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Calling On the Internet

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The buzz is back for Internet phones. Every few years it seems pundits start another round of cheering for Internet telephony, which always seems to be on the verge of slashing the costs of yakking to anyone anywhere.

I don't know about you, but between my cellular, long-distance and local service, I am paying more today for phone service than I did before Internet telephony started its big tease seven years ago. Maybe those bills are why I remain interested in Internet calling, despite the fact that my early trials of Net2Phone and Dialpad made my voice sound as if I was locked in the trunk of a Volkswagen.

Now comes a fresh round of Internet phone pioneers, with names like Vonage and Packet8. You plug regular phones into their special boxes and place calls by dialing the old-fashioned way, paying \$20 to \$40 a month for unlimited nationwide calling. By most accounts, thanks largely to improvements in broadband Internet access, their sound quality is better than what the pioneers offered in the 1990s.

The newcomers also have some momentum on their side. All kinds of companies are trying to exploit the Internet to more cheaply transmit calls that have long moved as analog signals over copper wires. There are various methods for Internet telephony, but the idea is to chop voice signals into digital pieces called "packets" and send them along separate paths over the public Internet. The packets get reassembled and converted back into analog voice signals when the call connects back into the traditional phone system. It's less costly than existing phone service mostly because software does much of the call routing and there's no need to maintain elaborate networks of physical wires.

The middle portions of some long-distance phone calls are already traveling over the Internet without the knowledge of callers as established carriers seek to cut costs. Eventually, analysts expect cable TV providers and phone companies to move calls over their private digital networks, which would allow them to guarantee higher sound quality.

"I think in the next year or two, it is really going to take off and take a bite out of the hide of the local telcos," Scott Cleland, chief executive of the Precursor Group, told a recent gathering of telecom execs in California.

Already, the former Baby Bells -- whose established networks are the most threatened by Internet telephones -- are lobbying the Federal Communications Commission to regulate the nascent industry and subject it to taxes and fees comparable to those of the traditional phone industry.

Meanwhile, cable and phone companies continue to run trials. In May, Time Warner Cable began testing an Internet residential phone service called "Digital Phone" with cable customers in Portland, Maine. Cisco Systems Inc., a maker of Internet phone gear, said it is working with SBC Communications Inc., BellSouth Corp., AT&T and Sprint to help them offer Internet-based phone services to business customers.

In the residential market, a 14-month-old service from New Jersey-based Vonage Holdings Corp. appears to be attracting the greatest notice. The company announced this week it has signed up 30,000 customers for its national broadband phone service, which piggybacks on customers' high-speed Internet connections. For \$40 a month and a one-time \$29 start-up fee, Vonage offers unlimited calling to anywhere in the United States and Canada, plus cheap global rates. Customers are assigned a phone number so they can receive as well as place calls.

Vonage ships customers a small box called an analog telephone adapter made by Cisco. One side of the box plugs into the router that controls the customer's broadband connection (either DSL or cable modem). A regular phone plugs into the other side.

A similar but cheaper Internet phone service is available from 8x8 Inc., a publicly traded company in Santa Clara, Calif., that has been making voice and video semiconductors for years. Last November, 8x8 started selling residential Internet phone service under the name Packet8. With only a few thousand subscribers, Packet8 recently decided to slash its monthly price to \$20 a month.

"We are going after this market on price," said Scott Dike, Packet8's marketing manager. "We are spending very little on marketing and applying our funds to lower our price. It's a gamble that we will get enough volume to generate revenue to offset our average cost of providing service."

Vonage Chief Financial Officer John Rego said he expects his privately held company to turn its first profit in the first quarter of 2004. Its chief executive is Jeffrey Citron, a serial entrepreneur who got slapped with a \$22.5 million fine by the Securities and Exchange Commission in February for allegedly engaging in improper trading while he was running the Web brokerage Datek Online. Citron also founded Island ECN, a financial exchange.

In addition to selling to homes and small businesses, Vonage and Packet8 are trying to get telecom companies to resell their services. Vonage has inked deals with EarthLink, the Internet service provider, Armstrong Cable and Advanced Cable Communications.

But I suspect most people won't want either service as their primary home phones yet because the reliability is still tied to the quality of their broadband Internet connections and their electrical service. Since the services piggyback on DSL and cable hookups, hiccups or outages in a customer's broadband connection will affect his Internet phone. That may be why a few reviews of Vonage have complained of dropped sound and echoes. Also worrisome is the fact that callers' addresses don't show up on emergency operators' screens when they call 911.

I do believe, though, that these services foreshadow the future, partly because they bundle goodies at no extra charge and let you manage them on custom Web pages. Free extras include caller ID, voice mail and call waiting. You can also pick your area code, and it doesn't have to be geographically tied to where you live. Some folks choose one where they have children in college or a lot of friends, allowing those people to reach them via a local call. For \$4.99 a month, you can add a second area code with Vonage that will ring on the same line. You can also buy multiple phone lines and use cordless phones.

Vonage co-founder Jeff Pulver, who left the company last year to run trade shows and start a free Internet phone service called Free World Dialup, said he regards broadband voice as "the killer app" that will entice more people to pay for high-speed Internet access. Other pundits envision cable companies rolling out Internet phone service that plugs directly into their cable wires, without requiring customers to buy stand-alone Internet connections.

My favorite scenario is Pulver's notion that the Baby Bells should adopt the Vonage model and sell Internet phone service as a parasitic add-on not only to their own DSL wires, but also over their cable rival's TV wires.

Now that's funny.

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