

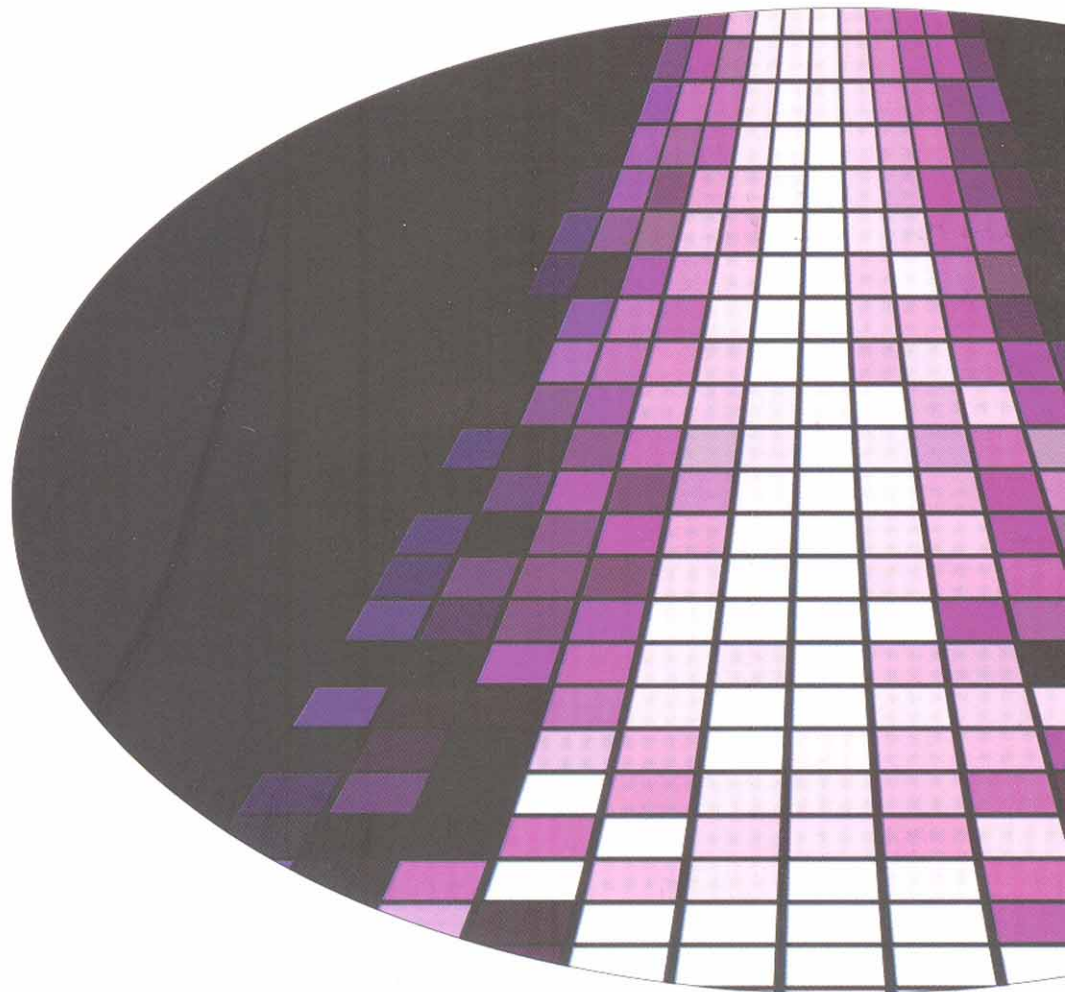
ISSN 0976 - 545X

JOURNAL of TECHNOLOGY MANAGEMENT FOR GROWING ECONOMIES

Volume 1 Number 2 October 2010

Wanted: New Business Models for Profitable Expansion of Mobile Telephony in Rural India

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Wanted: New Business Models for Profitable Expansion of Mobile Telephony in Rural India

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Abstract

Mobile network operators' agendas for profitable growth include expansion into rural areas of developing countries, especially India. However, capitalizing on that opportunity will not be easy. Our research suggests that operators have yet to create and implement business models capable of driving profitable growth through rural expansion. We found that mobile network operators hold some mistaken assumptions about rural consumers' needs and desires regarding mobile services. To achieve profitable growth and high performance through rural expansion, operators must develop a more accurate understanding of the mobile value proposition in rural communities, as well as potential barriers to adoption. Mobile operators in rural markets must also build business models that work in the short term as well as the long term. Sacrificing short-term revenues to expand market footprint may not be the best strategy, because stiffening competition in urban markets will likely prevent operators from cross-subsidizing their rural expansion strategies. This report serves as a "midpoint review" of some key presumptions, strategies and models companies have used to drive their rural strategies over recent years. It suggests that basic services are more important than higher-end ones in the short term. The mobile operators should ease post-connection costs borne by customers. Simplicity is the name of the game. Cost management will drive profitability, at least in the short term.

