

## Idea- Vodafone merger – Can it be a game changer

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In March 2017, Idea cellular decided to merge with Vodafone to create India's largest telecom firm. The merger of the second largest and the third largest telecom company is expected to create the largest service provider in India. The debt-ridden entities expect the merger to bring down the cost of operations and strategic move to address the cut-throat competition from the current market leader- Airtel and disruptor- Reliance Jio. With Indian telecom sector growing at a rate of 19.6 percent can the new entity change the market dynamics?

### Idea

Idea is part of the Aditya Birla corporation which was established in 1995. The telecom service provider has a network coverage in 4,00,000 towns and villages across the country with a subscriber base of 202.06 million. It has a fibre network of over 1.5 lakh kms. The company received the prestigious ET Telecom Award, 2017, for Best Enterprise Mobility Solution and Golden Peacock Award for Corporate Social Responsibility in 2016 (Idea website). Idea is among the top three mobile operators with an annual revenue of more than USD 5 billion in 2017.

### Vodafone

Vodafone India is the wholly owned subsidiary of Vodafone group -UK which started its Indian operations as VodafoneEssar by acquiring 67 % stake in Hutchinson Essar in May 2007. In 2011, the company increased its stake to 74 % and the company was renamed as Vodafone India limited (Previously Vodafone Essar Limited). In 2013, the Vodafone increased its stake



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The case writer(s) Jayakrishnan S, Assistant Professor - Marketing, SDMIMD, Mysore may be reached at jayakrishnan@sdmimd.ac.in Author(s) have prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of the situation. The case is related to a sector and a specific company. The case is based on the information available in the public domain. This publication may not be digitized, photocopied, or otherwise reproduced, posted, or transmitted, without the permission of SDMRCMS, SDMIMD, Mysore. For Teaching Notes please contact sdmrcms@sdmimd.ac.in.

to 100% following Indian governments policy to increase Foreign Direct Investment (FDI) in Telecom sector by 100 %. The telecom service provider has operations in 22 telecom circles with a customer base of 210 million customers and revenue of more than USD 1.1 billion during 2017-2018. The company was recognised as the Best Enterprise Service Provide - SMB' award in 2016 from Frost and Sullivan. (Vodafone website)

### Overview of Indian Telecom sector

India is the second largest telecommunications market with a subscriber base of 1.202 billion in 2017 (IBEF,2018). The sector contributes 6.5 percent to GDP in 2017 and generates 4 million jobs in direct or indirect manner. (KPMG, 2017). Indian telecom sector is highly pricesensitive with majority being prepaid customers with low average revenue per user (ARPU) along with the competition among the players have resulted in lower operating margins in this sector. The revenue growth for the sector is approximately 7.31 percent and currently estimated to be USD 20.4 billion. Telecom subscription is growing at the rate of 19.22 percent which is considered as a positive sign for the industry growth.

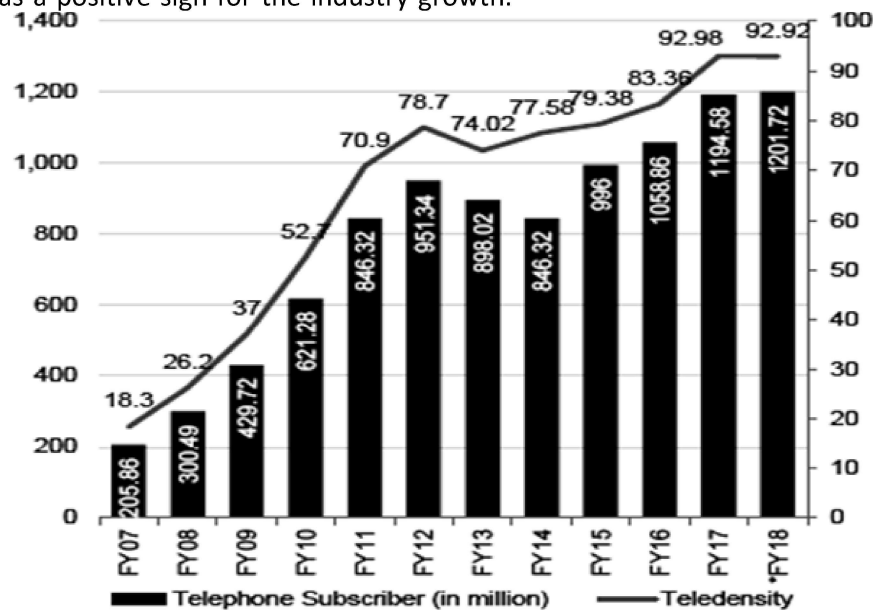


Figure 1: Growth in Total subscribers (Source- IBEF,2018)

The cumulative revenue growth rate for the sector is 7.31 percent and valued to be USD 42.6 billion in 2017 (Refer Appendix Figure-1). One of the biggest challenges faced by Indian Telecom sector is the increasing debt of the operators and constraints on achieving profitability over the years. The entry of new players has made the sector more competitive.

