Dramatically different price developments for mobile services in India and Switzerland and their underlying drivers

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Abstract

Purpose – *By comparing prices for mobile services in India and Switzerland, this article aims to highlight marginal differences in regulations – besides other significant factors – which can result in totally different price developments.*

Design/methodology/approach – *A holistic approach is used to explain the various drivers behind price developments. Besides costs (including licence fees), customer behaviours (summarized in demand elasticity), competitive behaviour (explained by the applied marketing mix) and termination fees (either as a price stabilizer – if not freezer – or as a relatively marginal cost component) represent the relevant drivers.*

Findings – *The comparative study underlines the crucial role termination costs play in dynamic mobile markets – besides the usually stressed general cost levels and numbers of competitors.*

Originality/value – *As a case study, this paper identifies country-specific factors which would have to be reviewed again before drawing conclusions for other mobile markets and their regulatory success.*

Keywords *Contract costs, Finance and accounting, Cost drivers, Prices, India, Switzerland*

Paper type *Case study*

Despite comparable price levels at the time of launch of liberalised mobile telecommunication services in 1999 and similar regulatory objectives for liberalising mobile markets, the mobile markets and price levels in India and Switzerland have developed quite differently. Today India has among the lowest mobile minute tariffs in the world, while Switzerland ranks among the most expensive. So what factors have caused this diverse pricing behaviour? In the following paragraphs, we try to identify (not quantify) the major drivers behind these diametrically different price developments.

Obviously, there are several substantial structural differences between the highly developed Switzerland and developing India. India, having over-stretched financial resources and a particularly weak infrastructure, a population above 1 billion, out of which about 50 per cent are illiterate and live below the poverty line, is also confronted with the challenges of a complex political decision making process and seriously handicapped by corruption and outdated bureaucracy. Small Switzerland, on the other hand, ranks on the other side of the scale. Here, the issues of concern simmer on a far lower level.

While there are numerous and substantial economic, social and political differences, there are also many similar approaches that are tried and tested in India as well as Switzerland. Both use democracy for political decision making and both appreciate the benefits of free markets. As most countries, the two expect free market forces to provide the best overall results. The main arguments to liberalise the telecom industry during the mid-1990s in both countries were better service, more solutions and selection and especially substantial savings for customers. Both issued mobile licenses for new players and partly sold (privatised) their 100 per cent stake in Swisscom respectively in VSNL. Both set up newly created independent telecom regulators, to secure ubiquitous telecom services, as well as ensure reasonable operator profitability that is so necessary for network investments.

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Their regulators' toolbox got equipped mainly with three commercial instruments:

(1) They can either allocate a number of licenses to organisations that can best exploit an opportunity i.e. can pay highest amounts in an auction, or they can allot licenses to those, that provide the most promising portfolios (beauty contest). The latter focusing on value to the customer and the former officially focusing on efficiency and unofficially on government revenues. Switzerland mainly took the beauty contest road while the debt-ridden Indian state could not resist the temptation to collect some hefty license fees.

(2) They can install revenue sharing schemes, in order to continuously benefit as a federal government from telecom turnover. This approach is popular where newcomers either cannot pay high amounts upfront or cannot estimate the value of such a license over time. After the auction results turned out to be unviable, India switched its license regime to revenue sharing. So today's operators pay up to 10 per cent of their Adjusted Gross Revenues – after deducting out-payment for third-party termination.

(3) They can set the corridor for access deficit and interconnect pricing, by which the incumbent gets over-compensated for certain services to its competitors like terminating their calls, providing access and interconnect with the justification of fulfilling universal service obligations – e.g. offering services in remote areas or offering generally unprofitable but popular products. For mobile operators normally no cross-subsidising arguments apply, i.e. termination costs (often referred to as accounting rates) should reflect purely operator costs plus a reasonable margin. In India termination rates are monitored by the regulator very closely and are capped at a low price, while the Swiss regulator tends to believe in the self-declared ''cost-based'' interconnect tariffs from Swisscom.