Keywords: Mobile telephony, rural India, profitable expansion, consumers.

ABOUT THE RESEARCH

In 2009, Accenture conducted a study into the future of mobile industry expansion in rural India. We explored rural consumers' views and interviewed senior-level executives from companies that occupy strategic positions across the mobile telephony ecosystem. Our key objective was to understand the value proposition of mobile services to rural customers, and to see how the potential to serve rural markets is making mobile network operators rethink their existing business models.

Journal of Technology
Management for
Growing Economies
Vol. 1 No. 2
October 2010
pp. 49-69



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The study's first phase (completed in June-July 2009) comprised 15 in-depth interviews with executives in India representing mobile operators, handset manufacturers, passive and active telecom infrastructure providers, technology enablers/application providers and content developers and aggregators. Additionally, in association with an independent research company, Accenture conducted a qualitative study of consumer priorities, using a focus group. Participants included primary wage earners, homemakers and students from rural areas in India.

For the study's second phase, we surveyed more than 2,400 rural citizens in India-current mobile customers and non-users alike-to understand what customers value most in mobile devices and services.

We believe that our findings can help mobile network operators evolve their business models and design appealing and profitable packages for rural consumers.

THE CHALLENGE: EXPANDING INTO URAL MARKETS THAT ARE MORE EXPENSIVE TO SERVE

Although India's mobile operators have enjoyed sustained growth, high levels of profitability and robust valuations, growth has been fueled primarily by urban markets. As penetration in some metro areas begins to exceed 80 percent, operators will not be able to sustain their current growth rates through additional take-up in large cities. To fuel future profitable growth, operators must look to India's rural markets, where mobile penetration currently ranges from 4 percent to 32 percent. Major operators are keenly aware of the growth projections: 70 percent of all future mobile subscribers in the country will come from rural areas.¹

But providing mobile service to India's rural populations presents challenges, including:

- an acute shortage of technical infrastructure across rural India, which slows the pace of mobile expansion and makes it more expensive
- diverse cultures, educational standards and technical knowledge
- frequent power shortages
- rugged environmental conditions.

Mobile network operators in India must grow their existing subscriber base by moving into India's rural areas. At the same time, they must devise strategies and business models that will enable them to retain

medium-term profitability, even as they try to reach a customer base that is more expensive to serve. The challenge is to minimize the costs of acquiring and serving rural customers to cover the initial investment, and then to drive future growth and higher valuations with the right services for this population.

New Accenture research has generated important insights into how mobile network operators must modify their business models to serve rural markets profitably. (See "About the research.") We found that operators in India need a deeper understanding of rural customers' distinctive service requirements. They must segment customers more narrowly and provide after-sales service appropriate to rural populations. And they need to manage costs.

Infrastructure challenges present a serious risk to rural expansion, and operators must collaborate to address that challenge. Perhaps most important, they must understand their customers deeply enough to develop relevant and innovative value-added services geared toward the rural population. Rural markets offer the possibility of volume, but operators must deliver value to generate profits from this untapped consumer segment.

ACCENTURE RESEARCH FINDINGS

Our study enabled us to compare mobile industry executives' perspectives on rural customers' needs with those same customers' perspectives. We found disconnects in the industry's understanding of rural buyers' values. In particular, executives appear to underestimate the complexity and the maturity of the rural consumer base and misapprehend the rationales behind consumers' buying decisions.

THE MOBILE VALUE PROPOSITION

Are consumers in India's rural areas interested in mobile devices and services, and do they have needs and interests that mobile operators can satisfy? In the first phase of our study, we asked executives to rank the top three value propositions—the needs or motivators they believe could drive rural consumers to become mobile customers. We asked consumers the same question. (See Figure 1.) We found both consensus and disconnect.

Types of needs	Top Three Mobile Value Propositions Identified by:	
	Rural Consumers	Senior Executives
Cheapest way to communicate over a distance for personal or business purpose	1	1
Reliable tool for communication	2	
Tool to enhance privacy in direct communication	3	
Style/status		2
A platform for entertainment at a personal level or for the household (e.g. songs, games, videos)		3
Cheapest source to know about opportunities (e.g. employment, business)		
Educational tool at a personal level and for the household		

Figure 1: The value proposition of mobile services: executives' vs. consumers' perspectives

Consensus...

Both respondent groups agreed on the number-one value proposition for mobile services: mobile phones are the cheapest way to communicate over a distance for personal and business reasons. As one executive for an Indian operator explained, "A mobile connection has reduced relationship costs at all levels."

