes and literal portability wherever the consumer is traveling, a phone number issued to an IP address for a broadband consumer in Virginia might actually an adapter plugged in to a California modem.

➤ **Demographics, Social and Cultural**

The Vonage VoIP product offers solutions to escalating phone service cost, poor service, and the feeling that the giant companies are in control. If VoIP is bundled with cable TV and internet connection, this satisfies many consumers liking for bundled services.

According to Faith Popcorn's consumer trends for this decade,²⁰ this product could appeal to those cashing out: looking for a less hectic lifestyle by setting up small or home businesses (SOHO). Currently, second home phone lines are heavily taxed and small business lines are even more expensive. The down-aging trend could be a factor as older adults learn to use the internet, feel comfortable with technology, and are willing to try new things. Vonage bundled

¹⁹ Rick Smith, *FCC Has More On Its Agenda Than Janet Jackson - It's VoIP Regulation*. LocalTechWire, February 12, 2004 <http://www.localtechwire.com/printstory.cfm?u=7033>

²⁰ Philip Kotler, *Faith Popcorn: Trends in the Economy*, Marketing Management, 11th ed., pg 160

services could be viewed as a small indulgence because all the features are free. As stated above, the appeal of icon toppling the seeming monopoly of land-line based giant telecoms can't be denied. Consumers have become intolerant of shoddy service, and even though VoIP transmission quality at this time is on a par with cell phones, the customer care that Vonage provides is superior. Vonage commercials appeal to this resentment of hidden charges in their "keep your phone, lose your old phone company" campaign.

Yankelovich submits that smarts really count, meaning people are no longer afraid to try a new brand, and are willing to accept change when they see a better product. The Me.2 group, looking for a world built by me, will find this product gives the feeling of being in control with the ability to customize features like call forwarding, filtering, rollover, and taking the phone number with them.²¹

The demographics most amenable to this type of product are the NetGens (echo boomers), those who are in college or who are starting new households. They grew up with a fluency and comfort with the internet and find this extension of it natural. They will carry this expectation into their business relationships. The features of integration with internet browsing, web cams, fax service, and dialing from contact lists will appeal to them as a natural outgrowth.

Another market segment that could readily buy into this concept consists of those moving from countries where VoIP is already accepted.

Transitional (frequent job changers) segments will appreciate the number portability offered. Not only can they take their phone with them while traveling, they can take it when they move to other cities, states, even countries. In addition, SoftPhone applications turn a PDA

²¹ Philip Kotler, *Tracking Consumer Trends*, Marketing Management, 11th ed., pg 161

(Windows CE based at this time) or laptop or any other web enabled device into a portable phone that you can take on the road.

The demographic least amenable will be the traditionalists, the parents of the baby boomers because they are comfortable with the devices they own, have a distrust of internet or technologies they don't understand and they won't be motivated to investigate other solutions to problems that don't exist. They also may have a large investment in devices and are not prone to replace things that still work or can be fixed (switching costs).

➤ **Gear Suppliers**

VoIP is a boon for Cisco, Motorola, and other telephony equipment suppliers who suffered during the downslide of telecom three years ago. Cisco has spent \$654.5 million to buy voice expertise and is totally IP including voice, and says that its VoIP products are its fastest growing advanced technology. In October last year they were predicting this product segment would hit the \$1 billion sales mark soon.²²

Kevin Mitchell in an Infonetics Research report on Next Generation Voice Products, says that plans of major telecom corporations to deliver VoIP has a ripple effect for the gear makers who are expected to show a 42% growth this year.²³

➤ **Merging Technology Environment**

Motorola is partnering with VoIP gear maker Avaya and Wi-Fi equipment manufacturer Proxim to develop products that combine cellular, VoIP and wireless technology.²⁴ The company has already started talking about delivering handsets that support both cellular and

²² Cisco Rolls VoIP Gear, TechWeb News, October 3, 2003 (12:29 p.m. EST), <http://content.techweb.com/wire/story/TWB20031003S0005> visited 3/23/04

²³ William D Gardner, *VoIP Infrastructure Gear To Boom*, March 11, 2004

²⁴ Marguerite Reardon, *Wi-Fi and VoIP: A perfect partnership?*, March 02 2004, <http://www.silicon.com/networks/wifi/0,39024669,39118800,00.htm>

Wi-Fi access. "Wi-Fi and VoIP are powerful technologies on their own, but together, they are far more powerful. It's sort of like adding one plus one and getting three." said Richard Webb, directing analyst for wireless LANs at Infonetics Research.

