



Cellular Operators Association of India

SUBMISSION TO TRAI

***STATE OF THE
INDIAN GSM MOBILE INDUSTRY***

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INTRODUCTION

Telecom sector in India is fully liberalized; with **there being intense competition and free or pure play of market forces**. Various policy measures and regulatory initiatives over the last several years **have put the telecom sector in India on a high growth trajectory**.

The industry has invested over Rs. 80,000 crores in setting up 133 state-of-the-art cellular mobile networks in around 8,000 cities/towns and over 1-lakh villages all over the country. The Cellular service providers are offering world-class digital mobile services to the consumers at the most affordable tariffs in the world.

The Indian GSM Mobile industry today boasts of:

- **Highest level of competition** as compared to international benchmarks, which is driving the growth of the sector.
- **Lowest tariffs** in the world with the mobile service thus being the most affordable for subscribers as compared to the global benchmarks.
- **Highest mobile subscriber additions** every month as compared to other parts of the world.

The dynamics of market forces are driving the expansion of service and the growth of the sector. India today has a **robust mobile telecom industry** which has become the backbone of the Service sector in India.

The Mobile Telecom industry is the only sector in India which has witnessed a continuous decline in tariffs over the last 10 years. As against this, all other service sectors such as power, water, hotels etc have witnessed a significant increase in end-user tariffs.

Thus the mobile telecom sector has **continuously absorbed inflation**. There is no other sector in India where tariffs have been continuously falling.

However, the ever falling tariffs and the resultant decline in ARPUs has become a serious area of concern for service providers. Declining ARPU leaves the service provider with lesser amount of re-investible surplus for expansion of service – which otherwise could have been far more widespread by now.

PRINCIPLES OF EFFECTIVE REGULATION

A clear, concise and effective regulatory framework is critical for the attracting private investment into the infrastructure sector, including telecom. Such a framework is also critical to ensure that the economies maximize the benefits that flow from a competitive sector and from the introduction of, and widespread access to communication. The need for such a framework is much more where there are increasing demands on limited capital investment for expansion of infrastructure.

As far as tariff regulation is concerned, it is very important to keep in mind that the **price an operator is allowed to charge its customers is the most important determinant of profitability and ability to finance sector growth.**

As per the *Regulatory Best Practices*, competitive markets should NOT be price regulated. Therefore, **sector tariffs should only be regulated to prevent abuse of monopoly power** (i.e. dominance), in monopolistic, quasi-monopolistic/ dominant markets.

Globally, a fundamental reason for tariff regulation is to prevent the abuse of dominance. There are **two market situations** in which tariffs are required to address dominance:

- ***non-competitive or monopoly markets*** and
- ***competitive markets.***

For service markets in which a dominant operator **does not face effective competition**, the regulatory concern is that prices will be set substantially above cost so that the operator earns a monopoly level of profit. In this circumstance, **regulators have historically used “rate of return” regulation**, which establishes the maximum return on capital invested, or increasingly, regulators **have imposed a price cap regime** (with or without consideration of the rate of return), which provides some level of incentives for operators to function efficiently and reduce costs.

For those markets **in which a dominant operator faces competition**, especially in the early stages of liberalization, the regulatory concern shifts to anticompetitive pricing tactics (e.g., predatory pricing and cross-subsidization) that are intended to weaken or damage new entrants.

Thus the **core principles of tariff regulation** in the telecom sector are that tariffs should be cost-orientated and aimed at elimination of cross-subsidization, **reflecting relevant international tariffing benchmarks.** Tariffs should be non-discriminatory and **set at levels that are likely to attract investment** into the sector. **Tariffs should be reasonable and wherever possible established by a functioning market.** To aid transparency, tariffs should be published or otherwise publicly available.



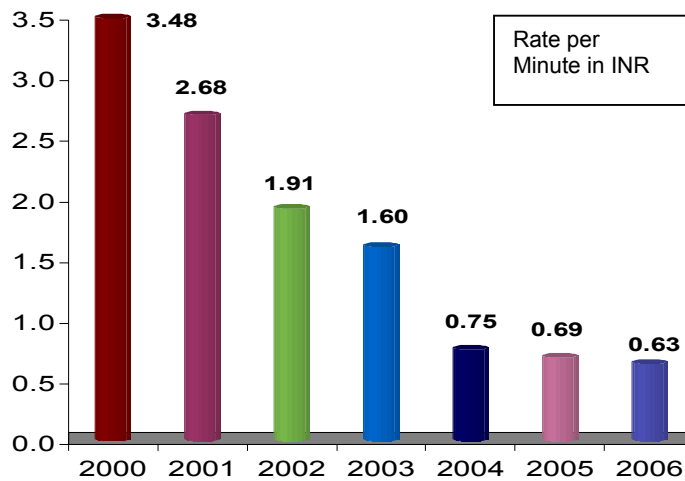
In the case of India, all the **well established core principles of tariff regulation are more than satisfied.**

