Indian telecom presses the red button

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What could be the cheapest mode of communication, tying a note to a homing pigeon or making a mobile call? Ask this of Tata Teleservices, one of India's most aggressive mobile-phone service providers, and the company would say that making a call through its network comes cheaper than using a pigeon.

This CDMA telecom player introduced in October a new "Non-Stop Mobile" tariff plan, in which a subscriber gets a mobile connection free for two years by paying about $50 just for the handset.

Not to be left behind, Reliance Infocom, Tata Teleservices biggest rival, introduced a similar service in November, which the company said "effectively makes the new handset come free of cost for the subscriber."

For Indian telecom users, however, this is an everyday game. Partly driven by the need to grab as many new users as a telecom company can lay its hands on, and partly getting pushed by the country's regulatory authority -- the TRAI -- to reduce telephone call rates, Indian telecom players are engaged in an open war over tariffs and subscribers that many experts fear may well spell problems for the sector.

"The country's telecom industry, particularly the wireless telephony sector, now stands at the crossroads," said Rajan Mittal, joint managing director of Bharti Tele-Ventures, India's largest privately owned mobile telecom company that has Singapore Telecom and Vodafone as investors. "While subscriber numbers are galloping -- the industry is adding 3.5 million new mobile (and about 0.36 million land line) users a month, its revenue per user is plummeting."

And this, say industry sources, is severely denting the profitability of Indian telecom players and hampering the ability to invest for future growth.

The Indian telecom market is an interesting story of contradictions. It is rated as the fastest-growing wireless market in the world. Its growth potential is impressive; the country subscriber base has grown by about 80 percent a year for the last three years, and, in a country of a billion plus people, where just 11 out of every 100 owns a telephone connection, the future potential too is big.

The country has also started attracting huge interest from foreign players, with almost all major global telecom equipment manufacturers setting up their manufacturing bases here and making major investments.

Revenues and profits of the telecom companies are growing impressively, too. For instance, according to a report by equity research firm India Infoline, the top telecom companies -- Bharti Tele-Ventures, VSNL, MTNL and Tata Teleservices -- are expected to witness a revenue growth of 23 percent year-on-year and a profit after tax growth of 27 percent during the financial year ending March 2006.

"Yet, even as telephone usage is high," says Kobita Desai, the principal telecom analyst at Gartner India, "the average revenue per user of the telecom companies is the lowest in the region."

Gartner reckons that at less that $8, India is the only country among China, Singapore and Australia to have a single-digit ARPU, while its mobile usage at 287 minutes per month is the highest.

"Consequently," says Desai, "The Indian players are suffering from increasingly thinner margins and lower profitability." The operating margin in India is down to around 30 percent compared to Asia's average of around 50 percent to 60 percent.

These thinning margins are putting the Indian telecom companies under stress, says V Ramachandran, director general, Cellular Operators Association of India. "While GSM services are becoming increasingly affordable, a fall in ARPU raises serious concerns regarding the ability of the business to fund the requirements for network expansion and growth."

But to know why the industry is facing this peculiar situation -- of explosive subscriber and revenue growth, yet stalling profit margins -- it is necessary to look back.

Back in 1992, while the Indian government liberalized the telecom sector by opening mobile telephony to private-sector operators, it imposed a very heavy entry or license fee.

To obtain a 10-year license, for instance, a cellular operator had to pay a license fee of over $7 billion (in the then-prevailing exchange rate). Consequently, to recover such a huge license fee, a mobile service provider had to charge high tariffs. For instance when mobile telephony was first introduced in August 1995, each outgoing call was charged at 40 cents per minute and incoming calls at 20 cents.

With such high call rates there were few ready to use mobile telephones. Over the next four years, India ended up with just 1.2 million mobile-phone users and a mobile-phone industry on the brink of collapse with accumulated losses nearing $18 billion in 1998.

Realizing its mistake, the government introduced a new telecom policy called NTP 99, with which it entered a new revenue-sharing arrangement with private telecom operators, thus absorbing some of their losses and bringing down license fees to about $5.5 billion. That helped in reducing call rates by about 60 percent and increased the subscriber base from 1.2 million to 1.88 million in 2000.

Over the next three years the government took a series of important steps that included opening telecom to more operators and introduction of the calling party pays (CPP) regime, which made all incoming calls to mobile networks free. That started a phase of explosive growth of subscriber base. As mobile-phone prices continued to crash to less than 2 cents per minute (for local calls) currently, the mobile-phone subscriber base grew from 13 million in 2003 to close to 120 million at the end of November this year.

But the price of this explosive growth is that "the downward trend in ARPU is expected to continue for the next five years at the very least," said Desai of Gartner. Some even suggest that ARPU is set to fall even more to $5.

Nevertheless there's hope. Experts say that with growth in urban centers petering out, the real potential lies in expansion in rural areas. According to Gartner, Indian telecom players should focus on non-voice revenues like data and content services and other value added services (VAS) like downloadable ring-tones, caller tunes, and themes and wallpapers that "can be charged at a premium."

This is where the Indian telecom industry is headed it seems.