Are recent post-paid price increases by SA operators justifiable?

- **CellC provides the best value on their mobile contract offerings (postpaid) followed by Telkom Mobile.**
- **Disgruntled contract subscribers may move to prepaid where some excellent high-value products are now offered or simply buy data bundles to use Over-the-Top services such as Skype and WhatsApp for voice and text services.**
- **The claim by operators that increased input costs that necessitate price increases is not reflected in current annual financial statements. Revenue has increased faster than operating expenditure for Vodacom while both revenue and OPEX are in decline for MTN.**
- **Capital expenditure (CAPEX) per subscriber has been in decline for several years. The test will be whether the big three will use the extra revenue from price hikes to reverse this trend.**

Introduction

Vodacom, MTN and CellC justified recent increases in their post-paid product prices with claims of rising input costs. These price increases have taken the form of increases in monthly subscriptions, out of bundle rates, and the quantity of bundled minutes, SMS's and data. Some plans remain unchanged but most plans face direct or indirect price increases.

A new tool has been developed by Research ICT Africa to analyse post-paid price changes across operators and across Africa taking very diverse post-paid features of products on offer into account. This tool is the Post-paid Value Index (PVI).

Postpaid Value Index (PVI)

The PVI measures the value a customer gets for the monthly subscription price in terms of bundled minutes, SMS's and data. Table 1 lists the PVI by monthly subscription categories for Vodacom, MTN, CellC and Telkom Mobile. Where there is more than one product per category the one with the highest PVI is selected. The average PVI is based on all contract offerings of the given operator.

With its pro-poor focus RIA's *Mobile Pricing Transparency Index* has focused on pre-paid voice bundles, and since 2014 also pre-paid mobile broadband pricing . The benchmarking of prepaid mobile broadband was combined with *Ookla* download and upload speeds by operator to produce the Mobile *Broadband Value for Money Index*.

As voice revenues began to decline and user demand and operators business models shifted from voice to data, RIA noted that voice and data use and tariff offerings could no longer be understood separately. Consumers were getting the best value for money from integrated voice, data and SMS offerings where operators were competing most fiercely to retain and attract users.

This resulted in RIA developing a new tool to analyse the value of different product in the post paid market - the *Post-paid Value Index* (PVI) discussed here and the Top-Up Value Index (TVI) which will be published in the next policy brief.

Cell C's Infinity Select contract offers South African post-paid consumers the best value for their money. The best value below R100 per month in South Africa is Cell C's Smart Chat 1GB.

CellC offers the best value for money with the highest PVI in eight monthly subscription categories and CellC also holds the contract with the highest PVI. Its Infinity Select product scores a PVI of 21.07 and at R999 it is the cheapest unlimited voice and SMS package. It comes with 10GB data. The average PVI of all of Cell C's contracts was 7.35 in Q1 2015.

Telkom Mobile contracts offer the second best value in South Africa. The average PVI was 6.48 and its Unlimited product scored 15.04 on the index.

Vodacom's PVI is increasing with the value of monthly subscription, peaking in the R600 -700 category with 4.3 and then declining again. Vodacom's best PVI product is Smart Red VIP, which boasts a PVI of 7.59 for a monthly subscription of R1,999.

The only product of MTN that provides a significant PVI is My Sky without a handset at a monthly promotional subscription price of R1,299 (see outlier in Figure 1).

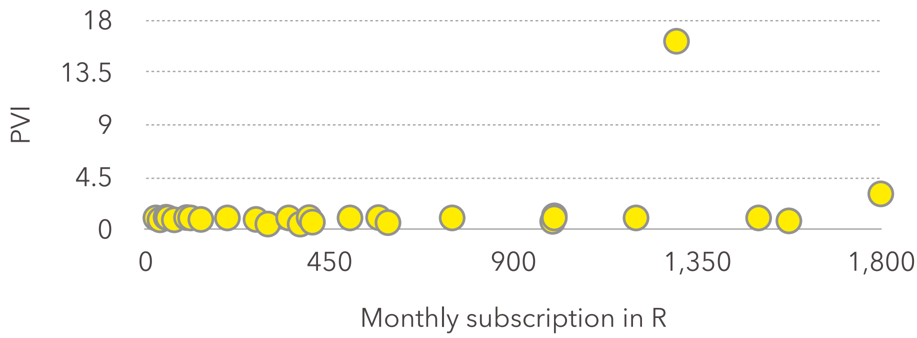
Table 1: Highest PVI by monthly subscription category Q1 2015