In India, **we have intense competition - a situation which is just the opposite of the monopoly situation or 'Dominance'.** And tariffs have fallen continuously because of intense competition. **As far as reflecting international benchmarks are concerned, the tariffs in India are the lowest when compared to international benchmarks.** High level of transparency exists as tariffs are reported regularly to the TRAI and the subscribers are also made aware of the tariff changes through various channels.

TARIFFS AND ARPU

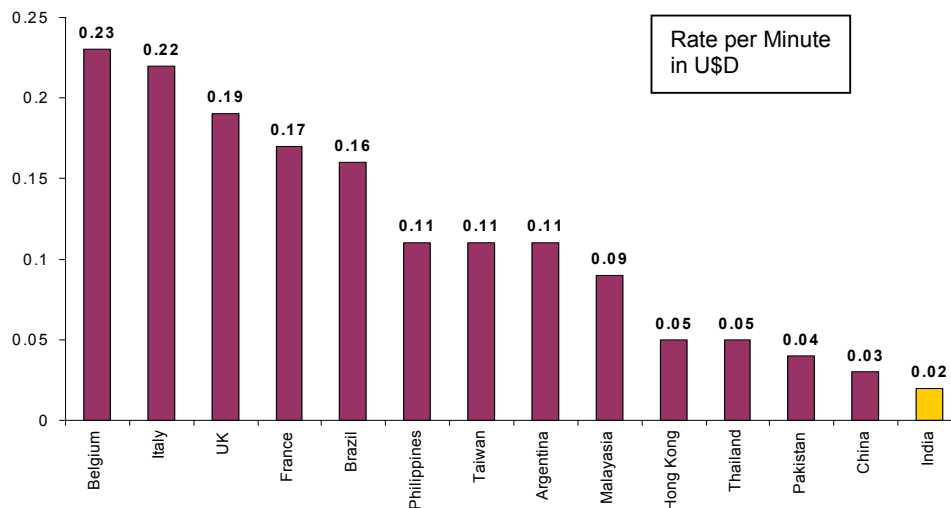
It is a well acknowledged fact that the level of competition in the mobile market in India is far more intense as compared to other parts of the world. Since the licenses were granted state-wise, there are 6 to 7 service providers who compete for the market share in every state.

As the service providers in every state compete for market share and subscriber acquisition, the mobile market in India has witnessed a continuous year-on-year decline in tariffs. The decline in tariffs has been quite significant and has been an area of serious concern for service providers.



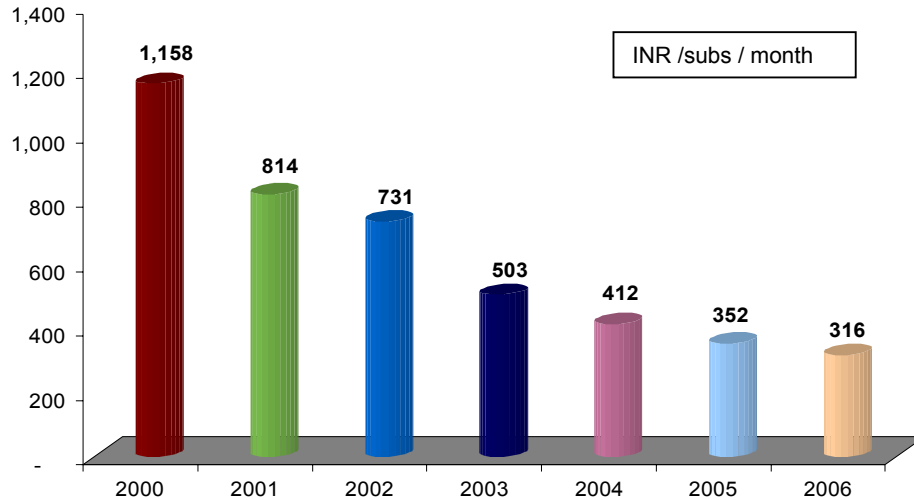
Source : PWC Benchmarking Study; Dec 2006

As a result of continuously decline in Tariffs over the last decade, tariffs in India are the lowest when compared to global benchmarks. **The mobile customers in India thus enjoy the service at most affordable prices.**