Some innovative features that could be incorporated with cable include caller ID on the TV and voice command.²⁵ VoIP phones could be set to filter how certain calls are routed from various senders. For instance a spouse could be rated as high priority to interrupt your current call, while children's calls could be set at a low priority. Many features that previously had to be implemented through an expensive telephone company appointment, like call hunt or rollover groups, can be handled by the consumer through an online control panel.

Market Dynamics

➤ **THE THREAT OF ENTRY**

Vonage and other VoIP services are in the position of actually being the new technology threat to an existing service or product. The existing telecom companies like AT&T and SBC are worried that the new VoIP technology will hurt their ability to compete. "It destroys the incumbent telephone-company business model," says David Isenberg, founder of Isen.com, an independent telecom-analysis firm based in Cos Cob, Connecticut.²⁶

However the threat of other competitors entering the VoIP market is very high. There are virtually no barriers to other start-ups that want to enter this market. The initial capital investment is relatively low compared to traditional telecoms and for high technology

²⁵ Jay Lyman, *Vonage, TI Team On VoIP Chips And Software*, TechNewsWorld, January 12, 2004

²⁶ "Battered Telecoms Face New Challenge: Internet Calling", By Peter Grant and Almar Latour, Wall Street Journal, October 9, 2003

companies. Vonage's initial investment was only \$25 million. As of yet, there is virtually no government regulation or taxation on VoIP service. Overall, the major barrier to entry is the substantial investment in the back office operations and in hammering out all the billing issues. In particular, new entries must deal with the handling of the "last mile" which must be carried by traditional telephony carriers.

In general, a start-up VoIP service provider is faced with a large fixed cost but low variable cost structure. The fixed cost is relatively independent of volume, which is why volume is so important to survivability in this market. So far Vonage has the advantage in North America in this regard. But that advantage will be hard to maintain when competitors enter the market. Vonage is already concerned about the competition from overseas.

Shortly the big traditional telecommunication providers, like AT&T, will also be entering the VoIP market. The investment issue is relatively small for the big telecommunication companies because they already have many of the systems and back office administrative infrastructure in place. For example, AT&T and MCI currently route a large volume of traditional telephone calls through the Internet. It will be very easy for them to add in the "last mile" through their own DSL or cable broadband subscription services. The danger is that these companies can afford to undercut Vonage's prices, in the short run, in order to gain market share. They can drive other VoIP competitors from the market and steal Vonage customers.

➤ **THE BARGAINING POWER OF SUPPLIERS**

Vonage requires electronic hardware suppliers, like Cisco Corporation, who make routers, and Motorola Corporation, that make the customer's VoIP adaptor device. However for hardware manufacturer's, like Cisco, their bargaining power is low because they offer

commodity type products that Vonage can get from dozens of companies at the lowest cost.

Vonage also requires programmers who write systems, billing and account management software. However with all these programming jobs moving to India, it is also quite apparent that programmers do not have tremendous bargaining power over Vonage either.

➤ **THE BARGAINING POWER OF BUYERS**

The bargaining power of the consumer is extremely high. The entire phone service market, be it cellular, conventional landline, or VoIP operates in a near-commodity environment. This means that the consumer holds tremendous sway over the telecommunications markets at large.

Vonage is taking advantage of a new technology to provide a much lower price for telephone service to the consumer. Normally a company that is first to market with a new technology enjoys a period of price control over the consumer. However because telecommunications is in general a commodity market, Vonage cannot exert as much control over prices as it might like to. Due to all of the telecommunication choices available to the consumer, the consumer still has the control. As Richard C. Notebaert, CEO of Qwest Communications International Inc put it “At this point, the Bells' phone-line monopolies are gone. It's history. It's over. Phone service has become a commodity because I can get dial tone in Denver or Atlanta or New York or Los Angeles from seven to 10 different companies, without any problem. I can get five or six wireless companies. I can get the [local] telephone company, the incumbent local exchange carrier. Or I can get it from a small company or a large company like MCI or Sprint. Or I can get telephony over the Internet as an information service. Now, if you are going to compete, you have to compete with a commodity mind-set”.²⁷