The Indian licensor and the regulator have used all three instruments explained above. First, mobile licenses were auctioned to eager bidders, while the incumbents (VSNL, MTNL and BSNL) were not allowed to participate. Having a huge potential market with more than 1 billion inhabitants and with extensive areas to cover, India granted licences to more than 20 different partnerships between Indian promoters and foreign carriers. Even after rigorous industry-consolidation over the last five years, India today still accounts as many as eight substantial mobile players. Switzerland, on the other hand, with its small territory, has attracted far lesser interest and started liberalisation in mobile communication by granting three cellular licenses in 1999. The number of competitors definitely is directly correlated with price developments. So the higher number of competitors has contributed to the lower Indian price level. This argument can also be over-stretched once the single units are not reaching critical mass anymore. Fixed (absolute) license fees set a certain necessary price floor to recover respective out-payments to the government while the following (revenue share as a percentage) has a far lower impact on price settings.

In the year 2000 the Indian government has reduced its exorbitantly high fixed license bids to a 15 per cent revenue share with the fixed fee paid up to the date of migration being deemed to be the entry fee for the mobile license. Although over the years, the revenue share license fee has been brought down to 6-10 per cent, this however is still much higher than what operators pay in Switzerland. The Swiss regulator is far more generous in financial demands. For example, the four 3G licenses were offered in 2000 for just about USD$35 million each and operators are not asked for any revenue share. While related network build-up requests in Switzerland have a negative impact on price reduction plans, these low license fees give a lot of room to share part of with the subscribers – which has not happened in Switzerland as yet.

Interconnection tariffs, as a third tool, are kept under close control in India while the Swiss regulator seems to rely on Swisscoms's assertion to charge ''cost-based'' interconnection tariffs. These fixed amounts are charged for terminating calls from other networks. Switzerland has excessively high interconnection rates, which can be twice as high as the total price for a mobile intra-network call. For example, a Swisscom mobile subscriber calls a Sunrise mobile subscriber and pays 75 Swiss cents per-minute versus only 25 Swiss cents per minute making an on-net call within the Swisscom mobile network. This simple cost element just blocks aggressive pricing since absolute prices and not relative prices were agreed by the operators and tolerated by the Swiss regulator.

Just looking at this set-up, you would expect the prices of the two countries to drop in a similar way after liberalisation. But here also the differences between the two countries could not be more stark/obvious unfortunately for Swiss customers and Indian operators. But let's look at the various factors that influence these price developments one at a time:

- Since the potential Indian customer base is much larger, it is safe to assume a higher price elasticity of demand in India, which implies a bigger incentive for Indian operators to lower their prices compared to their Swiss counterparts. In the graphical example below, Switzerland reduces prices from P1 to P2 while India reduces from P1 to P3. The graph shows the actual situation in which Swiss operators clearly have far less incentive to lower prices with its relatively inelastic and saturated mobile market, compared to an extremely elastic demand in India. The Indian price reduction from P1 to P3, however, might reflect a certain overshooting ($/\varepsilon/ < / - 1/$) due to cut-throat competition in which single operators try to make others' businesses unviable with temporary offers below costs (Figure 1).
- From a cost perspective again an advantage is given to Indian operators who have lower costs in areas like customer acquisition (currently around $12 in India versus around $350 in Switzerland per new subscriber), lower costs for manpower, electrical power, rent and repair, etc. Only on import duties and capital costs Indian operators face higher costs.
- Looking at the regulatory impact you could expect Indian prices and Swiss prices to move in a similar way. India charges more for license fees, while Indian interconnection charges are flexible and continuously capped at much lower points. Low interconnection charges allow operators to compete much easier on price, since out-payments for external termination moves parallel to price reductions. Since the Indian incumbents join the mobile fray much later, there was no regulatory pressure to keep termination fees at artificially high levels and so helping the established incumbent to weather competition.
- Looking at the competitive differences, we probably see the biggest cause of the different price developments in India and Switzerland. Significant differences in competitive conduct influence not only operator margins, market growth but also price developments and overall market behaviour of the competitors. The extremely high Swiss interconnection charges make it very difficult for a likely price competitor to substantially reduce mobile minute prices in Switzerland. As a way out, Swiss operators focus on the other marketing mix instruments. Promotions, phone deals and market presence act as popular substitutes. The Indian operators traditionally follow an alternative route. Here commoditisation is a way of life. Copying/matching competitors and driving down market prices is a phenomenon that can be observed in most Indian markets. So it is safe to argue, this to be the strongest price differentiator between the two countries. The last four years Swiss prices remained unchanged even though cost benefits of lower equipment costs, economies of scale and economies of time were obvious. During the same time, Indian customers have benefited from price decreases of about 85 per cent. In case, India would have similar termination rates, such a decrease would be simply impossible (Figure 2).

