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Shawn Young
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TELECOMMUNICATIONS

Phone-Service Bundles Could Backfire As Customers Switch

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MAKING THE SWITCH

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America's beleaguered phone companies hope to keep their customers loyal by offering them bundles of local, long-distance and other services, all at a discount.


But the strategy may end up backfiring. Customers love the discounts, but many of them still aren't faithful.

Among those still playing the field is Steve Jordan, a former assembly-line worker who lives in Bayonne, N.J. About a year ago, he was shelling out as much as \$130 a month for local service from **Verizon Communications** Inc. and long distance from **AT&T Corp.** To reduce his expenses, he signed up for a Verizon bundle offering a flat monthly rate for local and long-distance calling. A few months later, he switched to a cheaper Verizon plan. Then, in September, he defected to Newark, N.J.-based **IDT Corp.**, which is giving him local and long-distance service for \$40 a month, about \$20 less than his last Verizon plan.

"They give you the features you want and you can pay online, so why not?" says Mr. Jordan, who didn't care that IDT isn't as well-known as companies such as Verizon, AT&T or MCI, formerly called WorldCom Inc. As more companies use bundles to perk up sales and hang on to customers, consumers have an easier time figuring out their total telecom costs -- and hopping from one offer to another, since it involves switching just one account. That can lead to more price-cutting and more customer turnover, known in industry jargon as "churn." Furthermore, because of bundling, the local phone service that once tied consumers to their local provider, typically a regional Bell company, is increasingly a commodity, available at discounts from an array of suppliers. Analysts fear that a pending new rule that will allow customers to keep their phone numbers even if they switch between land-line and wireless service will greatly encourage churn.

"Churn has increased," says Wayne Huyard, president of mass markets for MCI. MCI started the race in April 2002 when it launched The Neighborhood, the first widely available flat-rate bundle. "We are entering an era of commoditization for local and long-distance. Anyone can see that."

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The Neighborhood, which costs \$50 to \$60 a month in most areas, loses about half its new customers

within the first six months, though turnover drops after that. AT&T says its churn is substantially lower, but declines to be specific. In fact, none of the carriers would say what their churn rates are or how much it costs them. Adam Quinton, a telecommunications analyst at Merrill Lynch, says turnover in bundled plans offered by Bell rivals is as high as 8% a month -- or nearly 100% in a year -- in some highly competitive areas.

SHOP AROUND

A sampling of packages that combine local and long-distance services, by monthly cost.

	\$30	40	50	60	70
The Neighborhood/MCI	\$49.99				\$59.99
Freedom/Verizon	\$49.95				\$59.95
One Rate USA/AT&T	\$48.95				\$54.95
America Unlimited/BDT	\$39.95				\$44.95

Note: Rates may vary by state and don't include taxes and some fees.
Source: the companies

"That can't be a good thing," Mr. Quinton says. "Who wants a business where your average customer stays with you less than a year?"

Customers switch, particularly in the early months, for an assortment of reasons. Sometimes it's due to sticker shock, because the prices the companies advertise don't include taxes and fees that can add 15% or more to the monthly bill. And many customers, not used to changing their local-phone service, are alarmed when the first bill reflects two months of charges because the carriers typically bill for the month ahead. Some people who don't make a lot of calls and don't want services like call waiting soon discover that most unlimited packages, which are geared to high-end customers, aren't economical for them.

And some consumers are quickly lured into switching again by so-called winback offers from the Bells: Verizon, of New York, **SBC Communications Inc.**, of San Antonio, Atlanta's **BellSouth Corp.** and Denver's **Qwest Communications International Inc.** The Bells, which until recently enjoyed near-monopolies, have the most to lose when consumers change their local phone service as part of a bundle. Competitors have grabbed more than one million customers from the Bells in each of the past two quarters.

Analysts say the rate of losses is slowing as the Bells compete harder, by cutting prices and focusing on regaining lost customers. Still, competitors continue to make inroads. MCI's Neighborhood service has signed up about three million customers, and Mr. Huyard says bundles now account for more than half of MCI's consumer revenue. AT&T, which has been introducing its One Rate USA bundle in different parts of the country since April, has 415,000 package customers and is getting 22% of its consumer revenue from these offers.

The Bells are trying to turn the same willingness to switch that has cost them millions of customers back to their advantage, says UBS Securities analyst John Hodulik. In many areas they are making aggressive efforts to woo back wayward customers with extra incentives, including Visa gift cards and special discounts or credits available only to returning customers. The extra spending makes it all the more important that the customers stick around long enough for the company to recover its investment.

The Bells' most powerful weapons against churn so far are bundles that include wireless or high-speed digital subscriber line Internet-access. Wireless is the key to distinguishing phone companies from their cable-television rivals, many of which also offer phone and Internet-access packages but don't have cellphone services, says Jeffrey Halpern, an analyst at Sanford C. Bernstein & Co.

But the Bells' strategic advantage may be short-lived: The big long-distance companies are starting to offer their own wireless and high-speed Internet services to compete for the most desirable customers.

"Down the road we really need to add those to the bundle," says Kevin Crull, senior vice president for marketing and sales at AT&T's consumer division. "When you get more of the pieces, you find you don't have to match penny for penny on every service."

AT&T currently offers DSL in some areas through a marketing partnership with Covad Communications Group Inc. and is testing a package that includes cellphone service from its former wireless unit, **AT&T Wireless Services** Inc. MCI is also offering DSL in some areas.

But the bigger the bundles, the more they draw full-price customers into signing up for the discount plans, says Mr. Halpern of Sanford Bernstein. Most of the big-name companies are trying to emphasize their brands and service even as competitors like IDT push the fight toward price. The big carriers all insist they won't resort to the kind of self-destructive price wars that helped cripple the long-distance phone business. But the pressure is fierce.

"Price," says MCI's Mr. Huyard, "is going to be the biggest element of most people's decision."

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