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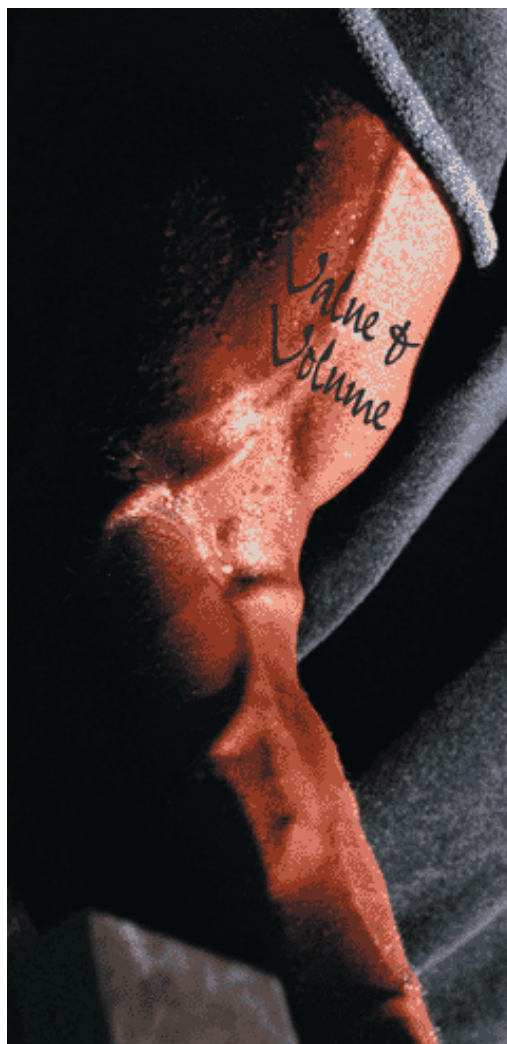
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DSL Resellers Pump Up Volume & Value

By Tara Seals



Business DSL for SOHOs and SMBs, or consumer DSL with excellent customer service to set it apart from the phone company — a year ago these were two approaches that put bread on the table for private-label DSL providers. Fast-forward 12 months: The rapid proliferation of broadband and end users' growing interests in applications, whiz-bang features and content has made the connection a commodity, threatening to leave many DSL resellers at the mercy of the competitive elements. Value and volume approaches will be the strengths of the survivors.

"You're going to see ISPs diversify their portfolios to include VoIP, wireless, VoIP over wireless, whatever it takes ... but it's going to be an interesting 24 months and there's got to be some shakeout, because not everyone can survive," says Jim Murphy, CEO for DSL Extreme, an ISP based in Los Angeles with 50,000 customers in 13 states,

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and a wholesale customer for SBC Communications Inc. and Verizon Communications Inc.

U.S. broadband providers added a record 2.3 million subscribers in third quarter 2004, according to the Leichtman Research Group (LRG). DSL and cable were neck-and-neck at 1 million and 1.3 million additions, respectively.

Total subscribers at the end of the third quarter, were 12.2 million for DSL and 18.8 million for cable.

Additionally, Nielsen//NetRatings reports that broadband connections surpassed dialup for the first time in October, representing 51 percent of the market. That leaves 49 percent left to be converted.

Then, the wind is taken out of the "sales," so to speak: Credit Suisse First Boston analysts estimate that it takes 39 months for DSL service providers to turn a profit on a new customer. However, the average customer switches providers within just 20 months. This gap means providers are facing net losses on DSL services.

The main reason for the disconnect between market opportunity and profit is fierce competition between ISPs and other second-tier providers. That means resellers have to provide either volume or value. "We have achieved economies of scale, so currently we're cheaper than the competition," says Murphy. "Small, independent ISPs in general are squeezed now and will get more squeezed," he adds. "Medium-sized ISPs who are quick on their feet with service offerings may have an advantage, but they have to move fast."

Moving fast means moving away from leading with the commodity and crafting innovative offers. "I don't believe the game is about resale of broadband," says Dan Foster, chief sales and marketing officer at MegaPath Networks, a hybrid private-label broadband reseller and service provider with a reseller program of its own. "It's about creating a bundle, and you almost have to sub-segment the market. You can't chase the lowcost provider and survive."

Offering value-added, targeted applications for businesses is one solid strategy in North America's highly competitive market. Dan Moffat, CEO and founder of wholesale provider New Edge Networks, notes that resellers selling frame or dialup replacement with IP VPNs can stay ahead.

"Multisite DSL is our focus," he says. "DSL is in place, it's solid and it's cheap, and those are three big competitive advantages. Doing IP VPN over DSL is half the cost of a traditional WAN, but it's more complex than standard frame. So there are lots of customers that need help with the network and the applications. If I were a reseller, I would be the go-to guy for installation and support."

MegaPath also markets productized application bundles for remote access, VPNs, managed security and other offerings. "Companies want to enable their applications sets without having to ramp up staff to do it, so we tell resellers to position themselves as augmenting the staff or



the CIO," says Foster.

One hot application is IP telephony, which Dave McMorro, executive vice president of sales and marketing at Covad Communications Group, says will be the single biggest driver of DSL going forward. "What e-mail was to dialup access, voice will be to broadband. No question." Symmetrical bandwidth available in highquality DSL flavors makes a difference for interactive communications like voice, video conferencing and gaming that require higher speeds with low latency.