Figure 1

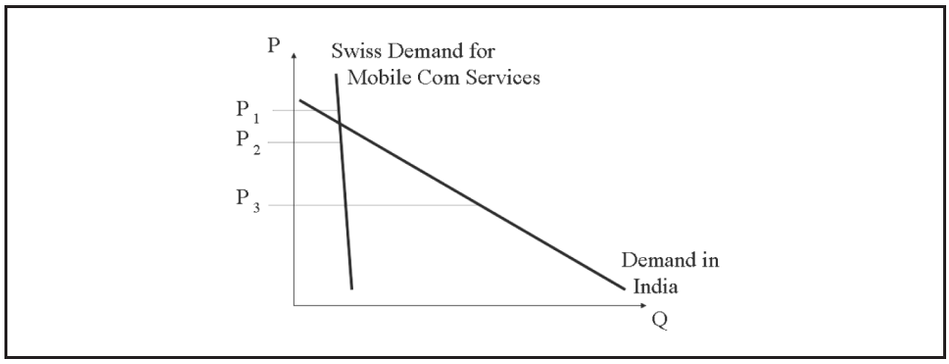
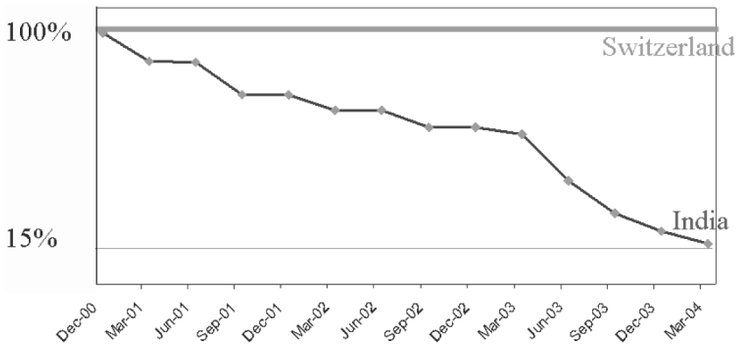


Figure 2



Source: COAI [Cellular Operator Association India] (2004)

From a regulatory perspective, both countries have achieved certain goals. The three established Swiss operators are flourishing; Swiss customers benefit from subsidized handsets and can choose from a variety of services and Swiss media enjoy the benefit of a lot of advertising orders. In India, on the other hand, GSM handsets are not subsidized and service offerings are less variegated. But the most powerful effect of open competition has worked 100 per cent. Prices have come down dramatically. While Indian mobile prices started quasi on an international level, its cost advantages and its huge price elasticity of demand and most importantly its price competition (unleashed by flexible termination rates) between the multiplicity of players brought prices down to minimal levels within less than five years.

As is evident from the above, from a development point-of-view the achieved price advantages are far more important for India's development than latest marketing gimmicks. However, also for the chronically high Swiss price levels this case implicitly asks for more price competition in Switzerland. While company decisions and market offers cannot be ''regulated or even enforced'' from a liberalisation point of view, the currently asked termination costs would have to be challenged and capped. Once this flexibility is infused into the Swiss system surely individual competitors (Switzerland has five by now) would start competing on price and price developments would finally start heading South, i.e. the combination of generosity in license fee demands and a certain number of ''competitors'' does not qualify as a sufficient condition for real price competition to happen in a mobile communication market.