The consumer focus groups agreed: "You can call from wherever you are, at any time," said one student. "My husband sometimes leaves a message with my sister-in-law, and she forgets to tell me," reported one homemaker; "I wish I had a mobile."

...and disconnect

However, executives were not on target with their other rankings. The second most important reason they cited for rural customers' wanting to

own a mobile phone was its role as a status symbol. Executives claimed that rural consumers are keen to showcase how their phone is unique. As a senior executive with a mobile device manufacturer put it, "The device becomes a talking point for the owner amongst friends, if it has been acquired even at a marginally higher cost in comparison to normal phones."

However, rural consumers felt that mobile phones no longer serve as status symbols. One focus group participant noted, "It was a prestigious thing to have a cell phone, because only the rich could purchase it. Now everyone has a cell phone."

Executives noted another motivator that rural customers did not rank as highly: entertainment. Because of poor electricity infrastructure, rural consumers in India are often "entertainment starved"-unable to regularly enjoy television. According to one device manufacturer, "If an operator or a device manufacturer at a very affordable price can facilitate the download of a limited number of songs and videos, this provides an identity to the cell phone user amongst his peers." However, the mobile phone's potential as an entertainment platform did not figure as highly in the consumer rankings.

Reliability ranked higher for the rural consumers in our focus groups. Rural Indians see mobile phones as having fewer connectivity problems than landlines. For our study participants, the third most important motivator for becoming a mobile customer was to gain privacy and more direct communication. As one homemaker in our study put it, "My husband works in another town, and I want to be able to talk to him every day. A mobile would enable me to do that."

PROBING THE MOBILE VALUE PROPOSITION

Phase two of our study probed the mobile value proposition more deeply. We found, for example, that mobile device usability was the most important characteristic affecting consumers' choice of mobile connection. (See Figure 2.) In rural communities, consumers have basic knowledge of mobile phone functionality. But the design must be clear and the device simple to facilitate quick and reliable connection.

Consumers in this phase felt that the usefulness of a mobile connection during emergencies is a key value proposition. The ability to contact people quickly-the number-one value proposition cited by the phase-one focus groups-was also noted as a key value point. These findings point to the strong need for executives to understand their customers' needs more precisely, as these needs may vary across geographies and age groups.

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Without an accurate understanding of rural consumers' needs, operators' product development and sales and marketing efforts may backfire. For example, a campaign using style or status as a motivator might fail to catalyze adequate uptake. Companies will realize a better return on their marketing spend if they focus on motivators that ranked higher with consumers-such as phone durability or privacy.

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Aspects of a communication device	% responses*
Ease of use	21
Usefulness during emergencies	19
Ability to contact people quickly	13
Reasonable price	10
Usefulness in keeping in touch with family	9
Low ongoing operating cost	5
Usefulness while traveling outside the city or village	4
Usefulness in contacting customers or suppliers	3
Efficient alternative to normal telephone lines when busy or not working	3
Ease of Charging	3
Usefulness while traveling within the city or village	2
Support for finding information quickly and easily	2
Makes life easier	2

* Does not total 100% because some respondents did not rank all options.

Figure 2: Aspects of Communications Devices most Important to Rural Consumers

Our findings also suggest that mobile operators should use bundled handsets and prepaid cards as a base platform, and then provide value-added services that make consumers feel they own a differentiated product. Moreover, if privacy and reliability override entertainment as a priority for rural consumers, then operators may have to market a prepaid connection with an instrument that has longer battery life and that can re-charge itself through renewable power sources (such as solar and wind).

POTENTIAL BARRIERS TO BECOMING A MOBILE CONSUMER

What are possible obstacles to rural customers' adoption of mobile services? Are barriers primarily about cost, inability to pay, insufficient education, inadequate infrastructure, lack of information or some other issue? Again, our study revealed both consensus and disconnect.

Consensus...

According to the executives and consumers in phase one of our study, the primary obstacle for rural consumers to become mobile customers is cost of the handset. (See Figure 3.) Rural consumers want handsets with attractive basic features- camera, speakerphone, torchlight-at an affordable price. As one executive mentioned, "While consumers are looking for affordability, they are also looking for functionality. This means that for rural consumers, 'cheap' is not equal to 'de-featured.' Affordability does not come by taking something out of the handset."