Covad, which has an extensive private-label program, also is finding interest from CLECs for its T1-capacity product. "As CLECs move towards VoIP in a faster fashion than they would have because of the regulatory shift, our T1 product allows them to do it easier."

DSL Extreme is in trials with VoIP for consumers and business. "A lot of people are looking for a

bundle," says Murphy. "RBOCs will soon have television, which will give them an advantage with consumers. So it's not that it's a high-margin addition for us to do VoIP, although the margin is there, but it's the customer-retention benefits that are huge. Some of these ISPs have ridiculous churn rates. You spend \$200 to get a customer, only to lose them in the blink of an eye."

Focusing on a niche could differentiate a reseller, too. One area where DSL has a growing play is the retail industry, which is moving rapidly to broadband to increase the competitiveness of their store locations, particularly at convenience stores and quick-service restaurants. Merchants use broadband for faster credit card transactions, real-time inventory tracking, online training, remote sales analysis, workforce management and video monitoring, among other applications. In- Stat/MDR estimates the vertical will spend roughly \$30 billion on telecom services and equipment in 2005, up 11 percent from 2004. More specifically, the retail vertical is expected to spend 28 percent of this total on wireline data services.

To gain a better foothold with shops and restaurants, New Edge Networks has formed the Retail Broadband Alliance to bring together providers that supply retail network solutions. The companies will develop marketing programs to increase awareness of their offerings in the marketplace, and will test and certify retail-ready solutions.

"Microprocessors are getting cheaper and the intelligence is deeper, so there is monitoring on deep fryers, for instance," says Moffat. "There are a lot of folks jumping into networks that weren't before. And Wal-Mart is driving uptake with inventory analysis requirements and RFID. For retail, piling more and more applications on top of the connection is a good strategy for resellers."

Another competitive defense is being first to market in an area with new versions of the technology. In San Francisco, DSL Extreme is in trials with ADSL2, which delivers speeds high enough to open up a whole new category of services, like video conferencing and streaming video.

"ADSL2+ and VDSL are two technologies that have come to us through the standards bodies that are improving the speeds, and in essence the rates, we can deliver over copper," says Jay Fausch, chairman of the marketing committee at the DSL Forum. "We're working on new technical reports to improve the approach the individual operator uses to deliver DSL, with interoperability testing. We have blueprints for the way to deliver differentiated services, like the turbo button, for example, to provide a high download speed for an hour. Things like that are being codified."

Covad has rolled out dedicated ADSL for bandwidth-hungry consumers like young people with no loyalty to the phone company, and for small businesses that don't want to share a connection. It's also exploring ADSL2, "which requires that we augment our network central office by central office," says McMorrow. "We will have a test trial going by the March-April timeframe."

Also, line-sharing providers like Covad or New Edge can give national coverage to resellers — an advantage in some customer segments when up against the geographically constrained RBOCs, for instance. The New Edge footprint covers more than 90 percent of businesses in the United States in 9,000 central offices, while Covad has 2,050 central offices that cover 6 million businesses nationwide and 40 million homes. There is an 8 percent overlap between the two.

Key Factors in Selecting a Business ISP

The market for U.S. business Internet access revenue, despite continued service price erosion, continues to generate positive revenue growth for U.S. telecom providers, according to data released in October 2004 by In-Stat/MDR. The firm's research indicates service providers need to strike an optimal blend between service quality and price.

In-Stat/MDR surveyed 560 U.S. firms with Internet access, and asked them what three factors they considered the most important in selecting an Internet service provider. Here's what they said:

	73%	Service quality/reliability
	69%	Price

"Our M.O. is to be the one-stop shop, the one neck to grab," says Moffat. "A reseller can come to us with 1,000 addresses and ask us what they can get, and we can deliver a detailed report. We offer smooth project management and one place to go for support, nationwide."

As for the macro level of competing access technologies, everyone knows the cablecos are putting on heat in the market, but two new developments stand to — eventually — impact DSL sales. One is the decision by the FCC not to mandate the sharing of fiber runs, clearing the way for RBOCs to monopolize with FTTH. The other is IEEE's 802.16-based fixed metro wireless broadband standard known as WiMAX, set to burst on the scene in mid-2005.

	21%	Company reputation, knowledgeable customer service staff and availability at multiple locations/national footprint.
	15%	U.S.-based customer service

As for fiber, no one seems too nervous, nor expects the rollout to happen overnight. "The most cost-effective way to do broadband is to reuse that expensive asset, copper, that's already there," says Fausch.

"Rewiring with fiber is an expensive option, only reasonable for greenfield

operators or new development. Where there are already copper loops, why dig through a person's garden or front yard to put in something new? We won't see serious deployments for some time."

WiMAX, on the other hand, is a different story. Rather than being bad news for DSL resellers, the broadband wireless technology has the advantage of offering a relatively inexpensive way for service providers to gain last-mile ownership and compete directly with the incumbents. "Right now, we are enormously dependent on the copper plant owned by phone companies. But there's no alternative," says McMorrow. "Wireless broadband has the potential to be highly disruptive and that would be a great opportunity for us. We would build our own or partner with someone. In fact, we're in pre- WiMAX trials right now in San Francisco."

Links

Covad Communications Group www.covad.com

Credit Suisse First Boston www.csfb.com

DSL Extreme www.dslextreme.com

DSL Forum www.dslforum.org

DSL.Net www.dsl.net

MegaPath Networks Inc. www.megapath.net

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