Are recent postpaid price increases by SA operators justifiable?

Vodacom released preliminary results for its financial year ending in March 2015, and CellC launched new products and started a buy back contract campaign in the same week as the RIA policy brief was launched. This required an immediate update.

- **CellC provided the best average value on their mobile contract offerings (postpaid) in Q1 2015. The average value offered by CellC to its contract customers declined through the launch of the Epic product series. Telkom Mobile provides the best average value in May 2015 as a result.**
- **Vodacom's claim that increased input costs necessitate price increases is reflected in its preliminary annual financial results for 2015. It invested significantly more in FY2015, overall and per subscriber.**
- **MTN's revenue, OPEX and CAPEX have been in decline for the last three financial years. This raises the question about what MTN's strategy is. Increasing prices while investing less weakens its potential to compete and innovate.**
- **Increasing prices may be justified by higher electricity costs and a weak Rand, but may not improve the bottom line. Disgruntled contract subscribers may move to prepaid or simply buy data bundles in order to use Over-the-Top services such as Skype and WhatsApp for voice and text services.**

Introduction

Vodacom, MTN and CellC justified recent increases in their postpaid 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, SMSs 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 postpaid price changes across operators and across Africa, taking very diverse postpaid features of products on offer into account. This tool is the Postpaid Value Index (PVI).

With its pro-poor focus RIA's *Mobile Pricing Transparency Index* has focused on prepaid voice bundles, and since 2014 also prepaid mobile broadband pricing . The benchmarking of prepaid mobile broadband was combined with *Ookla* download and upload speeds by operators 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 postpaid market - the *Postpaid Value Index* (PVI) discussed here and the Top-Up Value Index (TVI) which will be published in the next policy brief.

Postpaid Value Index (PVI)

The PVI measures the value a customer gets for the monthly subscription price in terms of bundled minutes, SMSs 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.

Cell C's Infinity Select contract offers South African postpaid 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-R700 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).

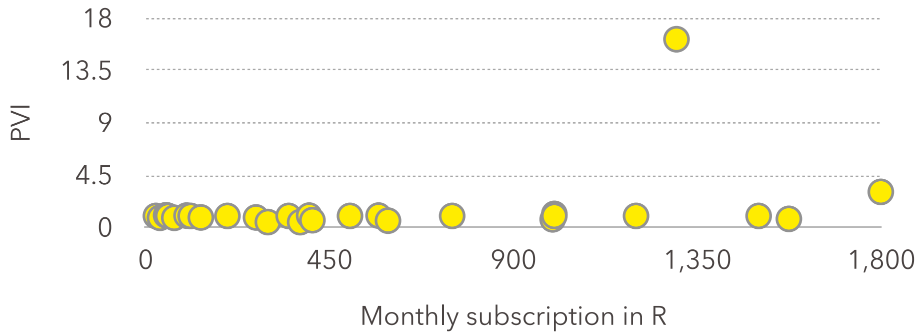
Table 1: Highest PVI by monthly subscription category Q1 2015

Monthly Subscription	Vodacom	MTN	Cell C	Telkom Mobile	Best Value for Money for each category
below R50	1.28	1.00	2.47		Cell C
R50 to R100	1.45	1.06	12.16		Cell C
R101 to R150	1.44	1.03	2.80	5.74	Telkom M
R151 to R200	3.48	1.00	12.10	9.27	Cell C
R201 to R300	3.54	1.01	14.50		Cell C
R301 to R400	3.21	1.03	3.64		Cell C
R401 to R500	3.77	1.01	15.96		Cell C
R501 to R600	3.42	1.03	15.98		Cell C
R601 toR700	4.30				Vodacom
R701 to R800	3.91	1.02	3.64		Vodacom
R801 to R900					
R901 to R1000	2.85	1.17	**21.07**		Cell C
R1001 to R1200		1.01			MTN
R1201 to R1400		**16.20**		**15.04**	MTN
R1401 to R1600	2.88	1.01			Vodacom
R1601 to R1800		3.07			MTN
R1801 to R2000	**7.59**				Vodacom
Average across all products	**2.87**	**1.33**	**7.35**	**6.48**	