Types of barriers	Top three Barriers to Mobile Adoption Identified by:	
	Rural consumers	Senior Executives
Cost of handset	1	1
Lack of mobile infrastructure leading to poor reception	2	2
Inability to access electricity when required for charging the handset	3	
Lack of information on available offerings		3
Inability to identify benefits from having mobile connectivity		
Inability to understand differences in tariff plans		
Lack of confidence to pay for the mobile service in a sustainable manner		
Absence of maintenance and after-sales support		

Figure 3: Barriers to mobile take-up in rural India: Executives' v. consumers' perspectives

...and disconnect

The third most important barrier noted by executives we surveyed did not align with rural consumers' views. Executives cited a lack of information available to rural customers about a company's offerings. Operators believe that despite their marketing efforts, rural customers lack detailed information about individual providers' distinctive services.

The consumers, however, did not see this as a top barrier to adoption. They seemed to have a strong general understanding of mobile offerings, though perhaps not a detailed understanding of how one operator differs from another. Whether that situation is unique to rural areas or something also experienced by urban customers (given the growing complexity of

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mobile products) has yet to be determined. According to one senior executive, operators must "create simple tariff plans . . . so the customer [can] compare [them] with other tariff plans easily and make a choice."

A final barrier mentioned by consumers but not industry executives was the concern that rural areas may not have consistent access to electricity to keep mobile phones charged.

PROBING BARRIERS TO ADOPTION

Our phase-two research examined potential barriers more closely. (See Figure 4.) The primary concern, mentioned by 36 percent of consumer respondents, was the cost of the device-echoing the opinions of our consumer focus groups. The next most important barrier was the cost of operating the device.

Barriers	% response*
Cost of a mobile phone is too high	36
Cost of making calls is too high	18
Mobile phone not needed	14
Using a mobile phone is difficult	6
Mobile phones are easily damaged	5
Poor network coverage	4
Mobile phones are too small	3
Difficult to understand various payment schemes	3
Not allowed to use a mobile phone by family / parents / husband	3
Difficulty in acquiring a mobile phone connection	2
Poor reception	2
Confusing advertisements and sales calls	1
Health risks	1

* Does not total 100% because some respondents did not rank all options.

Figure 4: Most important barriers to adoption according to rural consumers

Usability and durability of the device were also on consumers' minds. Fourteen percent of those we surveyed about barriers to adoption said they simply do not need a mobile phone. Still, high percentages of rural residents who are not yet mobile customers said they intend to connect in the next three months. (See Figure 5.) Fifty-four percent cited at least a 50-50 chance that they will purchase a mobile phone soon. For almost one in five, that chance is above 80 percent.

Intention to be a mobile subscriber during next three months	% responses
99 chances in 100	7
90 chances in 100	4
80 chances in 100	8
70 chances in 100	9
60 chances in 100	10
50 chances in 100	16
Below 50 chances in 100	46

Figure 5: Mobile Connectivity Intentions of Rural Consumers During Next three Months

IMPLICATIONS

Misunderstandings about the barriers preventing consumers from adopting mobile services could sabotage operators' attempts to procure mobile customers in rural areas. For example, operators could strive to reduce handset costs with manufacturers and develop special handset subsidization packages. But these efforts will fall flat if what consumers really need are tariff plans that reduce ongoing costs or bundled services that provide better value and thus justify the costs.

Moreover, operators may fail to fully appreciate reliability of electricity access as a barrier to adoption in rural India. For instance, the power grid efficiencies may vary across regions. Perhaps most important, attempts to construct a sustainable infrastructure in mountainous or otherwise challenging terrain could encounter delays. In addition, local approval processes and disputes over land titles and ownership can slow network deployments. The industry's fractured approach to providing mobile coverage will further slow infrastructure rollout and significantly add to individual operators' cost of this access.

OVERCOMING LACK OF AWARENESS OF NETWORK-ENABLED SERVICES

The second phase of our study uncovered another significant challenge confronting operators as they strategize about mobile expansion: consumers' lack of awareness of mobile services, beyond the functionality of the device itself. (See Figure 6.) Rural citizens who are not yet using mobile phones fully understand the functions of the device: making and receiving calls, camera, ring tones, and so forth. However, they are not so aware of network-enabled and other value-added services, such as mobile banking, SMS and Internet access.

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This finding is corroborated by responses to another question from our survey that asked consumers to rank the most important functions of the mobile instrument. Basic functions (camera, torch light, radio) scored quite highly, as did capabilities important to rural citizens specifically, such as dust resistance and a long battery life. (See Figures 6, 7 and 8.)