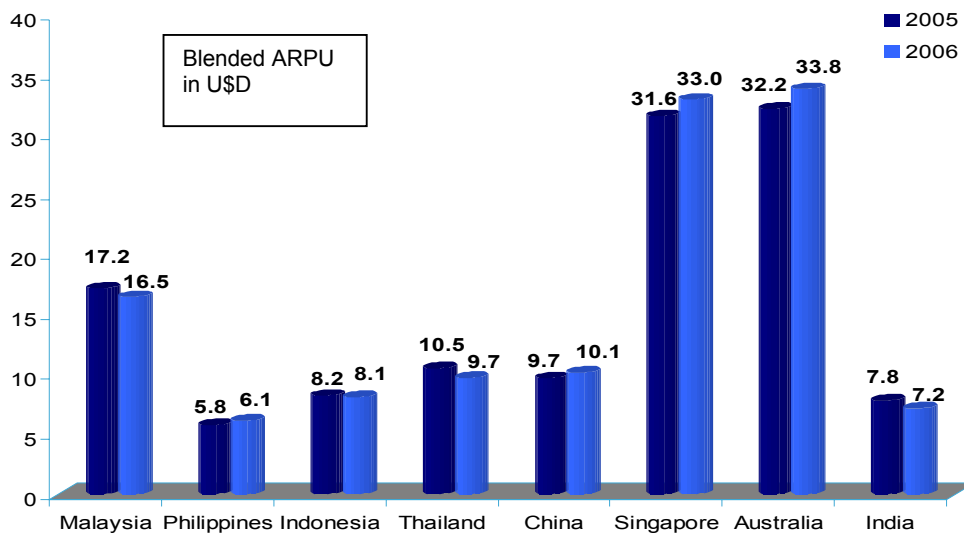
Source: Merrill Lynch Global Matrix 4Q 06

The decline in tariffs has led to a constant year-on-year decline in ARPUs as well. Over a period of six years, from December 2000 to December 2006, the ARPU has declined from Rs 1,158 to Rs 316 – which is a decline of more than 3 times.



Source : PWC Benchmarking Study; Dec 2006

As is the case with tariffs, India also has the lowest ARPU even when compared with the other emerging Asian economies.



Source : PWC Benchmarking Study; Dec 2006

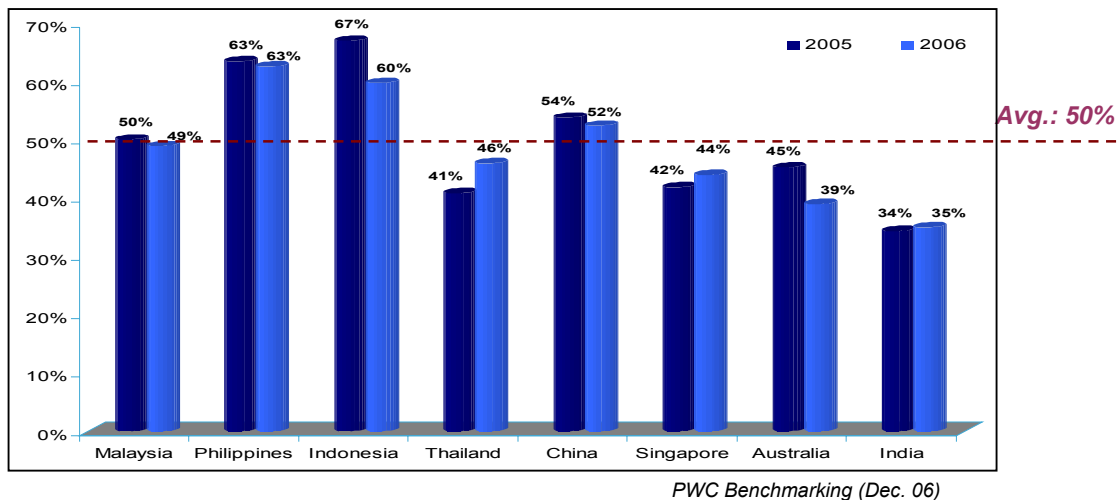
The ever falling tariffs and the resultant decline in ARPUs has become a serious area of concern for service providers.

FINANCIAL HEALTH

Declining Tariffs and ARPUs has put pressure on the operating margins and cash flows of the service providers.

Contrary to the popular perception that the EBITDA margin of mobile service providers in India has been expanding, it is pertinent to note that the EBITDA margin based on the data provided by service providers has stagnated between 32% and 34% over the last three years. There has thus been **no significant rise in EBITDA margin.**

Also the EBITDA margin of GSM service providers in India is the lowest when compared with other comparable Asia Pac economies having much higher penetration.



