Rearview

How to go bankrupt despite 300 million subscribers

A regular column on the information industries

Peter Curwen

It is not easy to find a country with 300 million mobile subscribers let alone a single network. The USA, Indonesia and China qualify as do the latter's three network operators. India also qualifies as do Bharti Airtel and Vodafone Idea separately, but there is an unexpected aspect in this case: Vodafone Idea is threatening to leave the market because it has become worthless. What follows seeks to unravel this conundrum.

In September 2018, the Department of Telecommunications (DoT) in India instigated an audit to determine whether operators had been under-reporting their so-called adjusted gross revenue (AGR) since the 2011/2012 fiscal year. The Government was accruing much less than it had budgeted for from licence and spectrum fees year-on-year because of the way in which operators were interpreting the definition of AGR in their tax returns and also because at the time their AGRs were falling as a result of severe price competition. This raises three issues. First, why is the definition of AGR so controversial? Second, why after so many years of loggerheads between the DoT and the operators was this matter still unresolved? And third, why has there been so much more competition recently compared to the previous decade?

The answer to the second question need not detain us. We are talking about India, and in India, disputes mean multiple judgements in the lower courts and endless appeals that often end up before the Supreme Court. The origins of this dispute may date back to 2003, but a dispute that remains unresolved for a decade is nothing extraordinary – there is, for example, the minor matter of the $2bn Vodafone is claimed to owe in the form of capital gains tax resulting from the acquisition that enabled its market entry a mere 12 years ago.

To answer the first question, it must be noted initially that operators are required to transfer to the regulator between 3 and 5 per cent of AGR in the form of a spectrum user charge (SUC) plus 8 per cent of AGR by way of licence fees. The long-held position taken by the operators is that the AGR consists only of revenue from "core" services whereas the DoT has long claimed that it also applies to "non-core" revenue including rent, dividends, interest payments, handset sales and

Peter Curwen is an Independent Scholar based at Callaghan, Australia.

any profit from the sale of fixed assets. And because the operators have refused to pay in accordance with the DoT's broader definition of AGR, the DoT considers it is entitled to charge interest on the outstanding sum and to impose penalties for non-payment.

An aspect of this issue connects the above to the third question because when this dispute first arose there were more than ten operators whereas currently there are effectively only four (after adjusting for impending mergers). The key players are the privately-owned Bharti Airtel, Vodafone Idea – in which Vodafone holds a 45 per cent stake – and Reliance Jio. However, the fact that many operators have either gone bankrupt or been taken over means that it is extremely difficult for the DoT to recover from these entities what it regards as unpaid fees based on its definition of AGR. Hence, to compensate, it needs to come down hard on those that still exist.

In July 2019, the DoT upped the stakes by claiming before the Supreme Court that it was now owed $13.5bn by the operators. In October, consequent on a submission from the DoT, the Supreme Court ruled that the operators would be obliged to pay $12.9bn in overdue fees plus interest and penalties (including on the interest) – an overall figure of $18.2bn was cited. The Supreme Court ruling covered the arrears arising from the difference between the two interpretations of AGR over a considerable period of years but, as noted, could not be applied to the operators that had gone out of business. The amount payable by Vodafone Idea was in the region of $5.6bn, despite which it stated that it would not be exiting the market – at least for now.

In November, Vodafone Idea announced its results for the quarter ending on 30 September. It declared a net loss of $7.1bn, the bulk of which it attributed to the recent decision by the Supreme Court. It valued the liability due to unpaid licence fees at $3.9bn and to the SUC at $2.3bn (including interest and penalties at $4.6bn overall). These sums dwarfed the carrying value in March of the operator of a mere $1.4bn even though Vodafone had invested some $20bn since it entered the market in 2007. Vodafone has now effectively written off its entire investment in India and is threatening to exit the market if the Supreme Court does not reduce its liabilities. Yet it has 310 million subscribers on its books – and the regulator's tally is considerably higher.

The situation faced by Bharti Airtel, which has nearly as many subscribers, is not much better. However, the perfect storm faced by the two largest operators cannot simply be placed at the door of the Supreme Court since if the market was uncompetitive they would be making more than sufficient profits to cover their above liabilities. In practice, competition is vicious and that is attributable to the appearance of Reliance Jio.

Reliance Jio Infocomm was created when Reliance Industries hived off the majority of its telecom interests in January 2013. As a result of the spectrum auction held in 2016, Reliance Jio acquired the means to provide high-speed data services using LTE technology. Reliance Jio launched in September 2016 immediately gained nearly 20 million subscribers by providing its Welcome Offer customers with free mobile services during a three-month period that was followed by a Happy New Year Offer which provided free services for a further three months. Reliance Jio subscriber numbers grew so quickly that it presented a serious threat to its rivals of whom one, Vodafone, promptly wrote down the value of its Indian assets by €5 billion.

All Reliance Jio's main rivals were forced to introduce much improved plans to protect their pre-paid customers. In January 2017, Reliance Jio stated that it would be terminating its free offer at the end of March but voice calls would continue to be free and data would cost as little as $1.50 a month until the end of June. Further offers ensued and Reliance Jio came to dominate the broadband market with its emphasis upon LTE connectivity. By February 2017, Reliance Jio had become the world's busiest network in terms of data carried.

Needless to say, it was making heavy losses, but its parent Reliance Industries was willing to write these off. In January 2018, Reliance Jio launched its "Happy New Year 2018" tariffs and stated that it had acquired 160 million customers. The quarter was notable in that a net profit was achieved for the first time. However, Reliance Jio's main rivals were unsurprisingly in some difficulties, not helped by the introduction of a new offer whereby free JioPhones would be available either online or via retail outlets. Also in May, Reliance Jio re-opened its price war by turning to the post-paid segment of the market when it offered a new tariff priced at roughly one-half of that of its main rivals. In June, it announced that it would launch a fibre-to-the-home (FTTH) network in September, branded as "JioGigaFiber", across 1,000 towns and cities.

The onslaught from Reliance Jio has been remorseless although it is slackening off a little currently as Reliance Jio has become profitable and needs to work on retaining existing customers as well as attracting new ones now that its services are no longer free. However, the damage has been done, with both Vodafone Idea and Bharti Airtel forced to take massive write-offs to the point at which the former has become worthless. A less attritional Reliance Jio should have provided a breathing space, with Vodafone Idea improving its balance sheet by implementing its strategy of discarding subscribers with very low average revenue per user. However, the Supreme Court has seemingly put paid to that unless substantive relief is forthcoming.

That an operator with 300 million subscribers might choose to exit a market may be unprecedented but as the above demonstrates, it may be perfectly rational.

Corresponding author

Peter Curwen can be contacted at: pjcurwen@hotmail.com