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

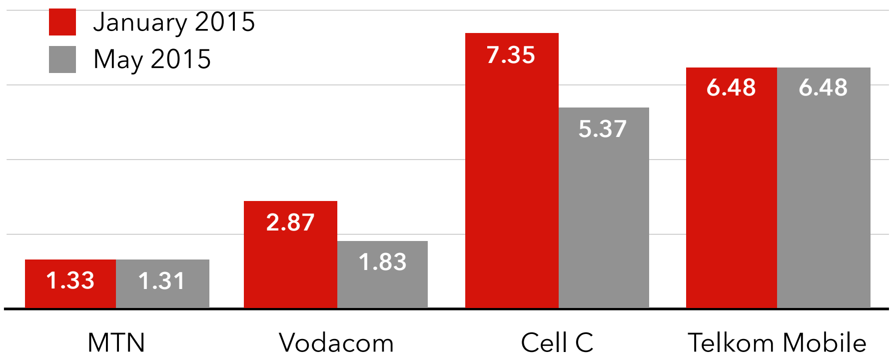
MTN contracts have the lowest PVI among the four mobile network operators included in this brief. It also has the highest number of postpaid products - 46 in total. It seems that MTN could benefit from an overhaul of its postpaid offerings, following Vodacom and CellC. It would be important for MTN to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

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



Vodacom had the highest reduction in postpaid consumer value 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 Q1 2015 in South Africa, even after its postpaid price increases. The introduction of the low value EPIC product range in May 2015 means Cell C's average PVI falls behind Telkom Mobile's.

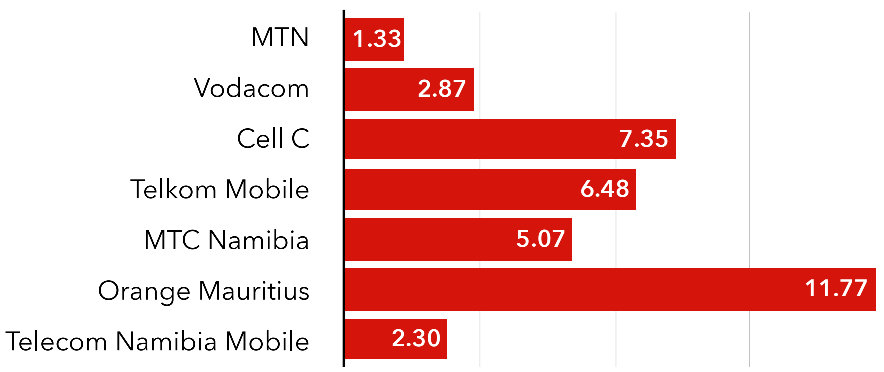
Figure 2: Changes in average PVI between January and May 2015



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 postpaid customers get on average nearly 12 times the value of their monthly subscription. Are rising input costs to blame for higher prices?

Cell C's contract buy out offering

CellC has offered to buy consumers out of their contracts with other operators. CellC is willing to pay consumers who are willing to switch between R1000 and R10 000 provided that the switching consumer take up one of Cell C's Epic contract packages.

The low PVIs of the Epic product range shows that customers switching to Cell C as per the buy back program may actually not get much better value for money.