An EBITDA margin of 35% is well acceptable for a mature market which already has achieved a high degree of penetration. However, in an economy like ours, where there is a pressing need to expand the service to the uncovered areas, the existing EBITDA margin of 35% leaves inadequate funds for meeting the capital investment required for expansion of service.

The above fact becomes even more evident when we look at the Capex/Sales(%) ratio, across emerging markets, the same is the highest for the Indian Service Providers – **as high as 70% to 80%** in some cases. This clearly brings out the fact that **high amount of funds are required for expansion of service.**

Capex./Sales (%) Comparison – emerging market wireless

Operator	FY 06	FY 07 (E)	FY 08 (E)
Bharti	50.6	51.3	32.6
Idea Cellular	59.4	68.6	52.2
Reliance Comm.	44.1	80.2	78.7
ASIA – PACIFIC AVG.	36.7	44.2	35.9
EMERGING EUROPE & SOUTH AFRICA (EESA) AVG.	24.5	23.6	18.5
LATIN AMERICA AVG.	16.1	13.8	11.8

ML Global wireless Matrix 1 Q07 – 15 June 2007

In line with the low EBDITA margins, the Service Providers in India have a far lower Return on Capital. TRAI itself has acknowledged that the Return on Capital Employed (ROCE) in India is much lower than China, with ROCE of mobile services in India being one third that of the mobile service providers in China.

	China	India
FISCAL YEAR	Dec 04	Dec 04
RoCE – Basic (%)	14.79%	10.92%
RoCE – Mobile (%)	22.87%	7.83%

Source: TRAI Study Paper on Telecom Industry of India and China June 2005

The above only **brings out the fact that there is a need to enhance the investment attractiveness of the Indian mobile sector vis-à-vis other economies to enable expansion of service by attracting greater investment.**

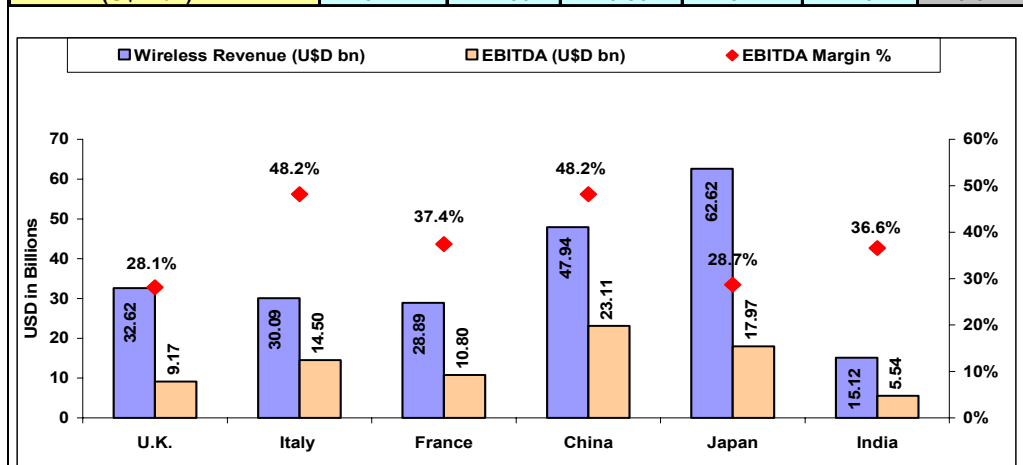
It is very pertinent to keep in mind that **percentages are a very misleading indicator of the absolute amount of funds which are available with service providers for expansion of service.**

EBITDA in %age terms does not in any way show the amount of funds which are available with the service providers to meet the investment requirement. For example, a high EBITDA margin in %age terms on a low revenue base will translate into a low EBITDA in absolute terms and this low EBDITA value may be very inadequate as against the funds required for expansion.

Therefore, it is important to keep in mind that a comparison of EBITDA margin in %age terms across countries is a misleading indicator of availability of funds for reinvestment. This is because the expansion of service is dependent upon or is governed by the absolute amount of funds available with the service providers. Since the wireless revenues in India are the lowest at U\$D 15.12 billion, the EBITDA is also lowest at U\$D 5.54 billion.