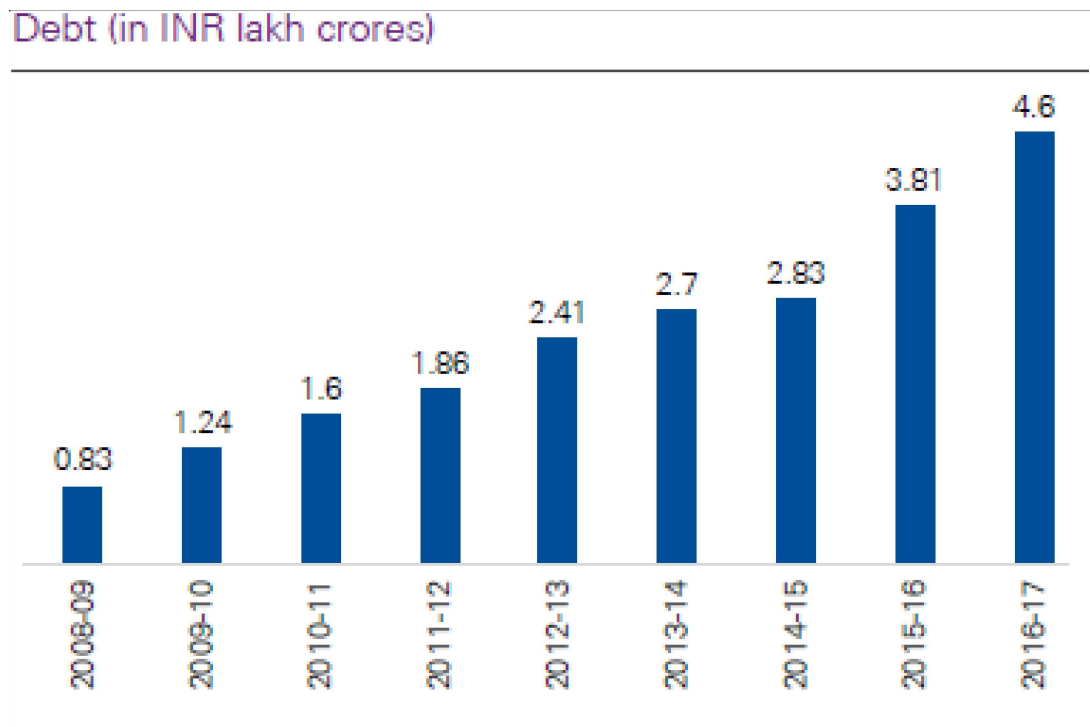


Figure 2: Year-wise debt of the Telecom industry  
(Source: Cellular Operators Association of India report)

Wireless segment dominates the Indian market which is about 98.04 % of the total telecom subscriptions. Urban regions hold the majority share (58.04 %) of telecom subscriptions. The wireless subscribers stood at 1,178.2 million in October 2017 (IBEF, 2018). India is the second largest smartphone market and is expected to have 1 billion unique mobile subscribers by 2020. The wireless segment in 2018 is dominated by Bharati Airtel followed by Vodafone and Idea. (Refer Figure 3).

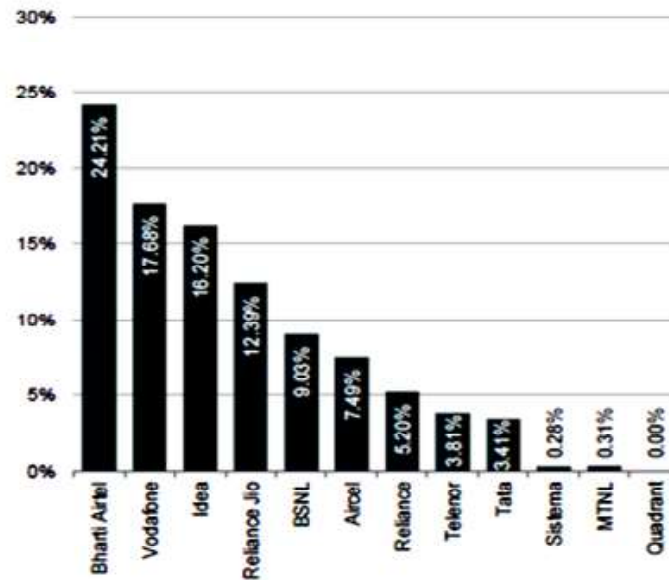


Figure 3: Market share of service providers Wireless segment (2018)  
(Source: IBEF,2018)

The fixed line segment is dominated by BSNL with a market share of 53.86 percent followed