Awareness levels	Mobile telephony functions and services	
Universal Awareness (93% plus)	Incoming calls	Ring tones
	Camera	Radio
	Sim card	
High Awareness (75-89%)	Prepaid	Network
	Postpaid	Subscriber trunk
	Outgong	Dialing (STD)
Moderate Awareness (50-74%)	Signal	Speaker phone
	SMS	Picture messaging
	Memoery Card	
Low Awareness (Less than 50%)	Voice recording	Internet
	Alerts	International subscribers
	Voice mail	dialing (ISD)
	Mobile banking	Bluetooth
	Video conferencing	Called ID
	WiFi	Touch Screen
	CDMA	MMS
	GSM	GPRS

Figure 6: Awareness of Mobile Telephony Functions and Services by Rural Consumers

Features	% responses*
Camera	23
Dust resistance	19
Torch light	11
Long-life battery for extra battery	11
FM radio	8
Internet Access	6
Clock/alarm clock	6
Games	4
Reminders	2
Music	2
Speaker Phone	2
Quickly recharged / powered	2
Keypad instructions / buttons in common language	2
Video / movies	1

Figure 7: Most Important Instrument Features to Rural Consumers

Value-added services	% responses*
SMS	31
Download ringtones / wallpapers	19
Agricultural alerts / news in local language	9
Parenting alerts / news in local language	8
Games	7
Employment alerts / news in local language	5
Internet browsing / surfing	4
Weather alerts / news in local language	3
Mobile banking in local language	1
Video Conferencing	1
Picture messaging	1

* Does not total 100% because some respondents did not rank all options.

Figure 8: Most important value-added services to rural consumers

WHAT MOBILE NETWORK OPERATORS MUST GET RIGHT

Accenture research suggests that mobile network operators must do the following to expand successfully into India's rural areas:

DEEPEN THEIR UNDERSTANDING OF RURAL CUSTOMERS' NEEDS

Our research shows that mobile network operators have begun considering business models that can deliver profits from rural expansion. However, a disconnect remains in the industry's understanding of customer value propositions when it comes to mobile services. Until operators fully grasp those propositions, as well as barriers to adoption, they will struggle to profitably acquire customers in rural India. Simply "cutting and pasting" practices from the proven urban business model will not guarantee success in the rural market.

SEGMENT CUSTOMERS MORE NARROWLY

Operators must carefully consider which regions, towns and villages they will serve and in what timeframe. A one-size-fits-all approach will not help. Rural India contains a myriad of regions, segments and sub-segments, each with different needs and attributes. Operators must carefully analyze target customer segments, including their reasons for wanting to acquire a mobile connection and the types of services and products likely to be popular and profitable.

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PROVIDE APPROPRIATE AFTER-SALES SERVICE

To acquire and retain customers, operators must treat customers well before, during and after the mobile connection sale. Rural consumers do not want to feel abandoned after becoming mobile customers. But customer relationship management in rural markets is "very tricky," as one operator put it. These customers have unique cultural characteristics.

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For example, many of them find call-center protocols confusing. "The customer wants face-to-face servicing," said one executive we interviewed, "[but] achieving this in the geographically dispersed rural markets is extremely expensive." Companies are trying to develop an after-sales service and customer relationship management model that will enable them to satisfy consumers' desire for face-to-face interactions while managing the costs of delivering such a high-quality experience.

DEVELOP A CLEAR DISTRIBUTION STRATEGY

We found that rural consumers prefer retail outlets located in the nearest city, rather than in their own village or a nearby village. (See Figure 9.) One executive from a mobile services operator described how his company's rural customers traveled for many hours to a service center, so they could resolve their queries face to face. Accordingly, his company established low-cost contact points at various locations in two states. This reduced the time needed for consumers to receive personal service from four hours to just two. Consumers rewarded the company by continuing to remain on its network. Some companies are also partnering with local institutions such as the Indian Technical Institutes to train young people to provide after-sales technical services. This approach has helped operators provide more personalized service with lower investment.

Consumers also told us they wanted the ability to choose from multiple mobile phone brands and operators, at the point of sale. In addition, consumers showed a preference for retail outlets dedicated to mobile phones rather than stores that sell other products as well, such as groceries. They are willing to travel to large urban centers to find a mobile-focused retail store offering more product choices.

Meeting these needs is expensive, so companies should understand what consumers see as an effective retail presence before launching a distribution strategy.

Outlet location	To acquire a mobile instrument	z
	% Responses	% Responses
A shop in the city	64	60
A shop in nearby town / village	26	26
A shop in my village	10	14
Type of shop	To acquire a mobile instrument	To acquire a mobile connection
	% Responses	% Responses
Exclusive mobile showrooms with multiple mobile brands	51	39
Shops which sell multiple mobile brands	39	40
Exclusive mobile shops owned by manufacturers	8	4
Shops owned by service providers	2	17

Figure 9: Outlet Preferences of Rural Consumers

ADAPT TECHNOLOGIES AND PROCESSES TO THE RURAL ENVIRONMENT

Most operator employees are trained in information systems and business processes created to serve urban markets. Mobile operators must identify the technologies and processes needed to support rural business strategies. For example, while companies have invested heavily in customer segmentation, they have not yet determined how best to use the resulting data to connect rural populations to their network-and keep them connected.

