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Road to Recovery: Regulatory clarity improves investment sentiment

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After a lull in 2012, the telecom sector witnessed an improvement in investor confidence in 2013, with the government taking steps to provide clarity on regulatory matters such as mergers and acquisitions (M&As) and the unified licensing regime. The sector is now poised for significant growth in 2014 with operators making concerted efforts to drive data service adoption. Industry analysts share their views on the current scenario in the telecom space, key challenges and the future outlook...

How did the sector perform during 2013?

Hemant Joshi

Some clarity was provided on regulations with respect to M&As, foreign direct investment (FDI) in the sector and the spectrum base price. However, the government needs to provide greater regulatory clarity on 3G roaming pacts, spectrum trading, the one-time spectrum fee, etc.

Ashish Khanna and Priyabrata Das

The Indian telecom sector has witnessed significant growth over the years. With over 900 million subscribers (about 870 million wireless and 30 million wireline subscribers), India continued to be the world's second largest telecom market in 2013. As per the Telecom Regulatory Authority of India (TRAI), the teledensity reached 73.5 per cent in June 2013.

From an operator standpoint, the focus has changed to acquisition and retention of high-ARPU customers. From fierce price wars and emphasis on subscriber growth earlier, the industry continued to move towards higher tariffs and a greater focus on profits.

Amit Sachdeva

The year 2013 was one of highs and lows for the telecom sector. The year started on a low as the sector was recovering from the setback of a failed November 2012 spectrum auction, and the trend continued with almost no participation from operators in the March 2013 auction. Nevertheless, a positive momentum started building up as the year progressed with the government announcing initiatives including an M&A policy, rationalisation of spectrum prices, the unified licensing regime and 100 per cent FDI.

The year also witnessed a round of virtual consolidation, as operators whose licences were cancelled shut shop, thus reducing the intensity of competition in the sector. On the other hand, incumbents increased tariffs as an attempt to ease cost pressures, marking the return of pricing power to operators.

Moreover, Indian operators have started to focus on the addition of profitable customers rather than just adding SIMs/ subscribers. The focus has shifted towards customer lifetime value, and innovative sales and service options such as self-service and community care.

Romal Shetty

The Indian telecom sector has shown remarkable resilience in the backdrop of controversies and uncertainty prior to 2013. The industry showed signs of growth albeit at a slower pace than in the past. Most operators started the process of revising tariffs upwards.

From a regulatory standpoint, delinking of spectrum from licences, implementation of the unified licence regime and opening up of the sector for 100 per cent FDI were the key steps that have laid the foundation for improved investor sentiment. Investments of over Rs 170 billion in the top two operators highlighted the confidence in the Indian telecom sector.

Dr Mahesh Uppal

A key highlight of 2013 was limited investor interest, which was indicated in the unsuccessful spectrum auctions. Another issue was the disagreement between TRAI and the Telecom Commission on various issues. Nevertheless, TRAI came out with some key guidelines, which will go a long way in bringing clarity on the regulatory front.

In terms of performance, most operators witnessed modest growth in their revenues and operational parameters. They disconnected several inactive (low-ARPU) subscribers. Further, to promote mobile broadband services, operators reduced the price of data services significantly. In contrast, tariffs for voice services witnessed an increase. However, operators will have to carefully assess the impact of tariff hikes on voice traffic and revenues in the future.

What is your view on the current policy and regulatory environment in the sector?

Hemant Joshi

Delays in policy implementation and scams have affected the investment scenario in India for foreign players. Clarity on policy issues like spectrum trading, one-time spectrum charge and licence renewal before the auction would ensure its success as operators would bid considering other policies of the government. However, the government needs to provide clarity on several issues. These include regulatory and policy matters (quantification of spectrum fees, 3G spectrum sharing and M&A guidelines) and tax-related risks (tax deducted at source on the sale of prepaid talktime, dual taxation on services provided, that is, whether sales tax or service tax will be levied and taxation of infrastructure assets like towers).