²⁷ “Now Comes the Hard Part”, By Almar Latour, Wall Street Journal, January 19, 2004

Since telephone service is basically a commodity service, the consumer just cares about reliability and price. Just like Internet providers. Consumers do not really care if it is DSL or cable, from their perspective they both provide what they want. Also since VoIP technology has some issues, such as being susceptible to power and Internet outages, and is new technology, what the average consumer will perceive as a disadvantage, it is wise for Vonage to offer a large price advantage at this time over traditional telecommunication providers. This price advantage will serve to help Vonage to attract new customers to VoIP and grow the business thru increased share of the overall telecommunication market.

➤ ***THE PRESSURE FROM SUBSTITUTE SERVICES***

In the case of Vonage and VoIP in general, they are entering a commodity market. Vonage is not so much competing with other direct VoIP service providers (since there are still few in the market, which we see changing fast) but with the indirect competition of telecommunication providers like traditional landline and cellular services. Despite its advantages, VoIP can not replace traditional phone systems overnight. For one thing, the big national and regional phone companies have huge amounts of money invested in traditional gear and are not in a hurry to write that off. They also have long-established relationships with customers, many of whom would be reluctant to jump to a technology that is not fully tested.

There are so many choices for the consumer to meet their telecommunication needs, that the price pressure on Vonage will always be great. So far, VoIP has only captured less than 3% of the global telecommunications market. Vonage, as of this report, has only an estimated 125,000 lines in service. The traditional telecommunication providers still control 97% of the telecommunication market. Also as mentioned above, the traditional telecommunication providers still have several advantages over VoIP that will not change, even with the price

advantage that Vonage currently enjoys. Though the quality of VoIP calls has greatly improved over the past few years, many fear the technology still does not offer the near-perfect level of reliability delivered by the traditional phone system. For example, it is still unknown how the Internet will work when tens of millions of calls are being made simultaneously.

Competitors and competing technologies also exert tremendous pressure on the telecommunications markets. In much the same way that VoIP has exerted price pressure on the conventional telephone companies; cell phones has also began to exert price pressure on both the VoIP and conventional landline providers. If a customer has made the conscience decision to by a cell phone, and cell phones offer virtually unlimited air time for an extra \$10 to \$20 a month, then many customers may wonder why they need to be connected to a landline at all. Indeed many consumers are canceling their home telephone service and switching to the sole use of a cell phone instead. The ability to move about freely and carry on a conversation for nearly the same price is hard to compete against.

➤ ***THE AFFECT ON MARKETING STRATEGY***

The danger from other VoIP providers entering the market is that Vonage will lose market share and profits. Vonage's marketing strategy goal has to be to differentiate themselves from their competitors with things that others don't have such as easy installation, small adapters which allow customers to use traditional phones, no long term contracts, superior account management features, 24/7 customer support and other unique service features. This will allow them to maintain market share, and profits in what is basically a near-commodity market.

Vonage offers a very feature rich product, above and beyond what most VoIP service providers offer at an average VoIP price. Vonage is not the lowest cost VoIP provider, and since the consumer has the major bargaining power, their marketing strategy must directly

target the final customers. Going forward, in order to grow market share in a commodity telecommunications market with intense competition, Vonage needs to aggressively publicize their superior customer services, such as the 24/7 support, directly to the consumers. In addition, in order to entice customers that would otherwise use a cell phone in the home, Vonage needs to offer a price advantage that is hard to ignore.

Strengths and Weaknesses

This section will examine internal and external strengths and weaknesses of Vonage.

➤ **Strengths**

Vonage has been able to gain several strongholds into the telephony market because of the innovativeness of the product. This section will examine some of these strengths that Vonage currently maintains over their competitors.

Price Savings

The most expensive plan with Vonage (for residential purposes we will do the comparison here) is \$34.99. This includes all of your long distance, and calling features like call waiting, caller id for which most phone companies would charge additional fees. The national average for local telephone service is \$34, and when you add on the national average for long distance of \$27 per month that leads to a total average monthly telephone bill of \$61.²⁸ This number is close to double what the maximum for a Vonage plan would be. Vonage also has other cheaper plans which would be more applicable to many customers thus resulting in even further savings. The cost for network charges for Vonage is almost 1/7th what it is for traditional phone services, indicating that there is potential for these prices to fall with a higher customer base.