(figures as of Dec. 06)

	U.K.	Italy	France	China	Japan	India
Wireless Revenue (U\$D bn)	32.62	30.09	28.89	47.94	62.62	15.12
EBITDA Margin %	28.1%	48.2%	37.4%	48.2%	28.7%	36.6%
EBITDA (U\$D bn)	9.17	14.50	10.80	23.11	17.97	5.54

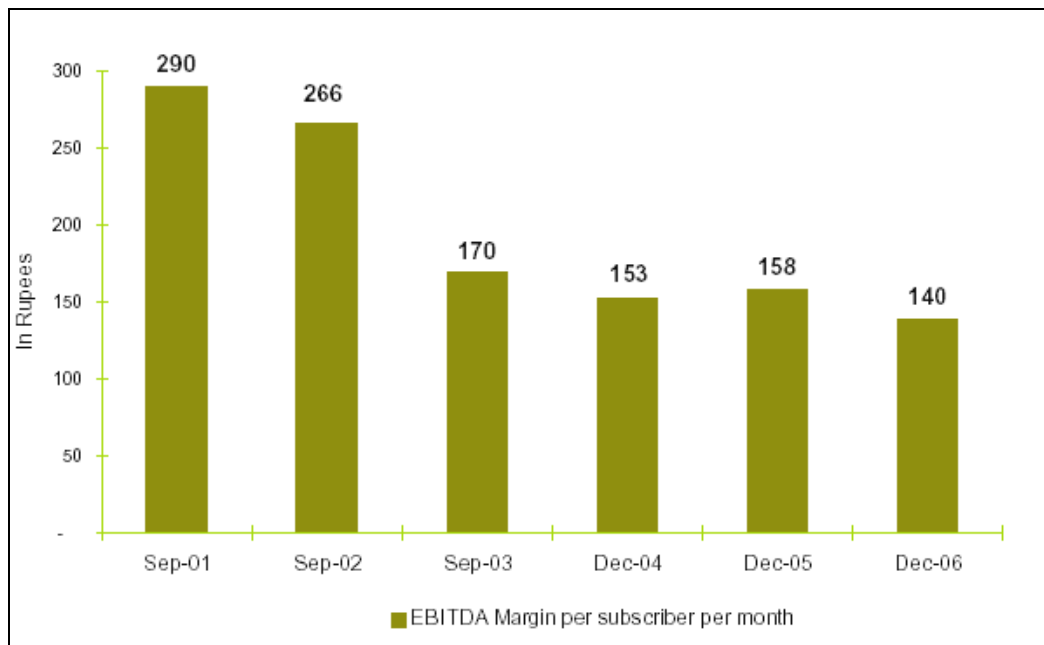


Source: ML Global Wireless Matrix 1Q07, data as of Dec'06

The absolute **amount of EBITDA of Chinese mobile service providers at U\$D 23.1 billion is 4 times that of their Indian counterparts** at U\$D 5.5 billion. Similarly, the **absolute amount of EBITDA in case of service providers in Italy and Japan is almost 3 times that of service providers in India.** From the above it is evident that the EBITDA of service providers in India is inadequate so as to support expansion of service.

The EBITDA which is generated first pays for the interest and depreciation. The interest burden is also higher for the service providers in India, since the interest rates in India are higher than the global average. Depreciation on capital equipments is similar since the same are procured at global prices which are more or less the same. Therefore, eventually the balance funds which are left with the service providers in India for expansion of service are much lower.

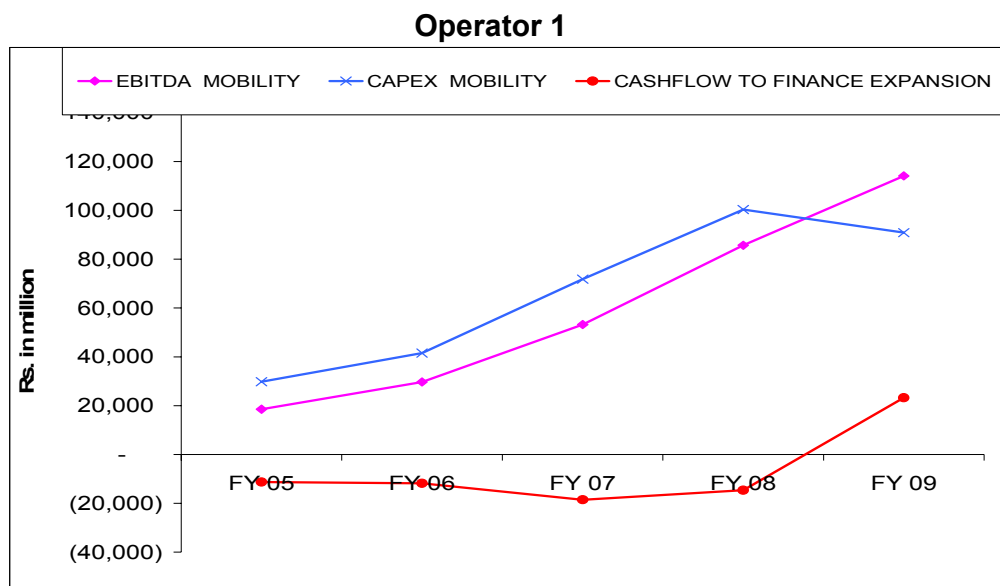
Besides the absolute value of EBITDA being lower, **the EBITDA per subscriber per month of service providers in India has been continually falling and that there has been a significant decline over the years.**



