

Financial Stress and Nebulous Policy Environment in the Telecom Sector

Need for pragmatic policies & establishment of effective grievance redressal mechanism

Telecommunications, which contributes around 3% of GDP, has greatly contributed to accelerated economic and social growth in the country. The sector has now grown to a total subscriber base of 893.15mn in January 2013 supported by huge investments in active and passive infrastructure which are required for the telecom sector.

In the aftermath of cancellation of 2G licenses in February 2012, there have been several new developments with respect to the government's policy towards allocation and management of spectrum. The sector has received increased focus from all stakeholders and an extra-cautionary approach has been adopted by the decision makers with an increased focus on monetising spectrum as a resource. The aggressive bidding witnessed during 3G auctions had strengthened the view on maximum monetisation of spectrum resources. In view of emerging trends in the sector, judicial interventions and the need of the government to reign in its fiscal deficit, the regulator had come up with new guidelines on several issues including allocation of new spectrum, re-farming of the already allotted efficient spectrum, imposition of one-time spectrum fee, green telecom, and mobile tower radiation emission norms. However, the success of the regulator's proposals have so far been impeded by a lack of clarity on implementation of its proposals and most importantly by the stringent opposition to its proposals by telecom operators supported by judicial interventions. The government had to back track and revise its proposals on spectrum allocation, may also have to restructure its plan on spectrum re-farming and is also bearing with delays in the implementation of one-time spectrum fee charge. The telecom service providers have frequently expressed disagreement with the proposals of the regulator and sought judicial intervention to address their grievances.

The implementation of these proposals on various aspects in the telecom industry will have a great impact on the current and envisaged business operations of telecom service providers. The telecom service providers have been actively approaching the judiciary for grievance redressal on various issues. Judicial pronouncements on such issues have led to virtual reversal or nullification of policy guidelines or instructions issued by the government thus adding to the policy uncertainty surrounding the sector.

➤ **Sector continues to be highly competitive**

After the exit of S Tel and ETISALAT from the Indian telecom market, following cancellation of licenses held by them, there are now 13 firms catering to the wireless telecom demand. Bharti Airtel is the market leader with a 21.35% subscriber market share as on January 31, 2013. The industry continues to be highly competitive and there has been no significant change in the competitive structure of the industry as the players who exited had relatively small scale of operations and most importantly, there have been no developments on the mergers and acquisitions front. Unfavourable policy guidelines which increase the cost of consolidation, along with lack of clarity on certain issues, have failed to

provide the required framework for M & A activity in the sector, making consolidation a difficult proposition. Consolidation, if facilitated can lead to efficient utilisation of spectrum as well as confine the number of operators to a much more reasonable number in each circle.

Spectrum holding by various telecom service providers after the March 2013 spectrum auctions in 900MHz, 1800MHz, 800MHz and 2100MHz is as under:

Table 1: Spectrum held by Telecom Service Providers in various Frequency Bands

	1800 MHz		900 MHz		800 MHz		2100 MHz	
	Spectrum held (in MHz)	Circles	Spectrum held (in MHz)	Circles	Spectrum held (in MHz)	Circles	Spectrum held (in MHz)	Circles
<i>Bharti Airtel</i>	84.65	21	91.6	15	0	0	65	13
<i>Vodafone</i>	100.75	22	79.4	12	0	0	45	9
<i>MTNL/BSNL</i>	76	22	144.4	22	61.25	22	110	22
<i>Idea</i>	80.3	18	45	7	0	0	55	11
<i>Aircel Ltd</i>	85.4	21	27.2	5	0	0	65	13
<i>Videocon</i>	30	6	0	0	0	0	0	0
<i>S. Tel**</i>	0	0	0	0	0	0	15	3
<i>Loop</i>	2	1	8	1	0	0	0	0
<i>Unitech</i>	30	6	0	0	0	0	0	0
<i>Spice</i>	0	0	14	2	0	0	0	0
<i>RTL/RCL</i>	73.2	18	39.8	7	92.5	22	65	13
<i>Tata</i>	79.2	19	0	0	72.5	19	45	9
<i>HFCL Infocom</i>	4.4	1	0	0	2.5	1	0	0
<i>Sistema Shyam</i>	4.4	1	4.4	1	35	9	0	0
Total	650.3	156	453.8	73	263.75	74	465	93