²⁸ http://www.arbitron.com/newsroom/archive/02_18_04_s.htm

Virtual Telephone Numbers

Vonage has innovated the notion of virtual phone numbers. This means that you can have multiple phone numbers, and they don't have to be within the area code where you reside. You can have a New York area code in California. This has several benefits. It could reduce the costs of people that would be calling you from those areas as they wouldn't need to place a long distance call to reach you. It would be especially beneficial to businesses who want to give the feel of a local presence in an area without having to have a physical office in that locale. It would also be beneficial to people whose families or friends primarily live in one location while they live in a different location.

Rapid Growth

The entire VoIP market is expected to see major growth in the coming years. The market was at \$924 million in 2002 and is expected to grow to \$1.4 billion in 2008. It is expected that there will be 7.5% annual growth in the market, which bodes well for Vonage as they already have a foothold into the market. Current estimates are that 10% of all voice traffic is carried via VoIP (with about 1% originating from services like Vonage's) thus providing clear growth potential into the future. Vonage is currently growing at the rate of 15,000 a month²⁹, and currently offers their service in all but 12 of the US states with plans of adding the Canadian provinces³⁰ to their offerings in the near future.

²⁹ http://www.vonage.com/corporate/press_index.php?PR=2004_02_02_0

³⁰ <http://www.vonage-canada.com/>

Leader in US VoIP Market

Vonage was the first company to attain 100,000 subscriber lines, adding 15,000 per month³¹, and is the leader in the broadband telephone market.³² They have clearly benefited from being one of the first to market, and are benefiting from this position to attain new customers at an astounding rate.

Leadership Team

Vonage has the benefit of having a truly visionary management team. The CEO, Jeffrey Citron, is credited with revolutionizing the financial trading industry through Internet trading technologies. Following that he went on to turn Datek into the fourth largest trading company.³³ This vision and entrepreneurial spirit was brought to Vonage and enables their employees to take the steps necessary to create a successful company. The entrepreneurial spirit encourages taking risks for the advancement of the company, with managed failures being an understood part of doing business that is so key at the early stages of a company.

Simplified Billing

The simplified billing procedures of Vonage are another strength that they have in dealing with customers. Traditional phone bills are notorious for being difficult to understand, given the small subset of billing operations that are available, and the fact that there is a limited amount of taxation on Vonage's services (3% Federal Excise Tax, sales taxes when applicable, and a Regulatory Recover Fee)³⁴. Additionally the bills are provided online, allowing

³¹ http://www.vonage.com/corporate/press_news.php?PR=2004_03_01_4

³² <http://www.voiptimes.com/research/news/archives/2003/jim/2-02-04/Story5.html>

³³ http://www.vonage.com/corporate/aboutus_citron.php

³⁴ http://www.vonage.com/learn_billing.php

customers to obtain more information than is available on traditional phone bills, such as all calls that were ever placed, with minutes and phone numbers called (this is impractical for paper based billing).

Standard Phone Interface

Vonage's technology relies on an adapter box, which integrates with existing phone systems. Several of their competitors require using the computer to initiate calls, using microphones and such to utilize their services. By providing the familiar interface of the phone set, Vonage can expand their offerings to people who are less technically astute, to gain greater market share. Vonage has been deemed the VoIP provider that most closely resembles traditional phone service.³⁵

➤ **Weaknesses**

This section will examine the weaknesses that Vonage faces. These weaknesses aren't really specific to Vonage but rather more of an artifact of the VoIP technology.

New Technology

VoIP is a relatively new technology to be in widespread use when compared to phone lines. The technology has not matured to provide the same quality and reliability of traditional phone lines (but the same can be said or was once said about cell phones and that notion is rapidly changing). This is one of the greatest fears of consumers when switching to the Vonage service, coupled with the dependence on broad band connections.

³⁵ <http://www.voipchoices.com/>

Requires Broadband Connection

Vonage's VoIP technology is tied to a broadband connection which means that this needs to be provided by somebody else. Thus it is necessary to get either DSL or cable modems for residential users to be able to utilize the service. There are a couple of issues with this dependence. The first being the cost of having both the broadband service and then coupling the Vonage cost on top of that (not a big deal because most people are switching to broad band anyway today). The second issue is that it seems likely that the broadband providers would be able to offer some sort of bundling discount thereby costing Vonage some of their client base (this can be mitigated by Vonage providing their service to the broadband providers for resale). The final issue is when your broadband connection goes out you have no means of making telephone calls, thus you have an issue of how to report your outage.