Monthly Subscription	Vodacom	MTN	Cell C	Telkom Mobile	Best Value for Money for each category
below 50 R	1.28	1.00	2.47		Cell C
50 to 100 R	1.45	1.06	12.16		Cell C
101 to 150 R	1.44	1.03	2.80	5.74	Telkom M
151 to 200 R	3.48	1.00	12.10	9.27	Cell C
201 to 300 R	3.54	1.01	14.50		Cell C
301 to 400 R	3.21	1.03	3.64		Cell C
401 to 500 R	3.77	1.01	15.96		Cell C
501 to 600 R	3.42	1.03	15.98		Cell C
601 to700 R	4.30				Vodacom
701 to 800 R	3.91	1.02	3.64		Vodacom
801 to 900 R					
901 to 1000 R	2.85	1.17	**21.07**		Cell C
1001 to 1200 R		1.01			MTN
1201 to 1400 R		**16.20**		**15.04**	MTN
1401 to 1600 R	2.88	1.01			Vodacom
1601 to 1800 R		3.07			MTN
1801 to 2000 R	**7.59**				Vodacom
Average across all products	**2.87**	**1.33**	**7.35**	**6.48**	

Vodacom and MTN should rather increase the value they offer to their customers instead of increasing prices.

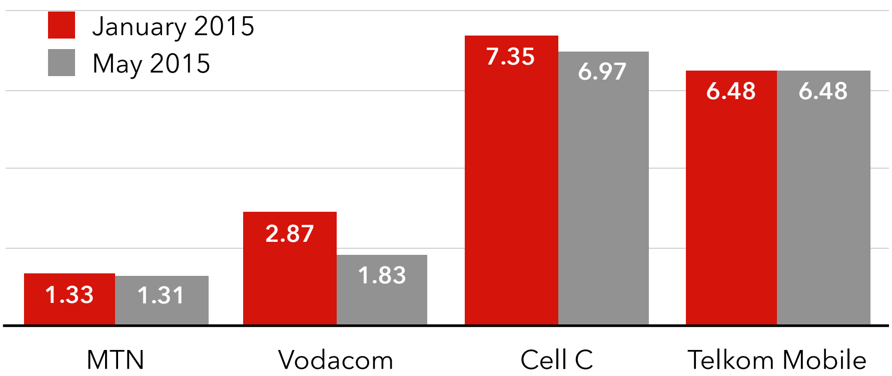
MTN contracts have the lowest PVI among the four mobile network operators included in this brief. It also has the highest number of post-paid products - 46 in total. It seems that MTN could benefit from an overhaul of its post-paid offerings, like those done by Vodacom and CellC. It would be important for MTN to simplify its offering while providing more value to its customers through bundling more minutes, SMS and data.

Figure 1: MTN PVI for Q1 2015 sorted by monthly subscription - Only My Sky provides significant PVI



Vodacom reduced its post-paid consumer value the most with a drop in its average PVI from 2.87 in January 2015 to 1.83 in May 2015. CellC still provides the best value for money in South Africa, even after its post-paid price increases.