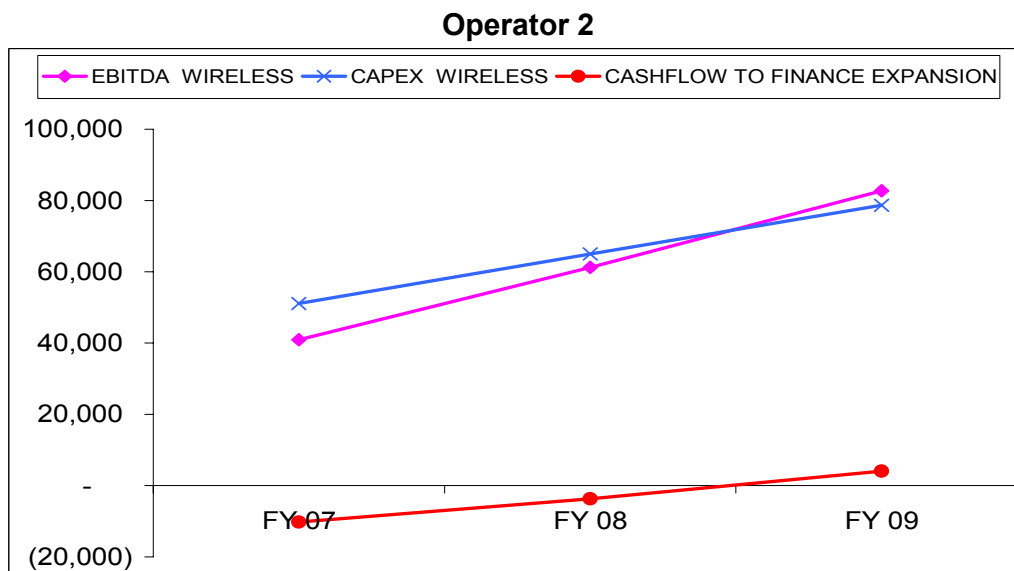
(Source: PWC benchmarking study, May 2007)

As a result, **even after being in service for more than a decade; companies still have negative cash flows. This would NOT have been acceptable in any other sector** and this is the factor which has severely hampered the spread of service.

Illustrative cases of negative cash flows prevailing in the mobile sector are shown in the graphs below:

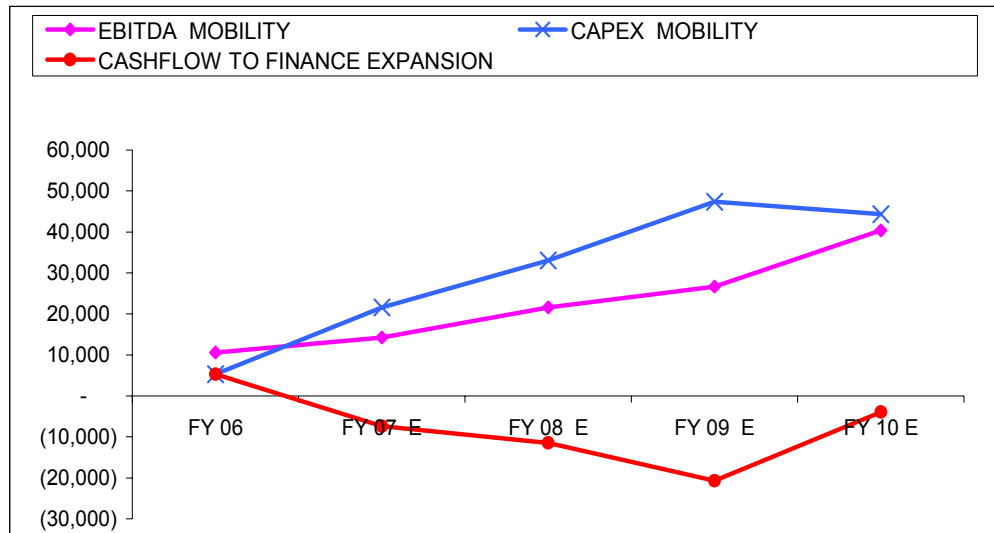


Source: Macquarie Research; April 2007



Source : Macquarie Research; November 2006

Operator 3



Source : Macquarie Research; April 2007

The negative cash flow clearly imply that the absolute amount of funds available with the service providers for expansion of service are very inadequate.