Ashish Khanna and Priyabrata Das

There has been significant progress in the policy and regulatory environment in the past several months, which is sending positive signals about the industry.

In August 2013, the government allowed 100 per cent FDI in telecom. This is not only expected to drive cash flow for investments by telecom companies, but also enable a foreign player to operate in the Indian market without a local player.

In another positive development, the Empowered Group of Ministers (EGoM) on Telecom cleared the M&A policy in December 2013, enhancing the cap on market share to 50 per cent for the merged entity from 35 per cent. Most industry experts see this as a welcome move as it may lead to consolidation in the fragmented telecom industry, which has about 12 players in some circles.

Further, the EGoM approved the auction of spectrum in the 1800 MHz and 900 MHz bands, which would not only increase revenues for the exchequer through spectrum sale, but also facilitate investments by operators.

Amit Sachdeva

In a bid to restore optimism in the sector and to bring in transparency on the policy and regulatory fronts, the government took several measures in 2013. The decision to reduce spectrum base prices was welcomed by all industry stakeholders, while the government's decision to allow 100 per cent FDI is expected to provide the much-needed financial fillip to the sector. Another key regulatory development was the move towards the unified licensing regime, which delinks spectrum from licences and allows companies to offer services using any technology. The new regime significantly reduces the entry barrier for service providers as it enables the rendering of all telecom services through a single licence.

However, significant efforts are required in other areas. Operators have expressed their concerns about the tiered mechanism for levying spectrum usage charge (SUC), which is a deterrent for telecom operators to acquire additional spectrum either through auctions or acquisitions. Further, there is a need to rationalise taxes and levies, which currently account for nearly 30 per cent of the total revenue of Indian operators. Another step in the right direction would be a comprehensive review of the definition of adjusted gross revenue, as the current definition includes all revenue earned by a service provider, including that earned from non-telecom services.

Finally, there is a need for a comprehensive and unified policy with regard to audit of telecom companies by DoT, the Comptroller and Auditor General of India and other regulatory authorities.

Romal Shetty

The government has made earnest efforts to implement the telecom policy introduced in 2012. It has also reached out to various stakeholders in an attempt to harmonise public policy and the interests of a vibrant industry that is able to invest and drive further growth while safeguarding customer interests.

Resolution of key issues related to the unified licensing regime, delinking of spectrum from licences, and the M&A and FDI policies have improved investor sentiment. Clarity on a few other issues will result in a reduction in the regulatory uncertainty, which will redirect focus on providing quality services at affordable prices over the next couple of years.

Dr Mahesh Uppal

In comparison to 2012, the regulatory environment in the Indian telecom sector improved in 2013. However, the government needs to clarify issues pertaining to the SUC and CDMA spectrum auctions. It has introduced the unified licence regime but clarity is awaited on several issues under this as well.

How has been the uptake of data services in India? What are the future growth drivers for the data service market?

Hemant Joshi

The uptake of data services has not been very high so far due to their high prices. Therefore, most of the large operators have slashed data tariffs significantly to attract customers and increase the footprint of 3G services.

As per a report by Nokia Solutions and Networks, mobile data traffic generated by 3G services increased by 196 per cent while that generated by 2G services increased by 66 per cent in 2013. Hence, the future of data services is bright. Some of the growth drivers for data services are increased proliferation of mobile devices such as smartphones, tablets and e-readers, reduction in data tariffs and greater consumer awareness leading to the demand for any time, anywhere connectivity.

Ashish Khanna and Priyabrata Das

Despite a significant reduction in 3G tariffs in India, the uptake of data services has been much lower than expected. This has been primarily due to the low penetration of compatible handsets/devices/smartphones and lack of suitable content, especially in vernacular languages.

Going forward, data services are set to grow, as some of the barriers to their uptake are removed. In fact, the data subscriber base is expected to grow to about 450 million by 2020 (COAI Annual Report, 2012-13)

Indeed, greater availability of smartphones and other access devices at low price points; generation of content related to cricket, music, news, video and gaming; and a further reduction in data tariffs are expected to drive data service growth.