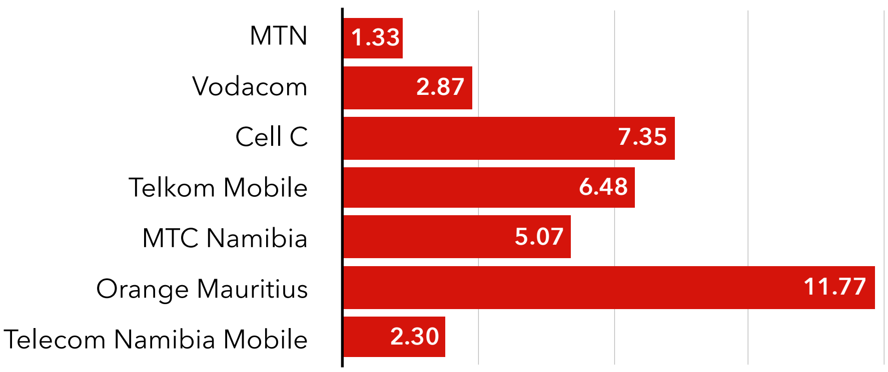
Figure 2: Changes in average PVI between January and May 2015



Vodacom appears to have joined MTN in its low value approach to contract products.

Comparing the PVI to selected operators from other countries shows that CellC is not alone in bundling minutes, SMS's and data resulting in an offering worth a multiple of the respective monthly subscription (Figure 3)

Figure 3: Average Post-paid Value Index (PVI) 2015 Q1



Namibia's MTC has a lower average PVI than CellC but all contracts come with a mobile phone. CellC's PVI is based on SIM card only contracts. Orange Mauritius provides the best "bang for its buck" in this comparison. Its post-paid customers get on average nearly 12 times the value of the monthly subscription.Are rising input costs to blame for higher prices?

Are rising input costs to blame for higher prices?

Reasons for the increases in post-paid prices cited by incumbent operators were inflationary adjustments, cost pressures faced by increasing electricity tariffs,electricity substitution costs incurred due to load shedding, depreciation of the rand and increases in hardware cost. Operators claim that they had to invest in generators and back-up batteries to power base stations to maintain service during Eskom's load shedding.[1] Vodacom also mentioned the massive investments that it undertook during the past four years (R30 billion) as a reason for its increased prices.[2]

If the operators are correct then this should be reflected in financial key performance indicators (KPIs), which are only publicly available for the listed companies - Vodacom, MTN and Telkom. Higher electricity costs should be reflected in higher operating expenditure (OPEX) and capital expenditure (CAPEX).

Vodacom's EBITDA margin has remained relatively constant over the last five years. This is indicative of an efficient operation with healthy operating profitability, effectively managing the regulatory and technology changes to the market. MTN's EBITDA margin for South Africa has been declining in the same time period.

Methodology

The PVI measures the value a customer gets for the monthly subscription price in terms of bundled minutes, SMS's and data. It does not take into account out of bundle rates. OECD usage baskets that RIA uses for prepaid products are based on out-of-bundle rates. The PVI complements this by looking at post paid PVI of South Africa operators, together providing a comprehensive view of the market.

The PVI adds the value of bundled minutes, SMS and data and divides it by the monthly subscription. The value of bundled minutes is derived by multiplying the number of minutes with a fixed USD value. One minute is valued at 10 US cents, one SMS at 1 US cent and one MB data at 10 US cents. A contract with 25 minutes, 50 SMS and 100MB data bundled, with a monthly subscription of 10 US$ will then have the following PVI:

PVI =(25*0.1+50*0.01+100*0.1)/10 =1.3

This means that the consumer gets 1.3 times the value of the monthly subscription. We used the same USD values across all operators and countries. Using operator specific out-of-bundle prices would make more expensive operators seem as if they are providing higher value. Unlimited calls, SMS's or data contracts were made comparable to capped packages by applying following rules:

- Unlimited minutes = 240 minutes per day or 7200 minutes per month
- Uncapped SMS = 240 SMS a day or 7200 per month.
- Uncapped data = the smaller value out fair terms of use policy limit and 30 GB.