COLLABORATE TO ADDRESS THE INFRASTRUCTURE CHALLENGE

The mobile industry must address a number of infrastructure issues to expand into India's rural markets. For example, when we asked rural customers what aspects of the service environment mattered most to them, we found that reliability of network coverage and quality of the connection ranked higher than quality of customer service or type of tariff or payment plan. (See Figure 10)

Aspects	% responses
Reliability of network coverage	55
Quality of connection	54
Extensive network coverage	52
Quality of customer service	51
Ease of getting connection	51
Ease of pre-paid connection extending / getting recharge cards	49
Special offers	47
Tariff / payment plans	36
Discount schemes	34
Other value-added Service Such as caller ring-back tones, devotional songs etc	30

Figure 10: Most Important Service Aspects to Rural Consumers

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Operators are considering ways to overcome the infrastructure challenge. Possibilities include acting individually, partnering with an infrastructure provider and collaborating in an industry-wide initiative to provide one network to rural India. Rolling out a mobile services network alone will be costly and time consuming, and will likely prompt executives to question the wisdom of entering this market. Moreover, it will be difficult, perhaps impossible, to pass the resulting costs on to rural customers, as cost is a primary barrier to adoption of service. For these reasons, partnering with an infrastructure provider or collaborating in an industry-wide strategy seems more promising.

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REDUCE OPEX

Operators must focus on cutting operating expenses, which are concentrated in marketing and after-sales service. According to one executive we interviewed, companies can reduce OPEX by using local resources in rural markets. Another executive added that mobile operators must share passive and active infrastructure, and that the government should fund the creation of passive mobile assets in rural areas.

USE OUTSOURCING TO CONTROL COSTS

Some practices that have reduced the cost of acquiring urban customers may succeed in rural markets too. An example is the outsourcing of infrastructure creation and maintenance activities such as network access and repair, and of business functions such as finance, procurement and customer service.

DEVELOP INNOVATIVE, VALUE-ADDED SERVICES

While rural consumers are aware of the mobile value proposition, it is becoming increasingly expensive to acquire them, to encourage them to use a variety of value-added services and to retain them. As one of our interviewees, from a content aggregator, put it, "Rural markets are offering volume, but what about value?" Another executive commented, "The way a company positions value-added services as a part of the package delivered to the consumer is going to define the revenue mix." Executives we surveyed unanimously agreed on the importance of value-added services as a driver of new mobile connections and a way to increase ARPU rates in rural markets.

Our interviews suggest that mobile operators aim to achieve at least 20 percent ARPU in rural markets from value-added services, with 80

percent coming from voice products. One executive noted, "While this mix is ambitious, it is very much possible." Explaining how this could be achieved, an operator executive pointed out the growing proliferation of wireless Internet data cards in villages. According to this interviewee, many young consumers use the cards to make voice calls as well as to access data and other value-added services from mobile network operator portals. This has fueled sales of value-added services across some rural markets in India.

AS AN EXECUTIVE FROM A CONTENT-DEVELOPMENT COMPANY EXPLAINED

Rural ARPUs are very low, and voice alone will not support sufficient revenues, because voice rates are so low in India and steadily going down. Value-added services will increase revenues and . . . the number of subscribers, because more people will buy the service for the first time and many people will come back to it if they see value. Value-added services could also be points of differentiation, as consumers [choose] carriers. If a particularly important service is available only from one carrier, or only available in an attractive format from that carrier, that can be the difference in the consumer's choice.

Mobile operators, handset manufacturers and content providers must also develop services that help rural business customers, such as farmers, succeed. An executive at a company that provides mobile content services for farmers explained, "Having the right information at the right time is extremely critical for [this] sector [in managing] production and marketing risks."

DEVELOP RURAL-CENTRIC MARKETING CAPABILITIES

According to a senior executive of a handset manufacturer, operators must identify the entity with whom they should "piggyback" to cut costs of reaching rural consumers. Another mobile services provider noted, "It makes sense to locate influential people in the village community and explore the opportunity to use them to market your voice and value-added services offerings." To sell re-charge cards, one senior executive suggested partnering with agencies selling fertilizers and seeds.

An executive at a value-added services provider also stressed the importance of training sales, after-sales and marketing teams to engage in "rural-centric marketing." Even the best tariff plans and the most useful value-added services will not achieve the desired results if they do not accommodate the unique rural environment.