Requires Electricity

Vonage requires electricity. The underlying broadband connections are what are going to fail, but that is then translated to the Vonage service.³⁶ This is an issue for both major markets being served, business and residential. For businesses they are often times down because of phone outages. Given that the power outage will cut out computer service and the increasing dependence of businesses on computers it is likely they would have trouble operating anyway without back-up power. The residential market is affected in that they can't make calls. Some users need access to phones at all times, like the elderly in case they need to make 911 calls. Some VoIP companies plan to provide battery backup add-ons.

³⁶ http://www.vonage.com/corporate/press_news.php?PR=2004_01_05_4

Price

While Vonage experiences a price advantage over the traditional phone companies, other VoIP providers are offering packages at an even lower rate than Vonage. Packet-8 for example offers unlimited residential services for \$20³⁷ which is close to half the rate that Vonage is charging (of \$35). There are also the Voice over Net (VON) providers that offer free calling capabilities. Several of these services have moved from previously providing free services to pay services, like dialpad.com, which now charges a rate of less than two cents per minute in the US, which indicates that there is a paradigm shift in the technology.

Credit Card Dependence

Vonage's only form of payment is via credit card.³⁸ For most individuals this is not an issue, but there are those that are hesitant to provide companies with access to this information on an ongoing basis. Additionally there are those that are not able to have credit cards because of issues that came up in their past (albeit these may not be ones that you would like to have as customers). Having credit cards, as the only payment method, greatly simplifies the management of customer's accounts and reduces overall costs for Vonage.

International Expansion

International expansion could be a problem for Vonage. One article states that there is little opportunity for Vonage to gain access to the European market because there is high broadband penetration already and little chance for indirect providers like Vonage (as opposed to bundled solutions) to gain access to the market. That market already has low cost phone

³⁷ <http://www.packet8.net/about/services.asp>

³⁸ http://www.vonage.com/learn_billing.php

packages at fixed rates. There will be increased costs to gain customers, and increased costs of terminating calls (going to the local exchanges).³⁹

Larger Competition

Several of the companies that are getting into the VoIP market are much more established and respected companies than Vonage. These companies include the likes of AT&T, Time Warner, and Comcast. All of these companies have resources far in excess of Vonage, and the additional advantage of already having access to end users' houses (like being the cable provider) and being known entities (one that they have done business with in the past).⁴⁰ Companies who provide the broadband connection required for VoIP have the ability to bundle the two services together, which may place Vonage at a disadvantage. Additionally Vonage service is dependent on receiving access to all facets of the phone call lifecycle (going through local exchanges, etc.) which are controlled by many of these MSO companies. They could even attempt to raise these transfer fees to price Vonage out of the market.

Regulation Issues

Currently the VoIP services are unregulated by the FCC or state regulators, though there is growing pressure for regulation because of the popularity of the services. The CEO of Vonage said that bringing in regulation now would slow the market. This shows that they are not as mature as traditional phone services and would likewise not be able to compete given the same regulatory issues at this point.⁴¹

³⁹ http://www.lightreading.com/document.asp?site=lightreading&doc_id=49427

⁴⁰ <http://www.wired.com/news/wireless/0,1382,61551,00.html>

⁴¹ <http://www.nwfusion.com/news/2004/0206vonageceo.html>

Cost Analysis

The computations in Table 2 below show a revenue analysis for Vonage. Their plan structure, plan prices, and total subscriber volume are all known. The plan mix is not known, but we made some assumptions to determine that they have about 51 million dollars a year in annual revenues, or about \$427 per customer per year.