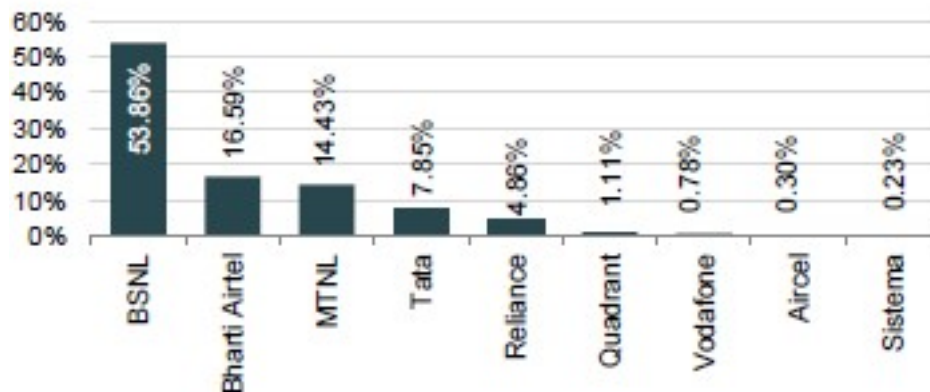


Figure 4: Market share of service providers – Fixed line segment (2018)  
(Source: IBEF,2018)

The broad band market (Wired and wireless) is dominated by Reliance Jio with a market share of 42.91 percent followed by Airtel (19.67 %), Vodafone (14.23 %) and Idea (9.12%) [IBEF,2018]. One of the emerging trends in the industry is creation of telecom tower companies to reduce operating cost and to improve the capital structure.

### **Merger – Can it make a difference**

In a highly competitive telecom market, the merger of Idea and Vodafone is expected to create telecom behemoth which will bring operational efficiency and profitability to these two entities. Vodafone will have 45% of the stake followed Idea (26%) and rest by public shareholders (Business line, 2017). But with an estimated debt of INR 1200 billion (USD 17 billion) [Kant,2018] it will be a tough task for the merged entity to be profitable due to market consolidation. The cumulative subscription base of the company is estimated to touch 400 million which makes it the largest telecom service provider in India and the most indebted telecom company in comparison with its competitors like Airtel and Reliance Jio. Both the companies (Idea and Vodafone) are constrained by lack of non-mobile revenues. The experts suggest that the merged company need to make significant investment in improving network quality, focus on segments, products and services which competitors have limited presence.

The merged entity will be the largest mobile phone operator. The priority area for the company is effective cost-cutting measures for profitability. The steps taken by the company include rationalisation of its distributors and tower networks, reduced advertisement spending and marketing, a recruitment freeze and closure of redundant offices across circles. By rationalisation of towers and networks, they can reduce the operational costs. The two operators together offer services through more than 250,000 towers. So, tower rationalisation at overlapping sites can add to cost reductions. One of the key areas in which the company is focusing is to offer attractive price plans to ensure its brand attractiveness and regain the lost market share. The new entity - Vodafone Idea Ltd can raise INR 5100 crore by selling the 11.5 % stake of Idea cellular in Indus (Telecom tower company) which is a venture between Aditya Birla Telecom Ltd, Vodafone and Bharti Airtel (ET, 2018). The company feels that the series of steps taken can reduce the debt to certain level.

Some of the key strengths of the merged company is the cumulative subscriber base of 39 crore which is higher than Airtel's 27 crore and Reliance Jio's 7.2 crore (ET, 2017). The market share of the merged entity would be 40 % which is higher than its nearest competitor (Airtel)-40%. The telecom sector is currently growing at a rate of 21.64 % for the past ten years which is a positive sign for the merged company and industry (IBEF, 2018). But with increasing tariff wars, debts, declining revenues and spectrum license fee; whether the merger between Idea and Vodafone will be a game changer or not in Indian Telecom industry.