**Although S. Tel holds 3G spectrum, the company has not yet rolled out 3G services in any circle.

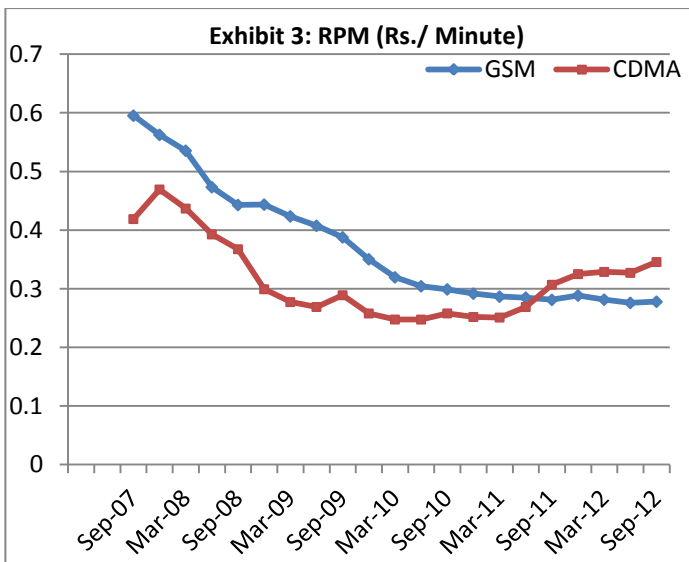
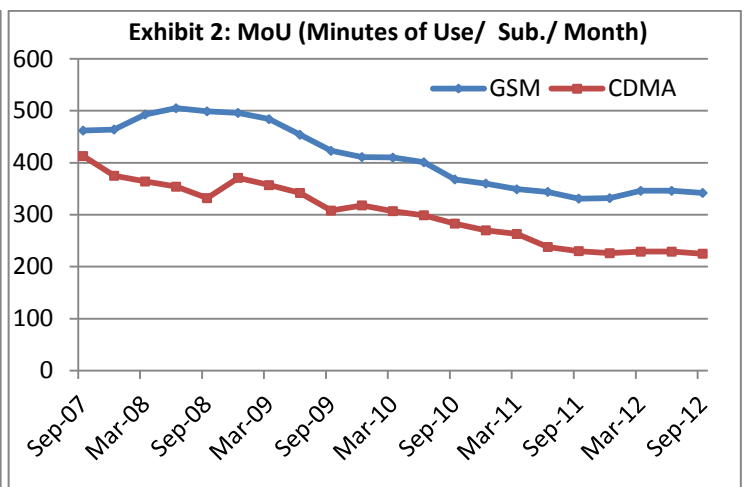
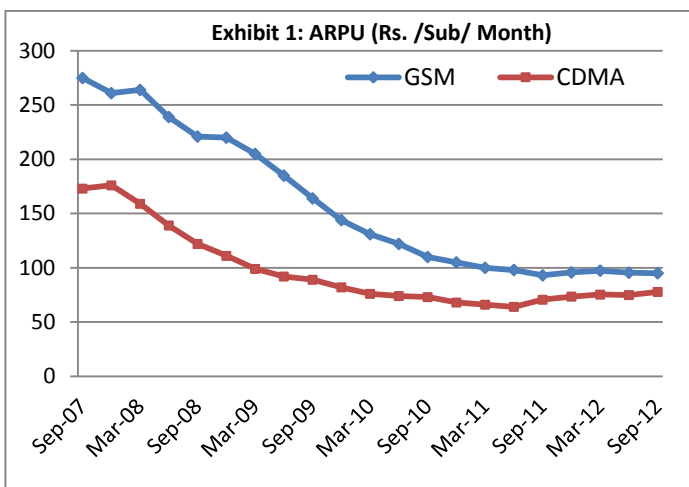
Source: TRAI Reports and CARE Estimates