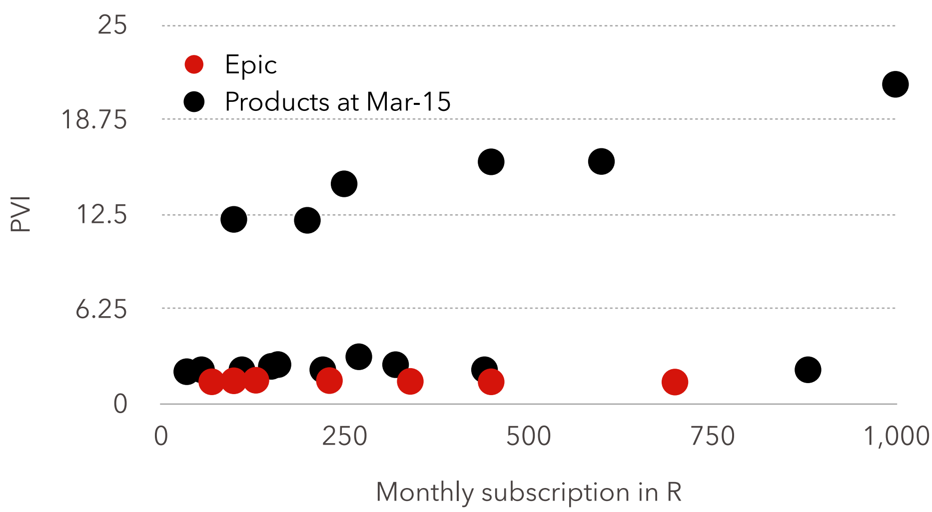
Table 2: CellC's new Epic product range

Product Name	Payout to Switching consumer	PVI	Monthly Subscription
Epic 100		1.45	69
Epic 150		1.52	99
Epic 200	Maximum of 1,000	1.55	129
Epic 350	Maximum of 2,500	1.53	229
Epic 500	Maximum of 4,000	1.47	339
Epic 650	Maximum of 6,000	1.45	449
Epic 1000	Maximum of 10,000	1.43	699

These contract buy outs are offered to consumers as a solution to postpaid mobile price hikes, however, CellC itself has increased the contract subscription prices of existing contracts and on new contract products as of February this year, so the action may be a bit sanctimonious on the part of CellC.

Further, the low PVIs of the Epic product range show that switching customers may actually not get a much better product.

Figure 4: PVI of CellC's existing products compared to the new Epic product range



Are rising input costs to blame for higher prices?

Reasons for the increases in postpaid 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, SMSs 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, SMSs 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, 1 SMS at 1 US cent, and 1 MB data at 10 US cents. A contract with 25 minutes, 50 SMSs 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, SMSs 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 SMSs a day or 7200 per month.
- Uncapped data = the smaller value out of the fair terms of use policy limit and 30 GB.

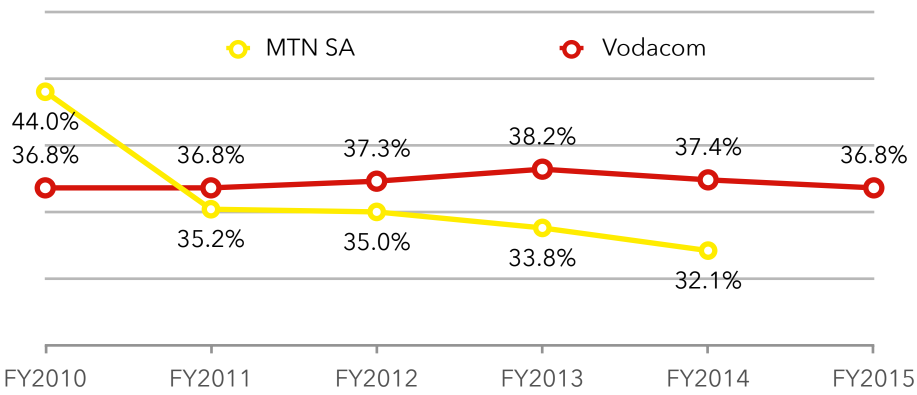
Generally RIA captures postpaid products without handsets. In cases where handsets are attached to the contract the effect would be an underestimation of the actual value offering.

