



Impact of Increased Competition on Mobile Service Industry

Contacts:

Anjan Ghosh
aghosh@icraindia.com
+91-22-30470006

Vikas Aggarwal
vikas@icraindia.com
+91-124-4545301

Manita Singh
manitas@icraindia.com
+91-124-4545366

Background

The Indian mobile services market is highly competitive with six to eight players operating in each of the 23 telecom circles that the country is divided into. The intensity of competition has increased in recent months following the launch of GSM¹ services by Reliance Communications (RCom) and Tata DoCoMo, CDMA² services by Sistema Shyam; and the continuing pan-Indian GSM rollout by Aircel, Idea Cellular (Idea), and Vodafone Essar (Vodafone). The competitive intensity is expected to increase even further as new licensees launch their services and Mobile Number Portability (MNP) is introduced in India.

The recent increase in competition in the Indian mobile services market is evident from the aggressive tariff plans being introduced by players, a move that has led to a decline in the average revenue per user (ARPU), revenue growth, and profitability of the industry. Besides, profitability of the mobile service providers is also being impacted by the increasing share of low ARPU subscribers in incremental additions, the bulk of which is happening in the semi-urban and rural areas where the mobile penetration rates are still low. The financials of the telecom companies for the second quarter (Q2) of 2009-10 show the impact of the ongoing tariff war and increase in competitive intensity in the Indian mobile services market.

While India remains one of the fastest growing mobile services markets globally by subscriber addition and still presents an opportunity for further growth, the rates of revenue growth and margins of the mobile service providers are expected to decline as the intensity of competition increases further. Although some of the incumbent operators with strong financials, extensive networks, and larger share of high paying customers would be better positioned to withstand the kind of competitive pressures anticipated, high capital expenditure on 3G³ may well lead to continued negative free cash flows and push up funding requirements. Intensified competition and the aggressive pricing strategies adopted by the existing operators could challenge the sustainability of the new entrants as breaking even at lower tariffs would take longer. This would also imply delay in the generation of positive cash flows for the new entrants. Given this scenario, it is likely that the Indian mobile services market would see some consolidation over the medium to long term.

Website
www.icra.in

¹ Global Systems for Mobile Communications

² Code Division Multiple Access

³ Spectrum for 3G, or third generation mobile services, is expected to be auctioned early next year; a reserve price of Rs. 35 billion has been set for pan-Indian 3G spectrum.

Revenue growth for mobile service providers slides despite growth in subscriber base

Most telecom operators reported a decline in revenues from mobile services in Q2, 2009-10 despite growth in their mobile subscriber base. The all-India mobile subscriber base continued to expand in Q2, 2009-10, reporting a 10% growth over the previous quarter. However, because of the increasing competitive intensity, most of the large telecom operators like Bharti Airtel, RCom, and Idea reported a drop in their subscriber growth rate in the stated quarter, as compared with the growth rates seen in the previous quarters.

Most telecom operators also reported a decline in revenues from mobile services during Q2, 2009-10 despite growth in subscriber base primarily because of a fall in ARPU. According to the data released by the Telecom Regulatory Authority of India (TRAI) for Q1, 2009-10, nine out of 14 telecom service providers witnessed a decline in revenues in Q1, 2009-10 over the previous quarter. In Q2, 2009-10 also, Bharti Airtel and RCom saw a 2% and 16% decline in their revenues from mobile services, respectively, over the previous quarter. The decline in revenues shows that the decline in ARPU (owing to increased competitive intensity, consequent reduction in tariffs, and increasing share of incremental subscribers from semi-urban and rural areas) has more than offset the increase in subscriber base.