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For example, we found that personal relationships-with family, friends and neighbors-are rural customers' most important information sources. (See Figure 11.) Physical showrooms ranked high as well. The importance of personal relationships dictates different forms of marketing; for example, leveraging the power of a social network rather than one-to-one communication. To achieve better rural-centric marketing capabilities, companies must forge partnerships for sales and service in India's rural areas, as these areas lack a dedicated mobile retail presence. Innovative solutions may include using a bank or other companies with a national presence to sell mobile phones. If each operator creates its own retail presence in rural areas, the business case for rural expansion will come into question. An industry-wide solution may provide the best financial model.

Sources of Information	Mobile handset % responses	Service Provider % responses
Family/friends/colleagues/neighbors	91	77
Mobile phone showroom	73	60
Television	59	34
Newspaper	48	22
Recharge coupon centre	40	29
Radio	29	14
Grocery store	6	2
Internet	4	2
Fertilizer shop	2	1

Figure 11: Most trusted sources of information to rural consumers

CONCLUSION: ACHIEVING HIGH PERFORMANCE IN NEW MOBILE MARKETS

India's rural markets present a significant opportunity for continued growth of the mobile industry and for the economic health of the country as a whole. However, operators must overcome significant challenges to provide mobile coverage profitably to rural populations.

According to the executives we interviewed, generating sufficient cash flow from a rural business model is the key difficulty facing operators looking to expand their mobile presence in non-urban areas of India. Companies want to transform their rural initiatives into independent profit centers that do not require cross-subsidization by

their urban business. However, as one executive noted, "No one has yet cracked a business model for this." Executives are concerned about the long learning curve required to understand rural customers' distinctive needs and to devise a compelling suite of products and tariffs.

The senior executives in our study agreed that the possibility of achieving high margins on a pre-paid rural connection is not strong in the short term, even as 95 percent of the rural consumers we surveyed said they favor a pre-paid plan. One senior executive from a mobile operating company pointed out that, given the low ARPUs in rural markets, companies should use a cost structure 30-40 percent below the one used to serve urban markets.

According to another executive, "[It's] going to be a volume game"-companies will need to minimize costs while simultaneously achieving the desired rural penetration to gain a first-mover advantage. However, focusing only on cost does not constitute a successful business model. Our research shows that operators must also provide value-added services appropriate to rural customers. The development of agricultural market information and sports downloads on a mobile device are good examples of innovative, value-added services that have proved useful to rural consumers.

Such services will likely be the main differentiator between operators in rural India. Differentiation on price alone, as the industry has discovered in urban markets, will only erode profitability.

THE RISE OF INDIA'S MOBILE INDUSTRY

India's mobile industry has enjoyed unusually strong growth over the past decade. (See Figure 12.) With its mobile subscriber base expanding at a compounded annual growth rate of 76.3 percent from 1998 to 2008, India has emerged as a key market destination for mobile telecom operators.

Operators have also enjoyed high levels of profitability: Although India's mobile subscribers have among the lowest ARPU rates in the world, operators have managed to maintain high margins of 30-35 percent. Valuations of mobile operators in India remain extremely robust, in part thanks to the market's sustained growth and implementation of business model innovations such as network sharing and outsourcing.

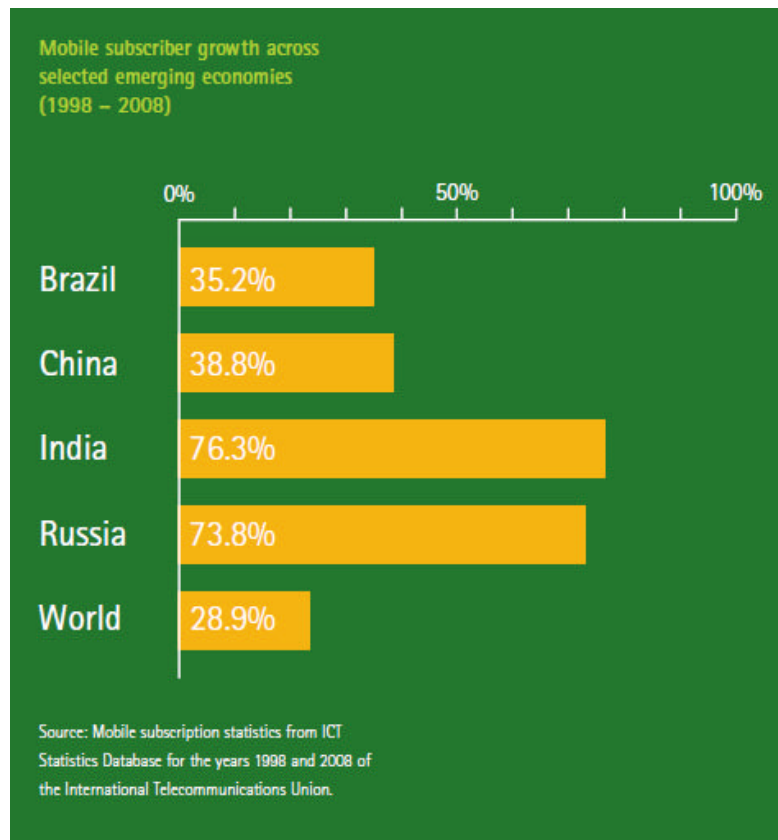


Figure 12: Mobile subscriber growth rates across selected emerging economies (1998-2008)