Bundled minutes and SMSs 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

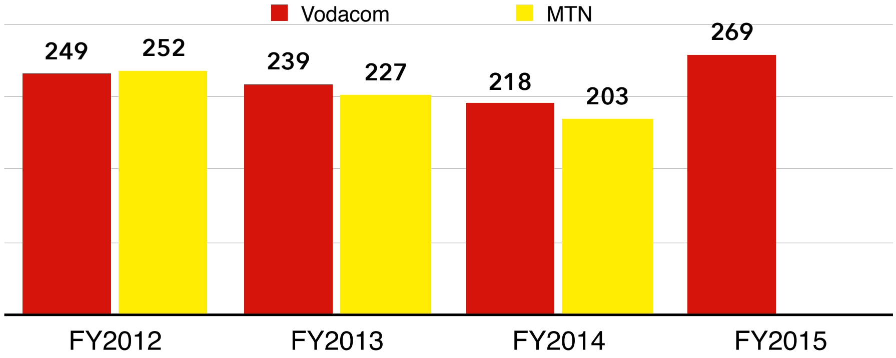
Figure 5: EBITDA Margin



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]

An EBITDA margin of 36% plus gives Vodacom a lot of room to absorb electricity cost before shareholders get nervous.

Figure 6: CAPEX per subscriber in R



At the same time capital expenditure per subscriber has been decreasing in recent years for MTN. For Vodacom it also decreased between the FY2012 and FY2014 but increased considerably for the last financial year (FY2015).

Vodacom

Vodacom's revenue increased for the last six years. Its EBITDA also increased for the first five years but in the last financial year it declined slightly (Figure 8). Vodacom's argument regarding input cost increases that necessitate price increases is thus plausible based on the preliminary results released on 18 May 2015.

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

Figure 7: Vodacom KPIs in R(m)

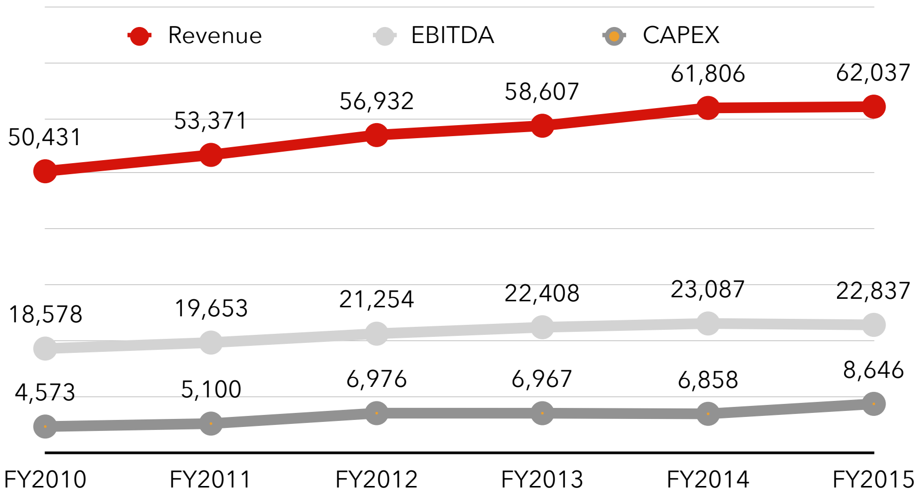
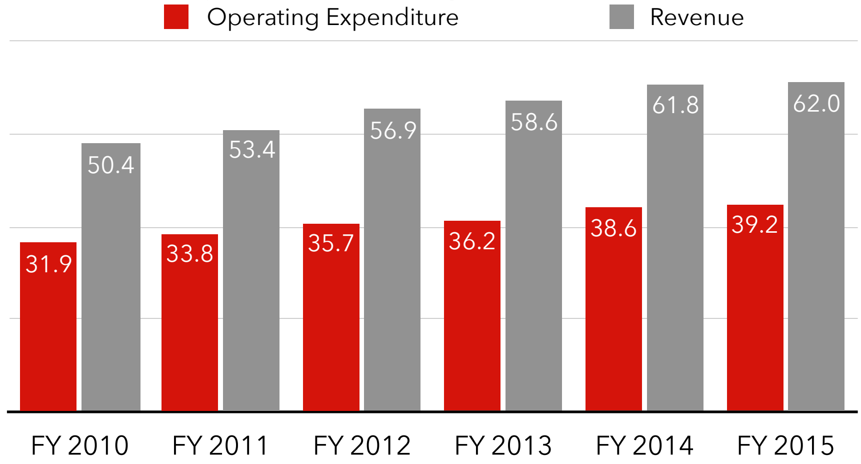