Table 1: Mobile Subscriber Base and Quarter on Quarter (QoQ) Growth in Subscribers

Subscribers (million)	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
Bharti Airtel	62.0	69.4	77.5	85.7	93.9	102.4	110.5
QoQ Growth		12%	12%	11%	10%	9%	8%
RCom	45.8	50.8	56.0	61.3	72.7	79.6	86.1
QoQ Growth		11%	10%	9%	18%	10%	8%
Idea*	24.0	27.2	30.4	34.2	38.9	42.8	46.8
QoQ Growth		13%	12%	13%	14%	10%	9%
MTNL^a	3.5	3.7	4.0	4.2	4.5	4.6	4.7
QoQ Growth		5%	6%	6%	7%	3%	2%
TTML^b	4.7	5.2	5.7	6.2	7.0	7.4	9.0
QoQ Growth		11%	10%	8%	13%	7%	22%
All India	261.1	286.9	315.3	346.9	391.8	427.3	471.7
QoQ Growth		10%	10%	10%	13%	9%	10%

* Standalone numbers for Idea (excluding Spice Communications)

^a Mahanagar Telephone Nigam Limited (MTNL)

^b Tata Teleservices (Maharashtra) Limited (TTML)

Source: Quarterly reports of companies; TRAI

Table 2: Revenues from Mobile Services and QoQ Growth in Revenues

Revenues (Rs. billion)	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
Bharti Airtel	64.2	69.2	72.8	79.4	82.2	82.3	81.0
QoQ Growth		8%	5%	9%	4%	0%	-2%
Rcom	41.6	41.2	43.4	44.1	45.0	47.9	40.1
QoQ Growth		-1%	5%	2%	2%	6%	-16%
Idea*	19.9	21.8	23.0	26.2	28.7	28.9	28.9
QoQ Growth		10%	6%	14%	10%	1%	0%
MTNL	3.1	2.2	2.0	2.1	2.1	1.8	1.8
QoQ Growth		-27%	-11%	6%	-2%	-15%	2%
TTML[#]	4.9	5.1	5.2	5.2	5.2	5.1	5.5
QoQ Growth		3%	3%	0%	0%	-1%	7%

* Standalone numbers for Idea (excluding Spice Communications)

[#] represents total standalone revenues of the company as segment-wise revenue break-up is not available

Source: Quarterly reports of companies

Decline in ARPU likely to accelerate in coming quarters as competition intensifies and subscriber additions happen mostly in semi-urban and rural areas

The Indian mobile services market is highly competitive with six to eight players operating in each of the 23 telecom circles. The competitive intensity has intensified further over the last few months following the launch of GSM services by RCom and Tata DoCoMo, CDMA services by Sistema Shyam; and the continuing pan-Indian rollout by Aircel, Idea and Vodafone. These players have introduced attractive schemes like per second billing (moving away from the industry norm of per minute billing) and aggressive tariff plans for local and STD calls to capture market share. The incumbents, facing a decline in subscriber additions, have also had to follow suit and reduce tariffs, which in turn has led to a decline in ARPU. This apart, the profitability of mobile service providers has also been impacted by the increasing share of low ARPU subscribers (from semi-urban and rural areas) in their total mobile subscriber base.

Table 3: Rural Subscribership of Mobile Service Providers

Mobile Service Provider	Subscribers (million) (June 2009)	Rural Subscribers (million) (June 2009)	% of Rural Subscribers (June 2009)	% of Rural Subscribers (June 2008)	% of Rural Subscribers (June 2007)
Bharti Airtel	102.37	33.78	33%	28%	19%
RCom	79.62	16.36	21%	20%	14%
Vodafone	76.45	24.83	32%	30%	27%
BSNL ^c	54.63	19.35	36%	34%	31%
Idea	47.09	19.80	42%	24%	20%
TTSL ^d	37.12	2.93	8%	6%	6%
Aircel	21.80	8.82	40%	31%	28%
MTNL	4.61	-	-	-	-
BPL	2.31	-	-	-	-
Sistema Shyam	1.19	0.06	5%	1%	2%
HFCL ^e	0.38	0.00	0%	1%	2%
Total	427.29	125.95	29%	25%	20%

^c Bharat Sanchar Nigam Limited (BSNL)

