State or Market?: India's telecom wars*

C.P. Chandrasekhar

As the shakeout in the Indian mobile telephony market continues, price wars are being complemented by verbal wars. The most recent spat involves the Telecom Regulatory Authority of India as well. Its latest revised tariff order has been attacked by Airtel and Vodafone (and by the Cellular Operators Association of India, or COAI) for favouring Reliance Jio, the aggressive new entrant that is seeking to get ahead of the other two, in what is clearly becoming a three-horse race in the industry.

The "split" within the COAI, with long-time members and a new entrant on opposite sides, is indicative of the shakeout in the industry in which the players, small and not-so-small, have either been the targets of mergers and acquisitions or have been forced to close. Though mergers and acquisitions have been a long-term characteristic of the industry, recent events such as the takeover of Telenor India (which had earlier taken over Unitech) and Tata Teleservices by Airtel, the merger of Idea and Vodafone and the closure of Aircel, point to an intensification of the consolidation process in the face of the entry into the business of Reliance Jio.

For acquiring firms, access to additional spectrum and a subscriber base in circles where they are absent or minor players is the objective. For those not acquired, the alternative may be bankruptcy. This was brought home at the end of February when Aircel, the sixth largest operator, filed for bankruptcy with the National Company Law Tribunal. The basic problem was debt in excess of Rs.15,000 crore that needed drastic restructuring of a kind that the lenders were unwilling to accept. An effort to merge with Anil Ambani-led Reliance Communications, which decided to exit after handing over its wireless infrastructure to Reliance Jio, had also failed.

Policy flip-flops

The telecom industry's problems intensified about a year back, when, after a long period of flip-flops in policy, wrong investment decisions and gradual consolidation, the industry was subjected to a sudden shock. The entry of the Mukesh Ambani-led Reliance group into the industry through Reliance Jio unleashed a new wave of competition more intense than ever before. Reliance Jio had many advantages: a promoter with deep pockets (and, many would say, an ability to influence policy) driven by an instinct to go for the kill; the benefits of late entry that allowed it to adjust strategy to the fact that technological changes were rendering pure voice channels irrelevant and making data flow supreme; and a market for data that was in its growth phase.

The Aircel case only highlights the fundamental problem afflicting the industry post Jio's entry, involving large debt and spectrum charge dues combined with falling revenues because of the price competition unleashed by the entrant. Reliance not only offered voice calls free, but opted for extremely low pricing of data traffic. In the event, data use is priced at around $3.5 per gigabyte (GB) in India, compared with around $10 in the United States. The result is that though the number of users has risen over time, the average revenue per user has fallen sharply, leading to losses in firms burdened with debt.

Consolidation has not merely concentrated the mobile telephony business in the hands of the three main operators, but will also change the pecking order once the Vodafone-Idea merger is completed. Airtel will be displaced as industry leader for now because the merged entity would notch up a 35 per cent customer share and more than 42 per cent revenue share in the market. The point, however, is that there are no clear signs that the consolidation process will end with this three-way division of the market. Reliance Jio is clearly committed to achieving market dominance. And the others cannot stand by, watching the rise of Reliance. Bharti Airtel's consolidated debt exceeded Rs.90,000 crore as of September last year, while that of the merged Vodafone-Idea amounts to over Rs.100,000 crore. These entities are not likely to easily give up the battle to get revenue back up to service those debts, and therefore are willing to take on the Reliance Jio challenge. In a consolidated market, a price war can be hugely damaging to all. So it is surprising that Jio is keeping to its game.

One reason could be that Reliance Jio believes that it has the implicit support of a non-market actor like the state. The spat over the TRAI's recent tariff order suggests that Airtel and Vodafone-Idea, too, sense that this could be the case. The COAI has been blunt in its assessment, saying that the TRAI's orders "seem to be strengthening the ambitions of one particular operator with deep pockets and monopolistic designs at the expense of other operators". Not surprisingly, Reliance Jio has reacted with aggression in a statement that said: "Reliance Jio condemns and highly regrets COAI's reckless, wilful and flagrant act of making slanderous and libellous accusations patently against Reliance Jio in the press release, which are ex-facie defamatory and veiled under the garb of criticising the orders of the sectoral regulator." It has sought a public apology from COAI and asked it to immediately stop making false and defamatory statements about Reliance Jio.

The Airtel-Vodafone anger at the TRAI's order arises because the latter has redefined its notion of "significant market power" (SMP), deployed in practice to prevent a "dominant operator" from misusing its position by resorting to predatory pricing. Earlier, four different indicators were used to identify the presence or absence of SMP: subscriber base, gross revenue, capacity and traffic share. In its recent order, the TRAI has decided to rely only on subscriber base and gross revenue, fixing a 30 per cent or more share in terms of these two indices to identify the presence of SMP.

Advantage Jio

This favours Reliance Jio for three reasons. First, because of their longer innings in the market and the merger of Idea with Vodafone, these two entities have dominant shares of the subscriber base and revenue, because of the large share of subscribers still using voice (as opposed to data) services. But this is changing because over the top (OTT) services that allow voice traffic to ride on data and Reliance Jio's aggressive pricing of data access has seen data use and its share of data traffic rising sharply, even if revenues have not been rising because of its near-free pricing policy. Second, Reliance's coverage in terms of data traffic potential is far in excess of that of Airtel and Vodafone-Idea combined.

A recent report from Credit Suisse, which examined network coverage across capitals of the larger States and major Union Territories, which account for a significant share of data revenues, found that Reliance Jio accounted for an overwhelming 94 per cent share, with Airtel and Vodafone-Idea accounting for a small 2 per cent each. Finally, given the large investments made by Reliance Jio, it holds about 35 per cent of network capacity in the country, making it a dominant player in terms of capacity share.

Despite these features of the industry and the belligerent pricing policy adopted by Reliance Jio, the new definition of SMP laid down in the TRAI's tariff order implies that Reliance cannot be accused of predatory pricing. On the other hand, any effort to set tariffs below those of Reliance Jio's by the other two leading players would be deemed to be a misuse of their dominant position. What this implies is that Reliance Jio is given the position of "price-cut leader", able to decide how low prices need to be taken so that it can win itself subscriber share till such time it too is identified as possessing SMP.

Given the large debt being carried by the industry and the implications for a banking system that is already under bad debt, Airtel and Vodafone possibly believed that the government would intervene to stop the destructive price war that Reliance Jio has unleashed, the ramifications of which go beyond the industry. However, the TRAI's order essentially gives Reliance the licence to continue with its strategy based on its own perceptions of what it costs to ensure dominance and how much of that cost it is willing to bear. Even if the other two majors want to stop this destructive play by Reliance Jio by slashing tariffs even lower in order to drive sense into the new entrant, they cannot. While Reliance Jio pursues its price-competition policy, the original incumbents cannot launch a price war to disrupt Jio's strategy.

The TRAI has sought to defend itself by saying that it has not prevented Airtel or Vodafone-Idea from reducing tariffs, so long as they do not fall below that of Reliance Jio—implying that it had a choice to prevent that, which it clearly did not without being sued for discrimination. This does support the contention that the TRAI's order, whether consciously or otherwise, unduly favours Reliance Jio in the still-evolving mobile telephony shakeout.

In an environment where there is a growing sense that the present government selectively favours a few business groups and entities, the charge against TRAI is not easily dismissed. The way this battle and the role of the government evolves would be keenly watched and have much larger implications.

*** This article was originally published in the Frontline Print edition: March 30, 2018.**