➤ Falling subscriber base growth; Urban market seems saturated

The wireless subscriber base fell by around 11% to 862.62mn as on January 31, 2013 from 965.52mn as on June 30, 2012. Urban subscriber base as a percentage of the total subscriber base has declined to 61.3%, reflecting an increase in rural teledensity. The urban teledensity, however has declined from 168.84 in January 2012 to 148.46 in January 2013 reflecting the saturation levels achieved in urban markets, especially the large metros. With telecom connectivity becoming a necessity, in urban as well as rural areas, there has been no real decline in demand for wireless connections. The decline in subscriber base and consequently teledensity may be attributed to large-scale disconnections of non-active subscribers by some of the service providers. As per National Numbering Plan (NNP), 2003, an additional number series was, given to a telecom service provider (TSP) when its subscriber base i.e. number of subscribers in the Home Location Register (HLR) reached 60% of the already allotted number series. However, the criteria for allocation of additional number series has been modified from HLR data to Visitor Location register (VLR) data i.e. at present, only those subscribers, which are currently in use, are counted for the purpose of allocation of a new number series. In addition, spectrum holding is no more linked to the subscriber base in the unified license regime; hence telecom service providers do not have any incentive to continue with inactive subscribers. As a result of the large-scale disconnections of in-active subscribers, active wireless subscribers on the date of peak VLR increased to 708.00 mn in January 2013 i.e. 82.08% of total subscribers from 695.82mn i.e. 74.49% in June 2012.

➤ **Prices heading north as companies go for hikes**

The sector has still not healed from the self-inflicted wounds of aggressive price competition after the entry of new players in several circles in 2008. After the aggressive bidding for 3G spectrum and cancellation of licenses, the debt laden TSPs are left with no option but to increase tariffs. The decline in Revenue per Minute has almost stabilised for GSM players while the same has displayed an increasing trend for CDMA players as a result of the increase in tariff rates already initiated by service providers. Average Revenue per User (ARPU) for both GSM and CDMA players has stabilised and with the tariff hikes and disconnection of inactive connections, it is expected to increase in the coming quarters.



In the past 5 years, MoU peaked during the low tariff period in the year 2008, which was initiated by aggressive price-based competition from new entrants especially in the GSM segment. However, since then MOU has declined and now appears to approach stability. Telecom operators have continued hikes in tariff by way of cutting discounted airtime, slashing promotional rates and hiking call rates. Operators have been hiking tariffs by reducing Minutes in the Minutes Pack or other benefits like Validity, SMS or Talk-time on STD Packs. The telecom operators are also expected to benefit from the evolving nature and scope of Value-Added Services (VAS).

Data services which fall under VAS are driving the change from a promotions-based VAS model to an interactive and transaction-based engagement with customers. Various telecom service providers have come up with promotional offers to push greater adoption of internet plans and data usage in order to increase income from VAS offerings. With increasing availability of affordable 3G devices, ARPU is expected to improve with increase in data consumption.

The total revenue of the Telecom Service Sector went up by 13.82% from Rs.1,71,719 crore in FY11 to Rs.1,95,442 crore in FY12. The revenue contribution from the public sector telecom companies in FY12 was 17.77% (PY: 20.37%) and from private sector companies was 82.23% (PY: 79.63%). As per CARE estimates, the total revenue is expected to be approximately Rs.2,11,100 crore in FY13. Apart from the improved realisations on account of better pricing, the growth in revenue is expected to be supported by increase in the size of the data consumption-driven VAS market. The improvements in pricing and higher operational efficiency will support margins in the future, however, it will depend on the nature of competition in the sector and amount of future payments & penalties.

➤ **Spectrum Auctions; Is the Golden Goose dead?**

Following the cancellation of licenses allotted on first come- first served basis, the government went ahead for auctions of partial capacity of vacated spectrum in various frequency bands in November 2012. At the reserve price set by the government, there was no bidding in the 800 MHz frequency band. The bidding in the 1800 MHz frequency band was also subdued and there was no bidding for Karnataka, Rajasthan, Delhi and Mumbai circles.

Table 2: Payment schedule for November 2012 Spectrum Auction Winners (in Rs. Cr)

	Full Upfront Payment	Deferred Payment	
		Upfront Pymt (33% of FBA)	Instl amt
Telenor	4018.28	1326.03	522.1
Airtel	8.67	2.86	1.13
Idea	2031.31	670.33	263.93
Vodafone	1127.94	372.22	146.55
Videocon	2221.44	733.08	288.63

Source: DoT reports

Following the tepid response received in the auctions, the government had slashed reserve prices of spectrum in 1800MHz frequency band by 30% in un-bidder circles and by 50% for spectrum in 800MHz frequency band in all circles. 102 blocks of spectrum in 18 circles were sold in the November 2012 spectrum auctions, for which payments were made in December 2012, by respective winners. The November 2012 auctions were used as a base to determine reserve prices for the spectrum auction in March 2013.