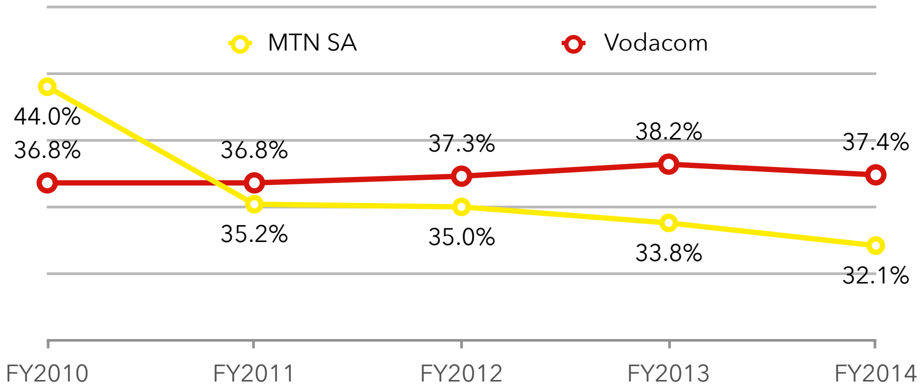
Generally RIA captures post-paid products without handsets. In cases where handsets are attached to the contract the effect would be an underestimation of the actual value offering.

Bundled minutes and SMS's are not distinguished by destination (on-net or off-net) or time period (peak or off-peak).

[1] http://mybroadband.co.za/news/cellular/124128-massive-mtn-price-hikes-how-much-more-you-will-pay.html

[2] http://mybroadband.co.za/news/cellular/122684-vodacom-prices-to-increase.html

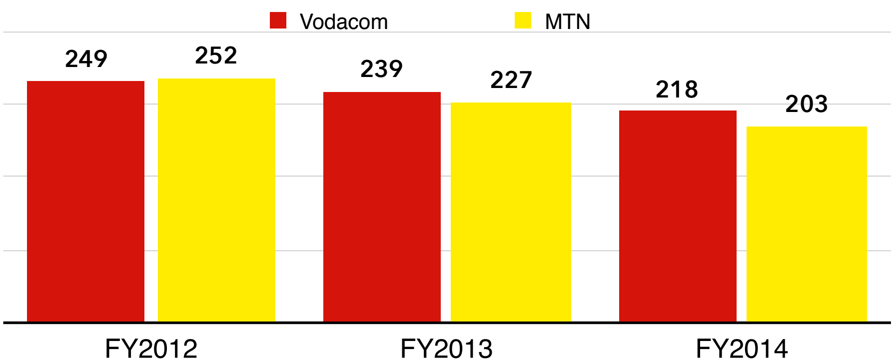
Figure 4: EBITDA Margin



An EBITDA margin of 37% plus gives Vodacom a lot of room to absorb electricity cost before shareholders get nervous.

However, EBITDA margins in excess of 30% are generally indicative of healthy operating profitability. New York University's Stern School of Business margin by sector analysis indicates that the average telecommunications service sector operator has a margin of 20.3%. Both MTN and Vodacom have EBITDA margins far higher than this.[3]

Figure 5: CAPEX per subscriber in R



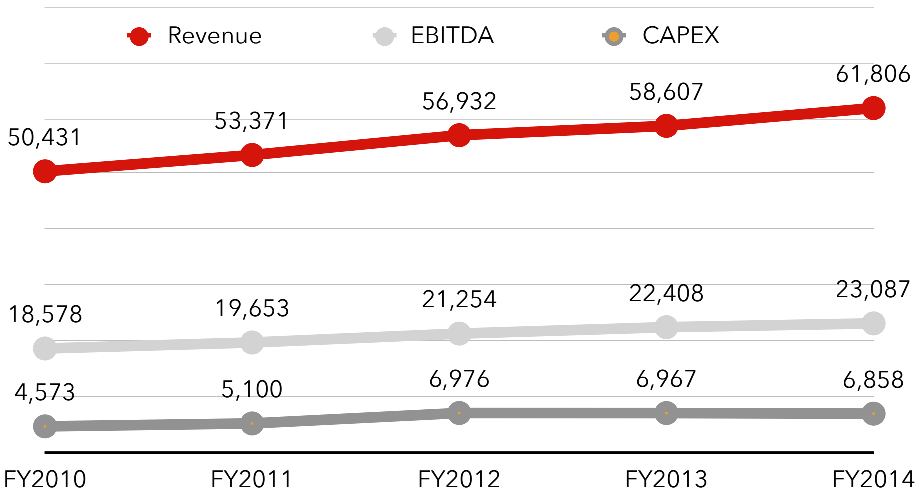
At the same time capital expenditure per subscriber has been decreasing in recent years for both MTN and Vodacom.