Amit Sachdeva

After a decade of slow growth, India has witnessed a phenomenal increase in the demand for data services. Although initially expected to be largely accessed through fixed broadband, data services have witnessed increased uptake through mobile devices. Availability of affordable smartphones and declining data prices have been instrumental in driving demand. Currently, 89 per cent of the country's 198 million internet users access the internet through mobile devices. 3G services, which were slow to gain traction in the initial years, witnessed a surge in 2013, especially in metros and urban centres. Mobile broadband connections stood at 58.3 million at end-2013 and are projected to grow fivefold to 308.5 million by 2018.

In the future, data services would provide a key revenue opportunity for telecom operators. Availability of localised content and delivery of services in vernacular languages would be critical for driving the next phase of data growth.

Romal Shetty

At present, only around 15 per cent of towers cater to 3G services and 4G uptake is still at an early stage. Ensuring quality of service (QoS) is a challenge in comparison to global benchmarks. Further, huge investments and debt burden are restricting operators from rolling out the network required to support data traffic growth.

India is likely to witness the fastest growth rates in the data segment over the next three to five years. Cisco's Visual Networking Index estimates that mobile data traffic will increase from 15 petabytes (PB) per month in 2012 to 900 PB per month in 2017.

This growth would be largely driven by the proliferation of smartphones and devices, high-bandwidth content offerings and the operators' ability to roll out networks capable of handling high data traffic. Lastly, technology is likely to be a major market disruptor in the coming years as the industry still requires high capex to support the anticipated growth.

Dr Mahesh Uppal

The uptake of data services has improved, but it is far lower than we need them to be. A reduction in prices led to higher adoption of data services in 2013. However, prices are not the only impediment to service uptake as the ecosystem for data services is yet to mature completely. Inadequate spectrum availability is another issue for operators as they attempt to ensure uptake of voice and data services.

Going forward, the availability of affordable smartphones, provision of vernacular content, greater awareness about these services and appropriate billing systems will drive the adoption of data services.

What are the key challenges for the sector? What are the steps that need to be taken to address them?

Hemant Joshi

The key challenges are:

Falling ARPUs

De-growth of the subscriber base

Overleveraged operator balance sheets

- Policy uncertainty
- Lack of clarity on tax-related and regulatory issues
- Repeated failure of spectrum auctions due to the high reserve price

The government needs to be proactive in taking steps to increase the proliferation of telecom services and new technologies. Also, it should provide a clear policy road map for sector growth.

Ashish Khanna and Priyabrata Das

Overall, while prospects for India's telecom market remain strong, it has experienced periods of uncertainty. The attractiveness of the Indian telecom sector was impacted in February 2012, after the cancellation of 122 mobile licences. The subsequent uncertainty, coupled with fierce competition, slim margins and the huge debts taken for expansion and 3G auctions were major challenges for the industry.

Amit Sachdeva

During 2013, the government made concerted efforts to move away from the regulatory conundrum of the previous two years; however, several challenges need to be addressed for true revitalisation of the sector. On the regulatory front, the current SUC regime is a deterrent to operators' plans of expanding operations and providing quality services. Second, the stringent radiation norms imposed on operators are beginning to impact network quality as operators shut down existing cell sites and cut capex due to inadequate yield from existing investments.

Further, the conflict over mandatory refarming of spectrum held by the incumbents remains an unresolved issue. The move will entail a substantial overhaul of operator networks and is likely to significantly affect the incumbents, given their high existing investments and wide network spread.

A positive move would be the introduction of spectrum trading, which would provide operators exit options by allowing them to sell their spectrum holdings in line with their business needs. Spectrum trading will also facilitate the much-needed consolidation in the sector, while ensuring efficient spectrum usage.

Romal Shetty

Regulatory uncertainty will perhaps be the key challenge in the sector over the next two years. Spectrum trading, refarming and harmonisation of M&A rules with the broader legislative framework will be the key investment drivers. The industry is likely to face challenges in balancing customer expectations regarding QoS with investments in providing that service.