Figure 8: Vodacom Expenditure R(billion)

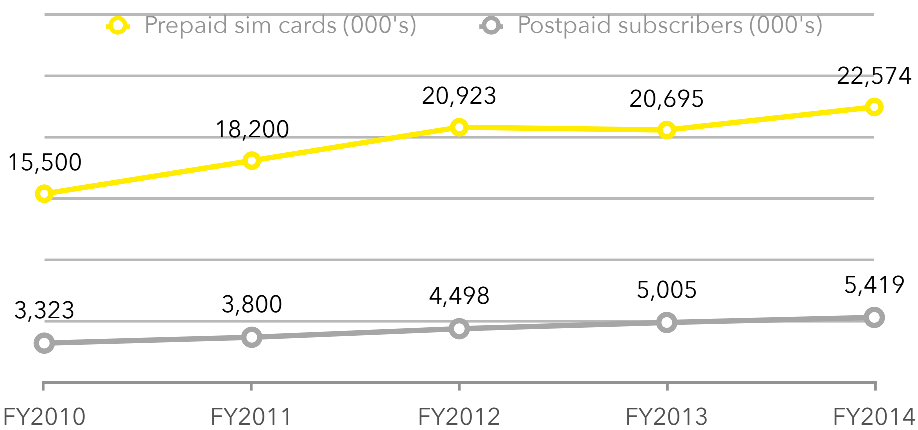


Preliminary annual results for Vodacom show that Capex (total and per subscriber) has increased and that OPEX also increased faster than revenue for the financial year ending in March 2015.

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 10).

Figure 9: MTN South Africa subscribers and revenues

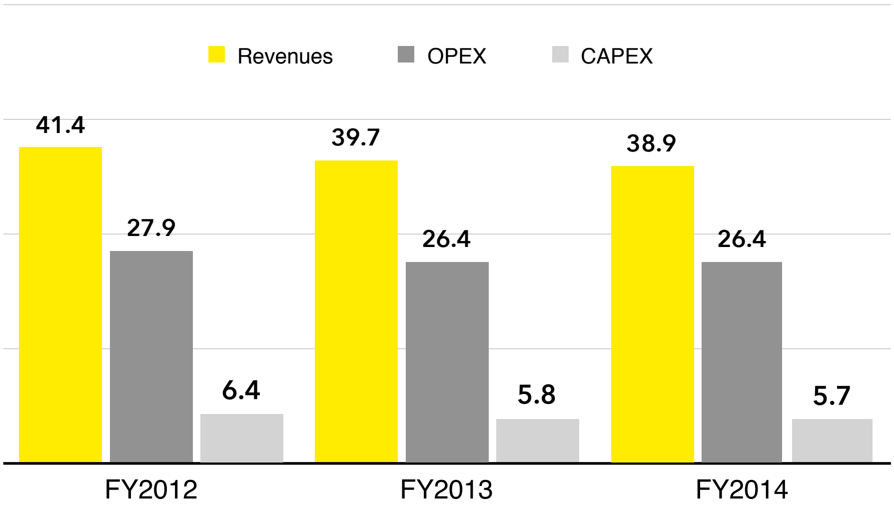


Decreasing revenue, decreasing operating expenditure, decreasing investment and increasing prices: What is MTN's strategy?

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 postpaid 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, investing in fibre to the home or office (FTTx), or buying Telkom's mobile network.

Figure 10: 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 postpaid 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.

The increased investment by Vodacom is good news for consumers and the price hikes may be worth it for the increased quality of service.

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 postpaid prices. Increasing postpaid prices and reducing the amount of bundled minutes, SMSs and data may lead to consumers substituting

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

traditional mobile services through Over The Top (OTT) services such as Skype, WhatsApp, Facetime, Facebook and the like.

Operators are counting on postpaid subscribers not moving to prepaid for several reasons including convenience, such as never running out of airtime and access to handset finance, and the heavy penalties of early exit from their contracts.

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

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

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, SMSs and data.

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