Vodacom

Vodacom's Revenue and EBITDA have increased for Vodacom over the last five years (Figure 6). Disproportional increases in input costs should be reflected in a decreasing EBITDA, which is not the case. Figure 7 shows that revenue growth has exceeded operating expenditure growth.

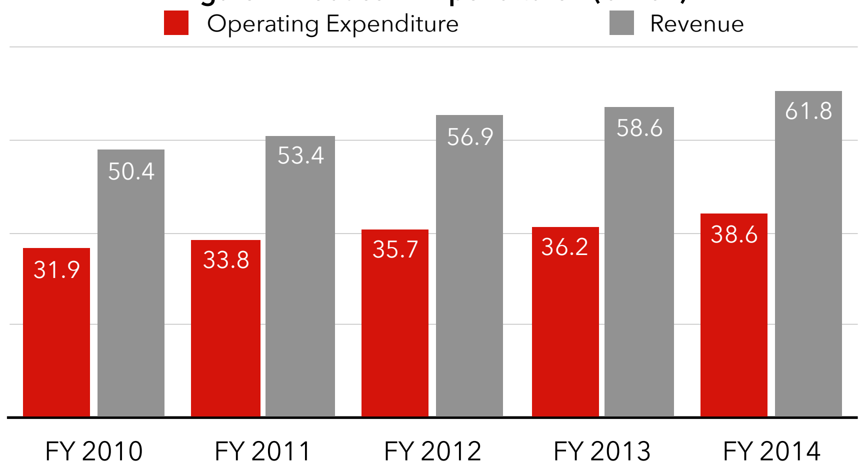
[3]http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html

Figure 6: Vodacom KPIs in R(m)



Vodacom's argument regarding input cost increases that necessitate price increases is not plausible and are not reflected in its financial statements as yet.

Figure 7: Vodacom Expenditure R(billion)

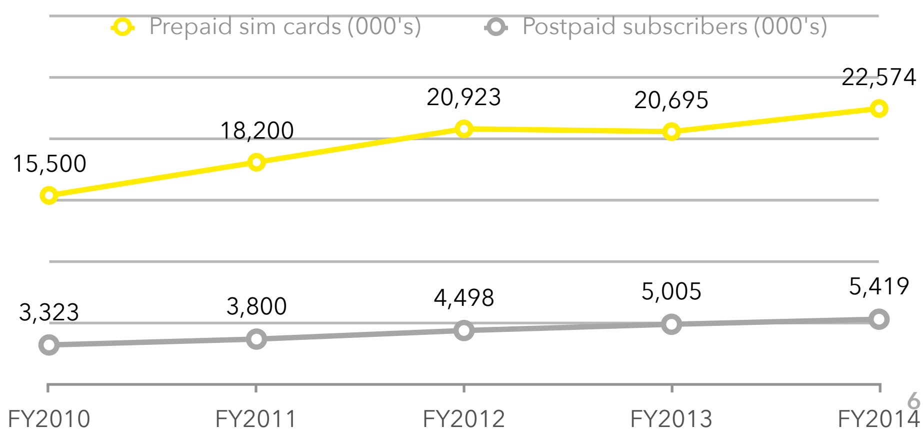


Vodacom's input costs are not a significant factor in explaining price increases. It's revenue growth exceeds its OPEX growth.

MTN

MTN South Africa's subscriber base has continuously increased over the last five years, coupled with a decline in revenue over the last three financial years. Operating and capital expenditures have also decreased along with revenue (Figure 9).