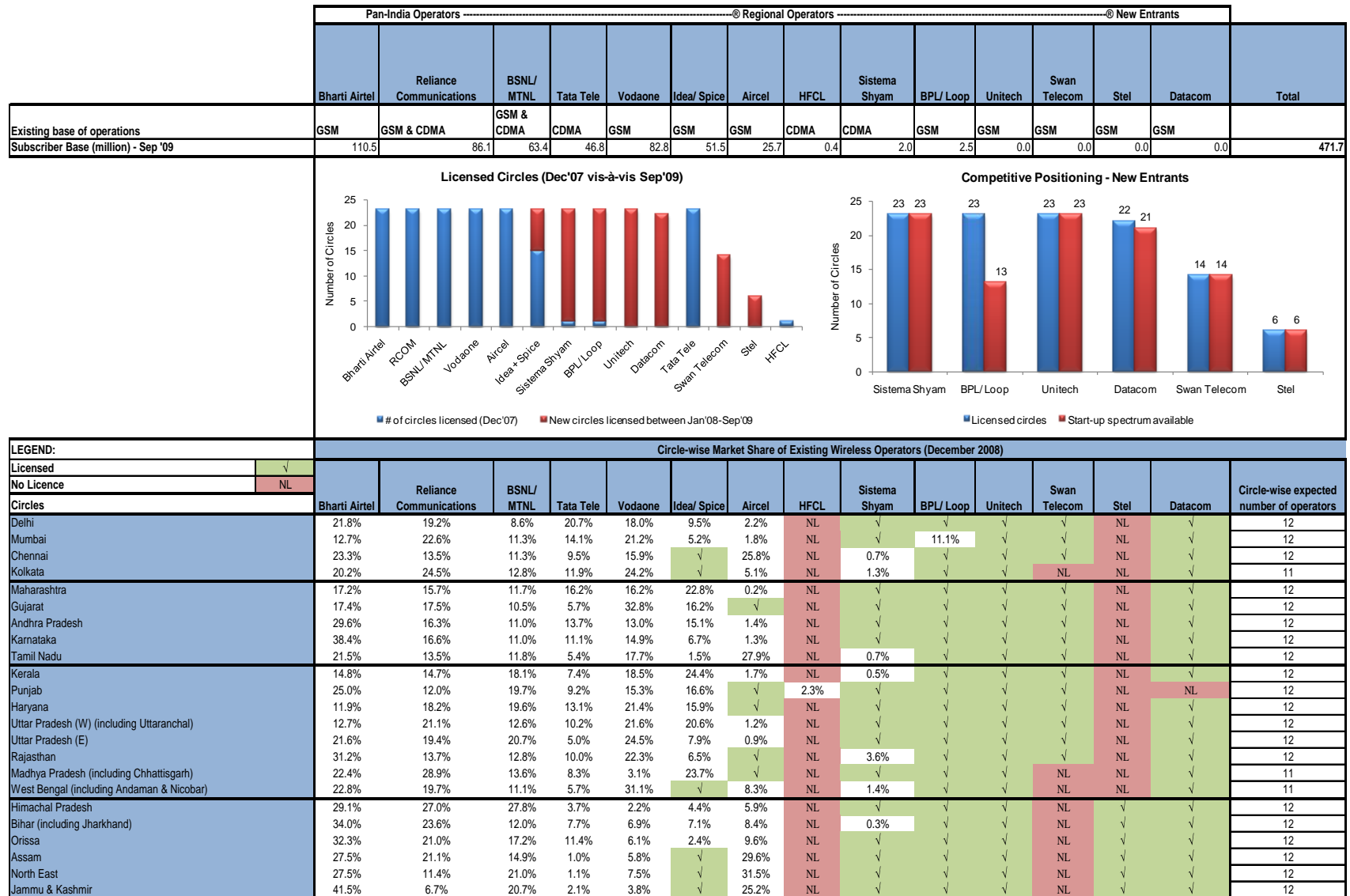
^d Tata Teleservices Limited (TTSL)

^e Hindustan Futuristic Communications Limited

Source: TRAI

The intensity of competition in the mobile services market is expected to increase further with the launch of mobile services by players like Unitech Wireless and Datacom over the next few months, which would take up the number of telecom players operating in each circle to 11-12. Moreover, with mobile penetration in the urban areas having reached high levels already (urban tele-density was 87.18% as against rural tele-density of 15.35%, both as in June 2009), subscriber additions are expected to happen largely in the semi-urban and rural areas, which in turn would impact ARPU further. A competitive matrix of the Indian mobile services market is presented in *Chart 1*.