RECENT CHANGES IN TARIFFS

Depending on the market dynamics, the service providers keep changing and keep introducing new tariffs, products and services. Since competition is very intense, any new tariff or a tariff change or a promotional package or a new service is matched by the competitor. **For example, if a service provider reduces tariffs or introduces an attractive package or a combo offer, the same is matched by the other service providers in that service area.**

The competition in the Indian mobile industry is so intense, that tariff changes are primarily driven by the competition.

In the present competitive scenario, **the primary aim of the service providers continues to be to maximize customer satisfaction and retain customers.**

In the **past several years, tariffs have fallen considerably and service providers have passed on benefits to the customers** and have thus **created value for customers.**

Contrary to what is being perceived, the recent hike in tariffs is not across all circles and is also not across all tariff plans. The hike varies from circle to circle and is a function of earnings or financial position of the Service provider in that particular circle.

Also there are quite a few cases, where in spite of intense competition, the hike **has happened at different time intervals** and in some cases the hike has not been matched at all. A **few illustrations** regarding the hike in **Prepaid STD tariffs is as given below:**

	Airtel	Hutch	Remarks
UP (West)	Jan 07	Not matched yet	Not matched for 7 months
Mumbai	Feb 07	August 07	Matched after a gap of 6 months
Punjab	March 07	June 07	Matched after a gap of 3 months
UP (East)	5 th August 07	Not matched yet	Not matched
Kolkata & West Bengal	10 th August 07	Not matched yet	Not matched
Karnataka	6 th August, 07	8 th August, 07	Matched in 2 days
Delhi	2 nd August, 07	10 th August, 07	Matched after 8 days
Rajasthan	10 th August, 07	12 th August, 07	Matched in 2 days
A.P.	12 th August, 07	13 th August, 07	Matched in one day
Kerala	11 th August, 07	12 th August, 07	Matched in one day
Gujarat	4 th August, 07	8 th August, 07	Matched after 4 days

The hike in tariff **is applicable to only those subscribers who have completed more than 6 months** in that particular package. To that extent, **the safeguards put in place by the Authority are fully applicable.**

Further, **seamless migration is available to the subscriber across various tariff plans.** The subscriber can easily migrate from one tariff plan to another without any difficulty. This option is always available to the subscriber.

Regarding the SMS tariffs, the hike has happened only in Delhi, and there is no change in tariffs for majority of the other circles. The Service providers had sharply reduced the SMS tariffs in Delhi April 2006. Hutch has **dropped SMS tariff from Rs 1.50 to Rs 1 in April 2006**, Airtel and Idea matched the same in a few days.

Airtel increased SMS tariff from Rs 1 to Rs 1.20 on 13th August 2007, and Hutch and Idea followed. This is only a partial roll-back of the steep decline in tariff which was offered to subscribers as early as April 2006. **The partial increase in Delhi comes after 1 year and 4 months during which the subscribers have benefited from low tariffs.**

There has been NO change in basic SMS tariffs in other circles.

It is also pertinent to note **that alternate SMS tariff packages are also available to the subscribers.** Depending on their usage profile a **subscriber can subscribe to a substantially cheaper SMS tariffs** available in multiple denominations to suit his or her individual needs.

Alternate Hutch SMS tariffs

	Illustrative Alternate SMS Tariff
Delhi	Rs 35 for 300 SMS
Haryana	Rs 25 for 500 SMS
Punjab	Rs 39 for 1000 SMS
WUP	Rs 10 for 50 SMS
EUP	Rs 30 for 200 SMS
Rajasthan	Rs 25 for 250 SMS
Kolkata & WB	Rs 25 for 30p/SMS
AP	Rs 45 for SMS @ 1p
TN & Chennai	Rs 3 per day for 750 SMS
Karnataka	SMS @ 10p with Student pack
Kerala	Rs 30 for 300 SMS
Maharashtra	Rs 50 for 1000 SMS
Mumbai	Rs 10 for 25 SMS
Gujarat	Rs 34 for 300 SMS

As is evident from the table below, **there has been NO increase in SMS tariffs in other circles; and what has happened in Delhi is in a way only a partial roll-back.**