Figure 8: MTN South Africa subscribers and revenues

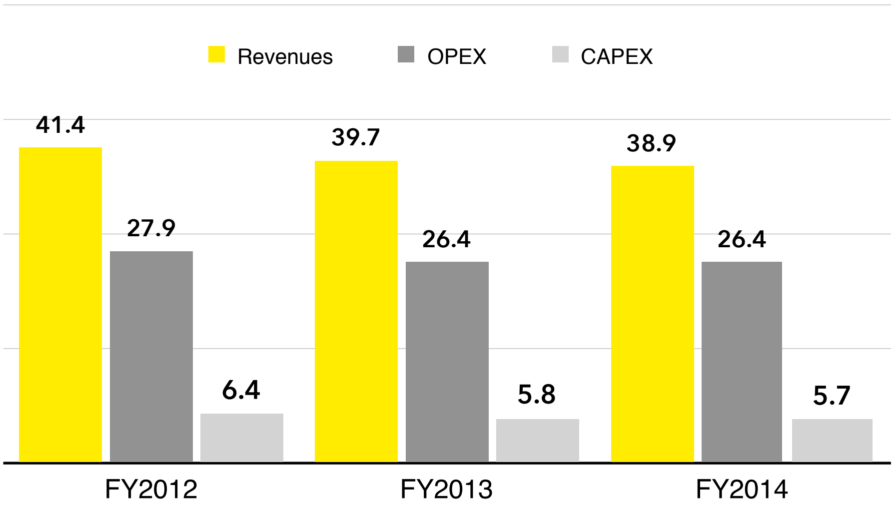


Decreasing revenue, decreasing operating expenditure, decreasing investment and increasing prices: What is MTN's strategy?

For MTN, it is less a case of a rise in input costs but rather a change in business strategy that is causing it to increase its post-paid prices. MTN's operating expenditure certainly did not increase in the financial year ending December 2014, despite a higher number of subscribers.

It is plausible that MTN is increasing prices in anticipation of higher investment outlays to come, such as further roll out of LTE networks, invest into fibre to the home or office (FTTx), or buy Telkom's mobile network.

Figure 9: MTN SA KPIs in R billion



Conclusion

Price hikes may backfire in two ways: decreasing trust of consumers and harming the bottom line by accelerating the move to OTT services.

Internationally telecommunications prices have either fallen or remained constant and thus declined in real terms. The increase in post-paid prices by SA's operators are contrary to global trends.

The three biggest operators increased post-paid prices more or less at the same time because they can. If only one had increased prices then consumers could have switched at the next opportunity to one of the other operators.

Postpaid subscribers are locked into contracts with high termination fees, leaving them with no choice but to accept the price hikes.

Even though there has been strong consumer backlash in the media, the unilateral increase in tariffs was not illegal since the minimum notification period to consumers of 20 days was kept. The National Consumer Commission has still launched an investigation into operators price increases.[4]

Apart from legality, a question arises to whether it was wise to increase post-paid prices. Increasing post-paid prices and reducing the amount of bundled minutes, SMS and data may lead to consumers substituting traditional mobile services through Over The Top (OTT) services such as Skype, WhatsApp, Facetime, Facebook and the like.

Operators are counting on post-paid subscribers not moving to prepaid for several reasons including convenience such as never running out of airtime

[4] http://www.fin24.com/Tech/News/Commission-investigates-Vodacom-Cell-C-over-price-hikes-20150405

and access to handset finance, and the heavy penalties of early exit from their contracts.

Have SA's biggest operators increased prices at the same time to avoid post-paid churn?

Vodacom and MTN also have the power to increase prepaid prices discretely by reducing discounts on their dynamic pricing products.

The operators seem to have a short-term view to satisfy their shareholders. This approach may backfire in the long-term in two ways: decreasing trust of consumers and secondly, harming the bottom line by increasing the move to OTT services.

The trend toward OTT is inevitable, but accelerating it through price increases that are going to drive consumers away from traditional communication mediums does not make much business sense while they remain significant revenue streams. Instead operators should aim to maintain constant ARPUs by providing more value to customers through more minutes, SMS and data.

Authors

Safia Khan, Researcher.
Dr Christoph Stork, Senior Research Fellow.
Research ICT Africa
409 The Studios, Old Castle Brewery, Beach Road, Woodstock, Cape Town
T: +27 214476332
E: skhan@researchictafrica.net
W: www.researchictafrica.net