Chart 1: Competitive Matrix of Indian Mobile Services Market



Source: TRAI Database, ICRA's estimates

Tariff wars along with a growing share of incremental subscribers from rural areas have already started impacting ARPUs and most mobile service providers have reported a sharp fall in ARPU in Q2, 2009-10. With the entry of new players, the ARPUs are expected to decline even further.

Table 4: QoQ Change in ARPUs of Mobile Service Providers

ARPU (Rs./sub/month)	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
Bharti Airtel	357	350	331	324	305	278	252
QoQ Change		-2%	-5%	-2%	-6%	-9%	-9%
RCom	317	282	271	251	224	210	161
QoQ Change		-11%	-4%	-7%	-11%	-6%	-23%
Idea*	287	280	263	268	255	232	209
QoQ Change		-2%	-6%	2%	-5%	-9%	-10%
MTNL		167	149	147	124	111	
QoQ Change			-11%	-1%	-16%	-10%	-
TTML	254	232	210	196	178	154	148
QoQ Change		-9%	-9%	-7%	-9%	-13%	-4%
All-India GSM	264	239	221	220	205	185	
QoQ Change		-9%	-8%	0%	-7%	-10%	
All-India CDMA	159	139	122	111	99	92	
QoQ Change		-13%	-12%	-9%	-11%	-7%	

* Standalone numbers for Idea (excluding Spice Communications)

Source: Quarterly reports of companies; TRAI

Decline in profitability in Q2, 2009-10 due to decline in ARPU and increase in costs

The operating margins and profitability of telecom operators have reported a decline in Q2, 2009-10 following a drop in ARPUs and an increase in customer acquisition and retention costs.

Table 5: Operating Profit and Margins of Telecom Operators (for Mobile Services Segment)

EBITDA ⁺ & Margins	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
Bharti Airtel	22.8	21.2	22.0	25.0	25.9	27.2	25.9
EBITDA (Rs. billion)							
Bharti Airtel	35.5%	30.7%	30.2%	31.4%	31.5%	33.0%	31.9%
EBITDA margins							
RCom	16.8	16.6	16.9	16.6	16.6	18.5	13.1
EBITDA (Rs. billion)							
RCom	40.3%	40.4%	38.9%	37.7%	36.9%	38.6%	32.7%
EBITDA margins							
Idea*	6.7	7.2	6.1	6.8	7.4	7.7	7.3
EBITDA (Rs. billion)							
Idea*	33.9%	33.2%	26.4%	26.0%	25.9%	26.7%	25.3%
EBITDA margins							
TTML[#]	1.5	1.6	1.6	1.5	1.3	1.6	1.2
EBITDA (Rs. Billion)							
TTML[#]	30.5%	30.7%	31.1%	29.2%	25.5%	30.8%	22.0%
EBITDA margins							

⁺ Earnings before Interest, Tax, Depreciation and Amortisation

* Standalone numbers for Idea (excluding Spice Communications)

[#] Represents standalone EBITDA and margins for the company as segment-wise margins are not available

Source: Quarterly reports of companies

Mobile Number Portability expected to intensify tariff war further

With TRAI recommending introduction of MNP, the domestic telecom sector appears poised for a paradigm shift. The reasons for seeking the introduction of MNP are compelling: to promote competition among mobile service operators so that service levels can improve further and to provide users the right to change operators at minimal cost and with minimal inconvenience. In ICRA's opinion, with the introduction of MNP, mobile service providers are likely to face higher competitive pressures, especially in the initial phase, as subscribers scout for better wireless deals, thereby raising the costs of subscriber acquisition and retention. As customers get a wider choice and are able to switch between service providers easily, mobile services providers would need to offer more competitive pricing plans. Overall, while maintaining quality of service (QoS) would be crucial for the retention of high-value customers, tariffs are expected to play an increasingly important role once MNP is introduced.