In the second round of auctions held in March 2013, the government had planned to sell 42.5MHz across 3 circles in the 900 MHz frequency band. This spectrum is currently held by incumbents whose licenses are due to expire in 2014 and was proposed to be sold to bring in effect the spectrum refarming proposal. In addition, 50MHz across the 4 un-bidder circles in the November 2012 1800MHz frequency band auctions were also put for auction at a reduced reserve price. However, yet again the government failed to receive any bids for spectrum in the 1800 MHz frequency band and only Sistema Shyam bid for spectrum in the 800 MHz frequency band. Sistema Shyam won 24 blocks of spectrum in 8 circles for Rs.3,639.48 crore, although it will benefit from an adjustment of Rs.1,626 crore against the initial license fee paid by it and will have to pay only the balance amount of Rs.2,013.48 crore.

The government has been planning to use the receipts from auction of spectrum to meet its fiscal deficit reduction targets. However, the estimates of receipt from such auctions were largely not met on account of poor response to the spectrum auctions.

➤ **No room for re-farming; uncertain policy environment leading to ambiguity**

A total of 413.6 MHz of spectrum was vacated in the 1800MHz band as a result of the cancellation of licenses. The government had planned to auction a part of the total vacated spectrum preserving the rest for re-

farming the 900MHz frequency band. In a recent order, the Supreme Court has directed that the entire spectrum vacated on account of cancellation of licenses will have to be put up for auction. DoT has decided that a separate auction will be held for the balance of Spectrum in 1800 MHz band in compliance with the direction of the Supreme Court. This is setback to the government's plan to re-farm the entire spectrum in the 900MHz frequency band. The fate of spectrum reframing will depend on the final outcome of auctions of the entire spectrum vacated in the 1800 MHz frequency band.

The operators that are going to be affected first are Bharti Airtel, Vodafone and Loop. In the 900 MHz frequency band, Bharti Airtel has 8MHz of spectrum in Delhi and 6.2 MHz in Kolkata. Vodafone has 8MHz of spectrum in Delhi, 8MHz in Mumbai and 7.8MHz in Kolkata; while, Loop has 8MHz of spectrum in the Mumbai circle. These licenses are amongst the first in the 900MHz frequency band coming up for renewal in the year 2014.

In order to retain 5MHz of spectrum in these circles, the incumbent operators will have to shell out at least Rs.3881.2 crore, Rs.3799.36 crore and Rs.909.76 crore in Delhi, Mumbai and Kolkata circles, respectively, on bidding at reserve prices. The operators will also have to bid for additional spectrum in the 1800 MHz frequency band to cater to their existing subscriber base. Incumbent telecom service providers might also decide to migrate fully to the 1800 MHz band and in that scenario will have to bid at Rs.485.15 crore and Rs.474.92 crore, per block in Delhi and Mumbai circles, respectively.

However, with the ambiguity surrounding the proposal on account of judicial interventions, it is difficult to ascertain the exact financial impact of refarming on the operators. The financial profile of most of the operators have weakened in the past few years on account of debt raised for the roll out of 3G services and other normal capex. Any further outgo on account of such proposals will increase the financial stress of the operators which may lead to another round of tariff hikes for the subscribers.

The government is also considering providing a spectrum swap option to BWA auction winners for spectrum in the more efficient 700MHz band against spectrum won in the 2300MHz band. As per preliminary plans, the spectrum in 700MHz band may be priced at 4 times the reserve price in the 1800MHz frequency band. In case of auction being proposed at such high price, any gains being expected on account of spectrum efficiency will be nullified by the cost involved in network deployment.

The telecom commission has also recommended that BWA players be allowed to offer voice services on paying unified license fee of Rs.1658.0 crore. However this scenario was not contemplated at the time of BWA spectrum auctions as a result of which, the existing voice operators who did not bid for BWA spectrum are crying foul. Operators with BWA spectrum are also unwilling to shell out license fee of Rs.1658 crore on the ground that they did not get any bundled spectrum with BWA licenses and that they had to separately bid for spectrum.

➤ **One-time spectrum fee faces stringent opposition from the operators**

DoT had served demand notices for one-time spectrum fee charge to various GSM telecom operators with the option of paying the fee in instalments. The total estimated one-time spectrum fee for GSM operators is around Rs.23177.65 crore which includes prospective and retrospective charges of Rs.18,925.82 crore and Rs.4,251.83 crore, respectively. Details of first instalment due are indicated in table 3.