	DROP in SMS tariff		INCREASE in SMS Tariff		Alternate SMS Tariff Plans by HUTCH (Examples)
	Airtel	Hutch	Airtel	Hutch	
Delhi	Followed Hutch within days	Reduced from Rs 1.50 to Rs 1 in Apr '06	Rs 1 to 1.20 on 13th Aug	Rs 1 to Rs 1.20 on 13th Aug	Rs 35 for 300 SMS
Haryana	No	No	No	No	Rs 25 for 500 SMS
Punjab	No	No	No	No	Rs 39 for 1000 SMS
UP(W)	No	No	No	No	Rs 10 for 50 SMS
UP(E)	No	No	No	No	Rs 30 for 200 SMS
Rajasthan	No	No	No	No	Rs 25 for 250 SMS
Kolkata & WB	No	No	No	No	Rs 25 for 30p/SMS
AP	No	No	No	No	Rs 45 for SMS @ 1p
TN & Chennai	No	No	No	No	Rs 3 per day for 750 SMS
Karnataka	Rs 49 for SMS @ 1p in Sep '06	Rs 49 for SMS @ 1p in Oct '06	No	No	Student pack for SMS @ 10p
Kerala	No	No	No	No	Rs 30 for 300 SMS
Maharashtra	No	No	No	No	Rs 50 for 1000 SMS
Mumbai	No	No	No	No	Rs 10 for 25 SMS
Gujarat	No	No	No	No	Rs 34 for 300 SMS

BENEFITS TO THE SUBSCRIBERS

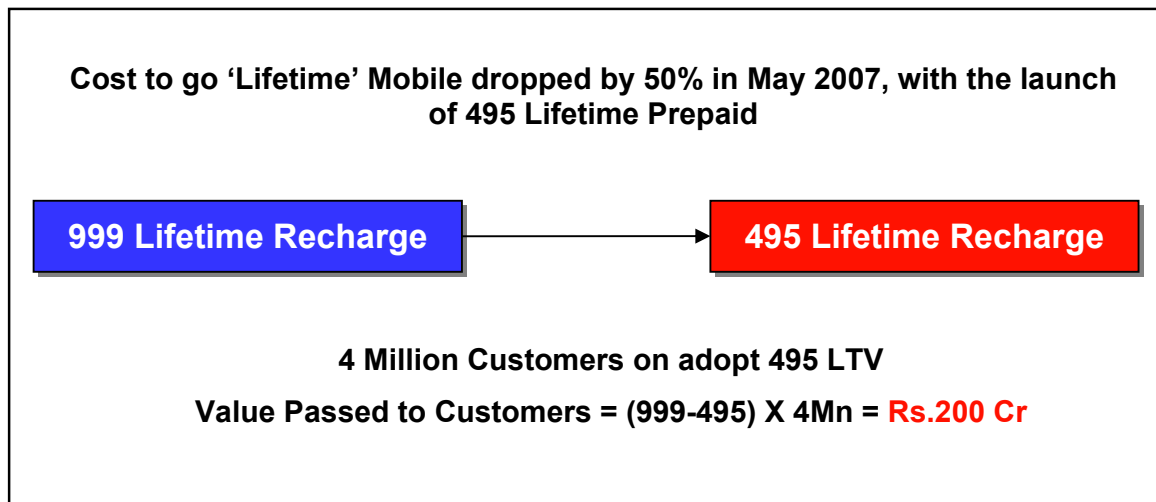
In the recent years, tariffs have dropped significantly and service providers have passed on considerable benefits to the subscribers.

Tariffs in lifetime packages have been dropped significantly – have been reduced to half from Rs 999 to Rs 495.

Processing fee has been waived off on many of the recharge **vouchers giving full talk time to the subscribers.** There are instances where in some of the recharge vouchers, the value of talk time has been doubled.

There are instances where service providers have launched bonus cards giving extra talk-time to their subscribers. For example, Hutch has announced the introduction of new bonus cards for its prepaid customers in Andhra Pradesh. On purchase of cards with different denominations, a subscriber gets an additional Hutch to Hutch talk-time depending on the value of the card.

A significant amount of value has been delivered to the mobile customers only on account of drop in tariffs for the lifetime packages since May 2007. It is estimated that one leading private GSM mobile service provider would have passed on benefits worth about Rs 200 crs to its subscribers.



Based on the above, it is estimated that **the private GSM industry as a whole has passed benefits to the tune of at least Rs 400 crs to the subscribers in just last three months (since Mid may 07 to mid August 07)** because of the reduction in rates for lifetime packages.

At this rate in the year, starting from June 07 to June 08, it is estimated that the pvt. GSM industry would have passed benefits of about Rs 1,200 crs to the subscribers. And this does not include the benefits on account of waiver of processing fee, higher talk time, other promotional schemes etc..