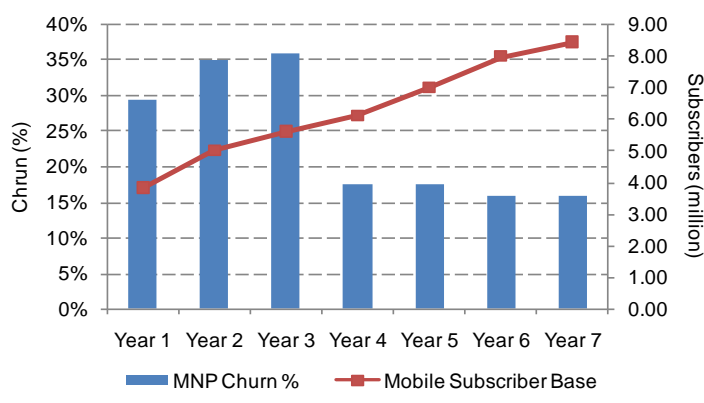
Customer churn expected to increase even further

Telecom operators spend substantial resources on adding customers and thus customer retention is of critical importance for them. Loss of subscribers is measured by “churn”, which is the ratio of subscribers leaving the network to the current subscriber base. One of the biggest “concerns” for the mobile services industry is that with the introduction of MNP, the churn rate, which is already quite high in India, may increase even further, thereby leading to a drop in revenues and an increase in costs, which in turn would weaken their competitive positions.

Case Study: Hong Kong

Experience shows that the rate of churn can increase significantly with the introduction of MNP. In Hong Kong, for instance, nearly 1.2 million mobile phone customers, or 30% of the market, ported their numbers in the year after number portability was introduced. However, after the initial flurry post-MNP, portability-driven churn rate in Hong Kong decreased to around 16% by Year 7.

Chart 2: Subscriber Base and Churn Rate in Hong Kong



Value-added service likely to develop into a significant revenue stream

As ARPUs decline and voice services get commoditised, the challenge for mobile service providers would be to retain customers, develop alternative revenue streams, and create a basis for brand/service differentiation. In the light of the changing dynamics of the Indian mobile services market (mainly because of increasing competition), value-added service (VAS) presents an opportunity to mobile service providers to augment their revenues and margins, as is corroborated by the experience of telecom players in the developed markets. Currently, the contribution of VAS to the total mobile revenues of Indian telecom operators is just 9-10%, which is significantly lower than the same of operators in the developed markets. The potential for VAS revenues appears all the more significant at the present juncture, given that India is set to introduce 3G, a standard that allows operators to offer users a wider range of more advanced services.

Outlook

Going forward, ICRA expects mobile subscriber additions to remain robust as tariffs decline and handsets become more affordable. However, the rates of revenue growth and margins of Indian mobile service providers are expected to decline, given that ARPUs are likely to fall further in the short to medium term as competition gets more intense (with the entry of new players and the introduction of MNP) and the share of subscribers from semi-urban and rural areas increases. As ARPUs decline and voice services get commoditised, mobile service providers are expected to increasingly look at VAS as a means of developing an additional revenue stream and retaining customers. Although some of the incumbent operators with strong financials, extensive networks, and larger share of high paying customers would be better positioned to withstand the competitive pressures, high capital expenditure on 3G may well lead to continued negative free cash flows and push up funding requirements. Further, intense competition and aggressive pricing strategies of existing mobile service providers could challenge the sustainability of the new entrants as breaking even at lower tariffs would take longer. This would also imply delay in the generation of positive cash flows for the new entrants. Given this scenario, it is likely that the Indian mobile services market would see some consolidation over the medium to long term.



ICRA Limited

An Associate of Moody's Investors Service

CORPORATE OFFICE

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300; Fax: +91 124 4545350

Email: info@icraindia.com, Website: www.icra.in

REGISTERED OFFICE

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50; Fax: +91 11 23357014

Branches: **Mumbai**: Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 **Chennai**: Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 **Kolkata**: Tel + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008, Fax + (91 33) 2287 0728 **Bangalore**: Tel + (91 80) 2559 7401/4049 Fax + (91 80) 559 4065 **Ahmedabad**: Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 **Hyderabad**: Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 **Pune**: Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 553 9231

© Copyright, 2009 ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.