The need of the hour is to build a vision for the industry over the medium to long term that guides decision-making at the policy level.

Mahesh Uppal

The biggest challenge for operators is lack of clarity on the availability and pricing of spectrum in various frequency bands. There is a need for a clear timeline for future spectrum allocation.

With regard to operations, penetration into rural markets remains a challenge for operators due to the high investment requirement and unattractive returns.

What is the future outlook for the sector?

Hemant Joshi

The year 2014 would be a better one as compared to the past two to three years due to the following factors:

The year could witness some M&A activities if the government supports consolidation in the industry. This will improve investor sentiment and confidence in the sector. Consolidation is already happening in the infrastructure space and would gain momentum in the coming years as operators try to reduce costs.

Data growth is expected to increase further due to the proliferation of smartphones, tablets and other connected devices. Also, the use of social media apps is increasing and more people are availing of 24x7 connectivity. Mobile video would add to data consumption. Operators are trying to promote data services to increase revenues due to near stagnation of voice services.

4G services might be launched in more cities and by more players as the 4G ecosystem develops.

Ashish Khanna and Priyabrata Das

As the voice market matures and with an already high subscriber base, the telecom industry will shift gears and operators are expected to focus on data services and value-added services to ensure growth and profits. It is important that the upcoming spectrum auction evinces interest from stakeholders. This will be crucial for telcos to focus on improving coverage, network and customer services. The new M&A policy is expected to provide a fillip to consolidation trends in the industry.

In summary, the Indian telecom market may finally be turning the corner and stabilise in the short to medium term, subsequent to successful spectrum auctions and the general elections.

Amit Sachdeva

The year 2014 is expected to be a significant one for the sector with over 400 MHz of spectrum expected to be auctioned in February 2014. Further, the government is likely to address key regulatory issues including the policy on M&As, resolution of pending cases and litigations, and introduction of a progressive policy on spectrum trading and sharing.

In 2014, operators would continue to focus on data services, as more subscribers migrate from 2G to 3G. The year will also witness large-scale roll-out of 4G services from some key players. The ability of 4G services to disrupt the existing market dynamics will, however, depend on a number of factors including the price sensitivity of services, strength of the supporting ecosystem and the capability to deliver voice services.

While new services will offer additional revenue opportunities, operators are likely to run a tight ship in order to control their burgeoning debt levels. Operators' focus on subscriber quality, improving margins and reducing operational costs is likely to continue.

Romal Shetty

Notwithstanding the macroeconomic slowdown anticipated over the short to medium term, the Indian telecom sector is set to grow given the huge market potential. Regulatory reforms have already attracted investments in the sector.

Large incumbents which are backed by financially strong parent companies are likely to have an edge in the competitive market. Mid-sized operators with a huge debt burden are prime targets for takeover in an industry that is likely to witness growth through usage rather than subscribers in the next few years. Growth in data usage will far outpace growth in other segments. India is also likely to be a regional innovator in telecom-enabled applications such as m-health, m-banking, m-education and m-governance.

Perhaps, the greatest change would be a focus on creating/developing local capabilities in telecom equipment manufacturing. The indigenous telecom manufacturing industry contributes only 12-15 per cent to an operator's requirements of networking equipment/solutions and the net capital outflow in the coming years is estimated to be more than $20 billion per year – second only to the country's oil bill. With a weakening economy and a weakening rupee, coupled with margin pressures, telecom service providers will drive equipment manufacturing companies to increase investments in local research and development as well as manufacturing capabilities.

Overall, the telecom ecosystem is expected to contribute to 6-7 per cent to the GDP, as compared to the current 3-5 per cent contribution, leading to job creation and productivity improvements.

Dr Mahesh Uppal

The outlook for the Indian telecom sector remains positive as telecom services are a utility. Electronic communication has now become more central to activities undertaken by users. Going forward, there is a need for the government to review its decision-making process so that there is more clarity on the regulatory and policy fronts. Further, greater investments for telecom infrastructure and electronic content and services to develop rural markets.