However, maintaining such profitable growth will be challenging. Mobile competition is fiercer than ever, and tariffs have fallen almost 95 percent since the start of the decade—from 14.5 to .72 rupees per minute over 1998-2010. This decrease has prompted companies to find fresh ways to drive innovation, tap new revenue sources and reduce costs. The granting of new operator licenses in India will bring several new entrants and mobile virtual network operators (MVNOs) into the market. The latter will likely siphon off existing profitable customers from urban markets. Accenture's analysis shows that churn rates in India continue to exceed 40 percent annually. We attribute this in part to the fact that about 90 percent of customers are prepaid users, who switch providers easily.

These are unusual numbers in the global mobile marketplace. Understandably, many mobile network operators in India question their

business viability. Mobile network operators' expansion into rural regions of India therefore represents a critical business strategy. Such expansion is also important to India's overall economic growth. A recent study conducted by the Indian Council for Research on International Economic Relations (ICRIER) has found a measurable relationship between mobile penetration and economic growth. According to this research, Indian states with 10 percent higher mobile phone penetration will enjoy a 1.2 percent higher annual average growth rate than those with a lower penetration. The study also found that a critical threshold is mobile penetration of 25 percent or more, at which point greater economic benefits begin to accrue. Many rural states in India have not yet reached that threshold.² (See Figure 13.)

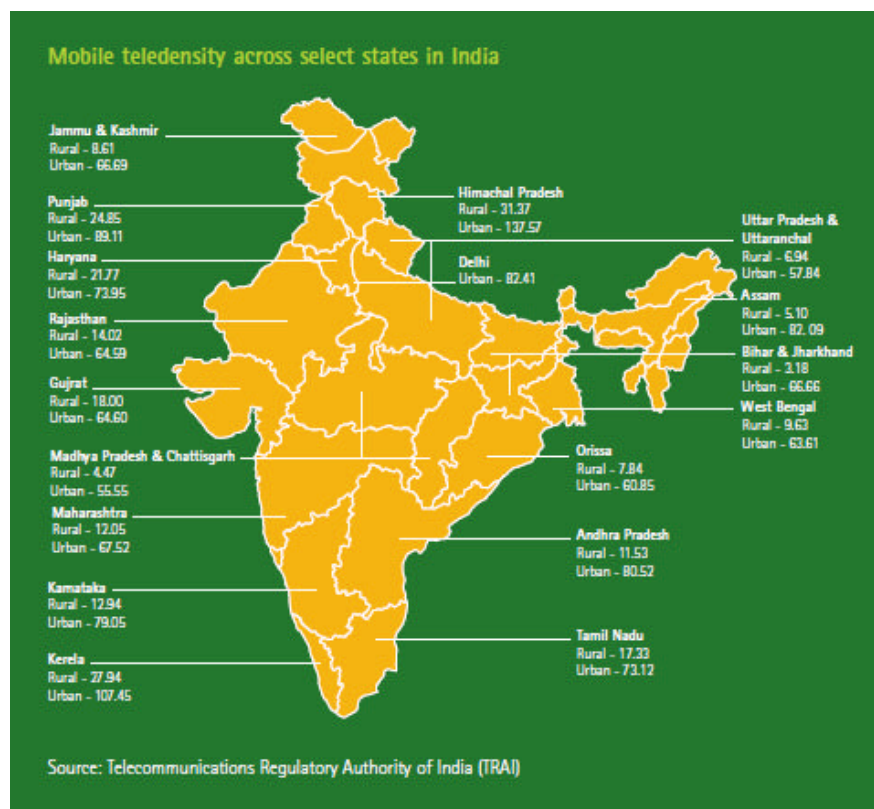


Figure 13: Mobile teledensity across select states in India

² ICRIER, "An Econometric Analysis of the Impact of Mobile," *India: The Impact of Mobile Phones, The Policy*

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END NOTES

1. "Measures to Improve Telecom Penetration in Rural India - The Next 100 Million Subscribers," December 2008, Telecom Regulatory Authority of India (TRAI).

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ACKNOWLEDGEMENT

"We are very grateful for the support and direction provided by Dan O'Brien and Rajesh Sennik to keep this research, focused and business-centric".

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