Table 2 - Revenue Analysis			
Total # Vonage subscribers	120,000		
REVENUE ANALYSIS			
Calling Plans	Price per month	% of Vonage Volume	Total Monthly Contribution
Residential Basic Plan	\$14.99	10%	\$179,880
Residential Unlimited Local Plan	\$24.99	30%	\$899,640
Residential Premium Unlimited Plan	\$35.99	10%	\$431,880
Small Business Basic Plan	\$39.99	20%	\$959,760
Small Business Unlimited Plan	\$49.99	30%	\$1,799,640
	Monthly Revenues	100%	\$4,270,800
	Annual Revenues		\$51,249,600
	Annual Revenues per Customer		\$427

The expense analysis in Table 3 is based on a known number of Vonage employees, the known current Vonage subscriber signup rate, and industry estimates for acquisition costs. With \$33 million in annual expenses and \$427 per customer per year in revenues, the breakeven volume for Vonage is 77,000 subscribers. This shows Vonage to be currently operating at a profit.

EXPENSE ANALYSIS	Annual Expense
SALARIES - 250 employees at \$60k a year	\$15,000,000
ADVERTISING / MARKETING - Customer acquisition costs - \$100 per customer * 15,000 customers a month * 12 months a year	\$18,000,000
	\$33,000,000

Table 4 below shows demand elasticity by Market Segment for the markets described in our "Market Being Served" section.

Market Segment	Demand Elasticity	Justification
Early Adopters	Low	They don't buy on price, they buy because of new / latest technology
Frustrated Traditionalists	Med	Service and simplicity is most important buying feature here, cost is secondary
Me-too technocrats	Med	These are copycat customers who mostly just want to keep up, cost is secondary
College students	High	Cost is very important to this segment
Impulse buyers	High	Cost is very important to this segment
Indecisive buyers	Med	Cost is important here, but some incentive is probably more important
Web Enthusiasts	Med	Cost is less important that the web integration features w/ VoIP
Value Customers	High	Cost is very important to this segment
Bottom Feeders	High	Cost is very important to this segment
Connected / integrated market	Low	Connectivity features way more important that cost
Mobile market	Low	Connectivity features way more important that cost
Foot-in-the-door	Med	Awareness / access is more important than cost
Elder care market	Low	Ability for others to monitor activity is way more important than cost

Table 5 examines realistic cost and profit goals. Overall it shows substantial profit potential. This is primarily due to the high fixed cost / low variable cost structure of this business. Key assumptions are growth rates.

- Customer growth rate assumed at 50%. This is the single most important assumption in the entire analysis. The VoIP market has less than 10% penetration in the US, and a current growth rate in excess of 200%, so we felt a 50% growth rate was reasonable.
- Salary expense growth rate assumed at 10%. This is due in part to a few extra programmers to support additional subscribers. Outsourcing pressure will keep this figure low. Also, despite the increased volume, we do not foresee a corresponding need for increased programming activity.
- Marketing expense growth rate assumed at 20%.

Table 5 - Revenue Projection			
	2004	2005	2006
REVENUE ANALYSIS			
Customers - Growth rate 50%	120,000	180,000	270,000
Revenues per year per customer	\$427	\$427	\$427
Revenues	\$51,249,600	\$76,874,400	\$115,311,600
EXPENSE ANALYSIS			
SALARIES - 250 employees at \$60k a year - Growth at 10%	\$15,000,000	\$16,500,000	\$18,150,000
ADVERTISING / MARKETING - Customer acquisition costs - \$100 per customer * 15,000 customers a month * 12 months a year - Growth at 20% per year	\$18,000,000	\$21,600,000	\$25,920,000
Expenses	\$33,000,000	\$38,100,000	\$44,070,000
Profits (before taxes)	\$18,249,600	\$38,774,400	\$71,241,600

Critical Evaluation

Vonage's current marketing strategy is quite comprehensive. They recognize the high investment / low variable cost structure of their business and are going to great lengths to grow their market share through various marketing channels. They offer broadband telephone service directly through www.vonage.com, as well as through numerous retail, e-tail and wholesale partnerships. Designed for large retail chains, Vonage's retail product enables retailers to bundle telephony services with existing products sold or upsell telephony services to broadband customers. Vonage Wholesale allows partners to leverage their existing brands to up-sell telephone service to current and future customers. Wholesalers use their own billing systems and customer care staff to support Vonage services as a component of a bundled offering or a stand-alone product. A summary of marketing channels include:

- DIRECT-TO-CONSUMER - via their web site
- E-TAILERS - through Amazon.com and Skymall.com
- RETAIL - through Circuit City and in trials with Best Buy and RadioShack
- WHOLESALE - through Advanced Cable Communications, ARMSTRONG, CableAmerica, Microwave Satellite Technologies, NuVisions Digital Voice, Associated Network Partners Incorporated, and Mid-Hudson Cablevision
- ISPs - through EarthLink, Ygnition Voice, and The Digital Voice Choice
- MUNICIPALITIES - Coldwater Board of Public Utilities, and CityOne Voice Powered by Vonage

Vonage is frantically trying to grow its market share by differentiating itself from other VoIP providers in what is becoming a near-commodity market. All their phone plans offer all of the advanced technical features including: Caller ID, Call waiting, Call forwarding, Call hunt, Call transfer, Call return (*69), Call block (*67), Repeat dialing, Area code selection,

Number mobility, Bandwidth saver, Web-based account management, Voicemail retrieval and real-time inbound/outbound calling activity. Their marketing strategy has been to position themselves as the market leader within the VoIP market. Their individual VoIP offerings are differentiated talk-time only, not by de-contented service. This was a direct response to a major market segment that has felt that they have been "nickel and dimed" to death by the conventional phone companies. By offering high-cost calling features at below average prices, Vonage has set themselves up as a market challenger to the conventional phone companies.

Vonage is also trying to generate consumer awareness and to educate the potential market to the cost and technical benefits of VoIP technologies. In fact, on Saint Patrick's Day 2004, they offered all their customers free calls to Ireland. This helped get them in the news and generate the additional consumer awareness that they need in order to grow the VoIP market. In addition to the occasional "give away", Vonage also aggressively advertises through banner and pop-up adds on a wide variety of web sites. Their own web site, www.vonage.com is also an excellent resource for learning more about exactly what VoIP is and how consumers can benefit from this emerging technology. The site has links to numerous newspaper articles and press releases about Vonage as well as the industry in general in its "Learning Center" section. In fact this section was so effective at presenting VoIP benefits, that it caused one of Team 1's members to sign up for its service, and other group members to strongly consider doing so.

Their current marketing strategy seems to be paying off. In September 2003 they hit a milestone of 50,000 subscribers. Less than five months later, on February 2, 2004 they doubled that milestone and had 100,000 paid subscribers.

After a critical evaluation of Vonage's current marketing strategy, our group felt that they were doing a lot of things right, and that is reflected in their current growth numbers. We

would recommend a few minor adjustments to help them grow their market share, as well as the VoIP market at large.

- **MILITARY MARKETS** - This is a huge market with distinct needs that a VoIP provider would be uniquely qualified to satisfy. Two of our five team members have been deployed overseas with the military and know the frustration and expense of dealing with foreign telephone companies and ever-changing phone numbers. Vonage should strongly consider catering a plan specific to this relatively large and technically competent market segment.
- **FREE "GIVE-AWAYS"** - In an effort to increase consumer awareness, Vonage should consider setting up booths at college campuses, at stores like Best Buy, at fairs, at ports where thousands of sailors disembark from naval ships, at various sporting events, and anywhere else that groups of people gather. These booths should offer free calls with a 5 or 10-minute limit to anyone interested. Vonage won't make money here, but they will increase consumer awareness. Naturally, potential consumers could sign up at these booths and even get a month or two for free as an added enticement to help seal the deal. This is different from their "call Ireland for free on St Patrick's Day" event, which was only offered to Vonage customers. These free events need to specifically target potential customers.
- **UNDER \$10 A MONTH PLAN** - There is a certain market segment that responds to price alone. Vonage should consider offering a plan with reduced minutes to set the hook for this market segment. Other VoIP providers like Packet8 currently offer a \$9.99 plan, and Vonage should offer something that breaks the \$10 a month psychological barrier. It should also be easy to upgrade to a more feature-rich plan that Vonage is more known for.
- **FAMILY / FRIENDS PLANS** - Satisfied customers are a company's best advertisers. Vonage currently offers a "Refer a Friend" program, but it is confusing and requires the friend to enter special e-coupon codes. The only real financial benefit goes to the referring customer. The referred customer gets one month free, but you can also get that by calling the 1-800 number. We recommend simplifying the rules, offering the referred

customer a better incentive, and re-energize marketing efforts on this program since the phone service is a very good, and will sell itself once in the consumers' home.

