

Narrow focus gives VOIP startup big byte

Low overhead and personalized service help M5 succeed; rivals enter market

BY JEREMEY QUITTNER

At the offices of M5 Networks, Inc. on West 26th Street, 40 employees are crammed into a 4,000-square-foot space in tightly spaced rows of well-worn desks. The place has the look of a down-at-the-heels New York City grade school.

Is the company being cheap? Absolutely, and it's proud of it. As Chief Executive Dan Hoffman sees it, his firm's low overhead is a key part of a strategy to do what few other recent telecommunications startups have done--survive.

"Clients have been burnt again and again by risk-takers in the telecom sector (who have folded)," says Mr. Hoffman.

In contrast, M5, which sells voice over internet phone systems, is on a tear. In recent years, revenues have grown at a 70% annual clip.

Not bad for a company whose business focus is as distinctly modest as its office. M5 targets only small and medium-sized businesses within New York City. Its customers range from 10-person offices to firms with hundreds of employees, like real estate brokerages Coldwell Banker and Century 21, both owned by Manhattan-based Cendant Corp.

"We are not taking risks with their service level, and we are not taking risks with our company stability," says Mr. Hoffman.

Good call

The biggest gamble that M5 took was its decision five years ago to focus solely on a radical technology called voice over Internet protocol, or VOIP, which promised users up to 75% savings by converting voice communications to bytes of information and sending them over the Internet.

At the same time, M5 decided to focus on getting its clients to outsource their communications networks, using M5 to purchase, maintain and update the system hardware.

"We are not taking risks with [our clients'] service level, and we are not taking risks with our company stability," says Hoffman."

That approach has worked fine for Brooklyn Brewery. Last summer, the core of the company's 10-year-old phone system literally melted down.

"We doused the flames, and then considered whether we would spend money on another traditional system," says Erik Ottaway, Brooklyn Brewery's general manager. In the end, he opted to have M5 take over the management of the phone system.

In addition to providing basic voice and data links, M5 brought cool add-ons: Each employee telephone has its own router, allowing it to be brought home and plugged into a broadband connection, instantly making it the employee's remote office extension. Mr. Ottaway also reports that his monthly phone bills have dropped to \$1,400 from \$1,800.

As VoIP has gained popularity, though, competitors have flooded into the New York market. They include not just VoIP specialists like Vonage, but also mainstream carriers, including Verizon. At the same time, the market seems to be moving away from M5's model of hosting its clients' phone systems.

"My belief is that businesses will prefer premise-based systems," says Elka Popova, research manager for IP communications at research firm Frost & Sullivan Inc.

Perilous position

Other industry experts say that M5's lack of advertising and its narrow geographic focus may also hurt. "If a company has a national scope or is super-regional, it will be hard for M5 to meet its needs," says Michael Lauricella, vice president of telecommunications for AMI Partners Inc., a research company.

Not to worry. Mr. Hoffman is convinced that by focusing solely on the city and by carefully managing his company's growth, he can beat his far larger rivals by consistently delivering better, more customized service. He believes that his edge is greatest among small businesses, a market segment that many of the giants have all but ignored.

He also says that if he had millions to spend on advertising, he wouldn't. Instead, he insists, he'd plow those funds back into expanding his business.

Meanwhile, he's happily laying plans for his company's anniversary party later this spring, which promises to be minimalist.

"We'll still be drinking out of plastic cups," Mr. Hoffman says. ■