Although the last date for payment of the first instalment has already passed but none of the telecom service providers came forward to pay these charges on the due date and have obtained stay orders from courts.

DoT has also served a one-time spectrum fee demand for Rs.3033 crore on CDMA telecom operators based on the reserve price that was fixed in the spectrum auction held on March 11, 2013. As per initial estimates Reliance Communications and Tata Tele have to pay around Rs.1752 crore and Rs.1,155 crore, respectively. However, Tata Tele has indicated that it would surrender excess spectrum beyond 2.5MHz in all circles except Delhi and Mumbai and has requested for a time of 120 days to ensure continuity in service. In Delhi and Mumbai, the company will be retaining one additional block of 1.25MHz each.

Table 3: Demand Notice for First Installment by January 15 (with a grace period of 21 days starting January 8) (in Rs. crore)

Vodafone	2093.00
Airtel	1758.00
BSNL	1282.98
MTNL	916.00
Idea including Spice	810.00
Aircel including Dishnet	584.00
Loop	607.00
Reliance Communications	63.00
Total	8113.98

Source: DoT reports

➤ **3G cannot roam on pacts**

Notwithstanding the already low off-take of 3G services by end-customers and better quality of service & seamless coverage that can be provided by an intra-circle 3G roaming pact between telecom operators who do not have 3G spectrum in all circles, DoT has imposed a ban and penalty on such roaming pacts. DoT has imposed a penalty of Rs.550 crore and Rs.300 crore on Vodafone and Idea Cellular, respectively, for alleged violation of license norms. A penalty of Rs.350 crore has also been levied on Bharti Airtel for providing 3G services in circles where the company did not have a spectrum. The company may also be fined an additional Rs.500 crore for sharing airwaves with other telcos. However, the company has got a breather by the Supreme Court, which for now has allowed the company to continue operations but barred the company from adding any new subscribers in circles where it does not have a spectrum. Similar directions have been given to Vodafone and Idea Cellular by the Delhi High Court. These disputes are fuelled by an absence of common perspective and understanding between the industry operators and the regulator as well as lack clarity on interpretation of policy guidelines. All this is leading to inefficient usage of spectrum and loss of tax revenue to the government in addition to the inconvenience caused to the end-consumer.

➤ **Challenges galore – Pragmatic view of the policies needs to be taken along with introduction of a suitable grievance redressal mechanism**

The telecom sector continues to be in a state of turmoil, with the uncertainty in policy environment continuing. The existing grievance redressal machinery in a sector as dynamic as telecom is not very effective. The dispute settlement authority needs to have an effective establishment so that it can exercise its powers for the benefit of the sector. There is also an urgent need to strengthen the TDSAT and ensure its proper functioning to deal with dispute resolution in the sector.

The outlook for the sector remains stressed on account of various liabilities which are contingent on regulatory and judicial outcomes. The debt-funded investments made for the acquisition of 3G spectrum and roll-out of services have failed to deliver the expected returns. The policy flip-flops have also created hurdles in long-term strategy formulation for the sector. Proposals on green telecom, mobile tower radiation

emissions, waiver of roaming charges etc are bound to affect the current operating structure of mobile operators. These proposals may lead to even higher operating and capital expenditures for telecom service providers and also impact the top line of the companies. Increasing debt burden for regulatory compliance will negatively impact the operational and expansion plans of telecom service providers which will affect further penetration to telecommunications. Furthermore, there are uncertainties surrounding future cash payments to fulfil obligations towards and demands raised by the government. As many issues are sub-judice, any clarity on future payments to be made by telecom operators will only happen after the Courts arrive at final judgements.

Annexure: Ratings assigned by CARE to various telecom service providers

Service Provider	Outstanding Ratings
Mahanagar Telephone Nigam Limited	CARE AAA (SO)
Idea Cellular Limited	CARE AA/ CARE A1+
Tata Teleservices Limited	CARE A+/ CARE A1+
Tata Teleservices (Maharashtra) Limited	CARE A/ CARE A1
Reliance Communications Limited	CARE A-/ CARE A2+
Aircel (includes Aircel Ltd, Aircel Cellular Ltd and Dishnet Wireless Ltd)	CARE BBB+ (SO)/ CARE A2+ (SO)
Sistema Shyam Teleservices Limited	CARE A2 (SO)

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