- **MAKE SURE WEB SIGN-UP IS THE CHEAPEST** - Currently if customers sign up via the toll free number, they get 1 month free. Web-signup gets you 1 month free ONLY when a customer gets a special, random, pop-up screen that makes this offer. Vonage is making a name for itself for superior customer service and they need to maintain that edge, but sign up is a lengthy error-prone process that is best done on the web by the new customer. One of our group members preferred to do this on the web, but did it through the 1-800 number because he couldn't get the "free month" pop-up add. Vonage should offer both sign up channels, but the web should be the cheapest because it saves the company money and it reduces errors.
- **NUMBER SELECTION** - Vonage currently offers area code selection. That is nice because it gives consumers the ability to make long distance calls as "local" calls. They should take this one step further and allow customers to select the whole number, assuming it is available. Business customers might find value in having a certain sequences of numbers that might spell something. Residential customers might also find value, probably sentimental value, in getting certain number sequences. This wouldn't cost Vonage extra money, but could further differentiate them in the near-commodity market place.
- **IN-HOME PHONE ACCESS** - All VoIP phones require direct access to a broadband internet access point. This means that if a consumer has internet access through a cable modem in their office, then the VoIP phone works great in the office. But consumers want multiple phones throughout the house as they have become accustomed to with conventional landlines. One solution is to get a cordless phone with a base station at the internet access point, then have satellite cordless phones at other locations. The problem is that most people don't have this type phone system and most people don't want to replace otherwise good phones with this type phone. There must be another technical solution to this problem that Vonage can offer. This will more completely allow Vonage to compete with conventional landlines and increase consumer acceptance of this new product.

- **TIE-IN WITH THE BIG BELLS** - The large conventional phone companies have pretty much been ignoring the VoIP markets until recently. Vonage has done extremely well to date amongst the smaller start ups, but now that AT&T and others have rolled out their own VoIP offerings, a potential tie-in should be considered. The main question would be at what point Vonage would consider merging with a "big bell" company. The answer, based on current marketing strategy, would be as late as possible and only if absolutely positively necessary. We would not recommend any tie-ins at this point, but because the big bells are so massive, they can not be ignored and some sort of tie-in at some point should be considered.
- **ENVIRONMENTAL REGULATIONS** - This is important because it gives the current VoIP providers a huge cost advantage over their conventional landline competitors. If VoIP markets were taxed at the same rates as their conventional landline competitors the whole US-based VoIP companies could collapse. Main marketing strategy recommended here is to maintain a dialog with the FCC and a public awareness campaign to inform the government and the public that VoIP will eventually displace the conventional phone companies as we know them. It is also a truly global business, and a foreign company could just as easily develop and deploy these services if America is unable or unwilling to do so. For these reasons, Vonage should continue their aggressive arguments that VoIP markets remain classified as data to maintain low rates in order to encourage its development and worldwide deployment.
- **CELLULAR PHONE CROSS COMPATIBILITY** – Vonage should also take advantage of a technological serendipitous relationship with the cellular phone services rather than compete against them. Some makers of consumer telephone equipment, such as Motorola, will soon be marketing cell-phones and VoIP phones that have a slot for a memory chip that carries consumers account information. The customer now has the ability to seamlessly transfer service between the cell-phone and the VoIP phone. When out on the road, the customer uses the cell-phone with the chip installed. When the customer is at home, the chip is plugged into the VoIP adaptor or VoIP enabled

telephone. Thus the same phone number and other services are now truly available everywhere, not just when plugged into another internet port per the usual VoIP service. Rather than a loss of market share and profits to the cellular service providers, Vonage should form partnerships with the cellular providers to market this capability. In this way, Vonage's growth will be enhanced by the growth of the cellular services rather than hindered by it.

- VIDEO TELEPHONE – In 1968, the motion picture *2001: A Space Odyssey* predicted video telephones in the home. Well in 2004 that capability is finally a reality via VoIP service. This may be the “killer application” that will attract the largest interest in VoIP. Vonage needs to be at the front end of this technology. Vonage should aggressively publicize Video-phone via VoIP and be properly positioned to take advantage of the ensuing interest in the market. A high end service package that offers real-time two-way Video-phone service will greatly enhance revenue at a relatively low additional capital investment and operating cost. The future profits from this capability are difficult to estimate. However it is also difficult to envision anything but a profit from the market that is, and has been since the 1960's, hungry for Video telephones.