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## Appendix

### Balance sheet – Idea cellular Limited -2017 (in Indian Rupee)

₹ Mn

Particulars	Notes	As at March 31, 2017	As at March 31, 2016	As at April 1, 2015
<b>ASSETS</b>				
<b>Non-current assets</b>				
Property, plant and equipment	7	221,885.23	209,633.63	178,155.65
Capital work-in-progress		13,243.96	6,613.48	8,481.23
Intangible assets	8	539,364.60	440,079.35	142,165.08
Intangible assets under development	8	62,048.00	53,774.79	42,313.23
<b>Financial assets</b>				
Non-current investments	9	22,265.98	16,668.52	16,466.07
Long term loans to employees		25.82	24.98	24.51
Other non-current financial assets	10	5,079.07	9,107.37	6,602.68
Other non-current assets	11	27,497.41	12,891.53	26,656.77
<b>Total non-current assets (A)</b>		<b>891,410.07</b>	<b>748,793.65</b>	<b>420,865.22</b>
<b>Current assets</b>				
Inventories	12	542.10	851.46	582.98
<b>Financial assets</b>				
Current investments	13	40,247.09	8,328.46	111,743.43
Trade receivables	14	12,580.95	11,360.58	9,321.71
Cash and cash equivalents	15	268.60	7,515.42	15,365.93
Bank balance other than cash and cash equivalents	16	44.05	61.21	53.45
Current portion of loans to employees		20.60	16.61	16.99
Other current financial assets	17	402.88	917.63	4,325.27
Current tax assets (net)		-	-	3,180.71
Other current assets	18	12,091.71	8,551.85	7,515.92
		<b>66,197.98</b>	<b>37,603.22</b>	<b>152,106.39</b>
Non-current assets classified as held for sale (AHFS)	19	16.11	154.96	22.34
<b>Total current assets (B)</b>		<b>66,214.09</b>	<b>37,758.18</b>	<b>152,128.73</b>
<b>Total Assets (A+B)</b>		<b>957,624.16</b>	<b>786,551.83</b>	<b>572,993.95</b>

Source: Idea cellular Limited (2018)-Annual Report 2016-2017(In Millions)

**Profit and Loss statement- Idea Cellular Limited-2018 (in Indian Rupee)**

₹ Mn			
Particulars	Notes	For the year ended March 31, 2017	For the year ended March 31, 2016
<b>INCOME</b>			
Service revenue		352,565.12	357,725.12
Other operating income	30	221.34	311.78
<b>Revenue from operations</b>		<b>352,786.46</b>	<b>358,036.90</b>
Other income	31	1,970.25	1,773.43
<b>TOTAL INCOME</b>		<b>354,756.71</b>	<b>359,810.33</b>
<b>OPERATING EXPENDITURE</b>			
Employee benefit expenses	32	16,256.38	14,735.23
Network expenses and IT outsourcing cost	33	106,648.54	92,655.82
License fees and spectrum usage charges	34	40,514.83	41,507.83
Roaming and access charges	35	42,754.44	46,653.46
Subscriber acquisition and servicing expenditure	36	31,441.66	30,019.48
Advertisement and business promotion expenditure		4,554.02	4,833.19
Administration and other expenses	37	9,668.17	8,686.00
		<b>251,838.04</b>	<b>239,091.01</b>
<b>PROFIT BEFORE FINANCE CHARGES, DEPRECIATION, AMORTISATION AND TAXES</b>		<b>102,918.67</b>	<b>120,719.32</b>
Finance costs	38	40,108.53	17,778.52
Depreciation	7	48,642.82	47,716.68
Amortisation	8	28,357.35	14,515.61
<b>PROFIT/(LOSS) BEFORE TAX</b>		<b>(14,190.03)</b>	<b>40,708.51</b>
Tax expense:			
- Current tax	56	-	8,621.82
- Deferred tax	56	(5,879.28)	5,623.81
<b>PROFIT/(LOSS) AFTER TAX</b>		<b>(8,310.75)</b>	<b>26,462.88</b>
<b>OTHER COMPREHENSIVE INCOME / (LOSS)</b>			
<b>Items not to be reclassified to profit or loss in subsequent periods:</b>			
Re-measurement gains / (losses) of defined benefit plans	53	(49.49)	(205.48)
Income tax effect		17.13	71.11
<b>Other comprehensive income / (loss) for the year, net of tax</b>		<b>(32.36)</b>	<b>(134.37)</b>
<b>TOTAL COMPREHENSIVE INCOME / (LOSS) FOR THE YEAR</b>		<b>(8,343.11)</b>	<b>26,328.51</b>
<b>Earnings per equity share (in ₹):</b>	<b>58</b>		
Basic		(2.31)	7.35
Diluted		(2.31)	7.33
The accompanying notes are an integral part of the Financial Statements			

Source: Idea cellular Limited (2017)-Annual Report 2016-2017(In Millions)



### Financial Summary – Vodafone India Limited- 2018 and 2017 (in Indian Rupee)

Key Financial Summary			
INR crores	H1FY18	H1FY17	YoY%
Service revenue	19,002	22,579	-15.8%
EBITDA	4,075	6,704	-39.2%
EBITDA margin (%)	21.4%	29.6%	-8.2pp
Capital expenditure	2,915	3,356	-13.1%
Capital Intensity	15.3%	14.8%	+0.5pp
OFCF	1,543	3,307	-53.3%

\* Net Debt for Vodafone India standalone for H1FY18 is c. INR 618 billion

OFCF- Operating Free cash flow

Source: Vodafone India Limited (2018)- Half Year results.

### Telecom sector revenue in India (USD Billions)

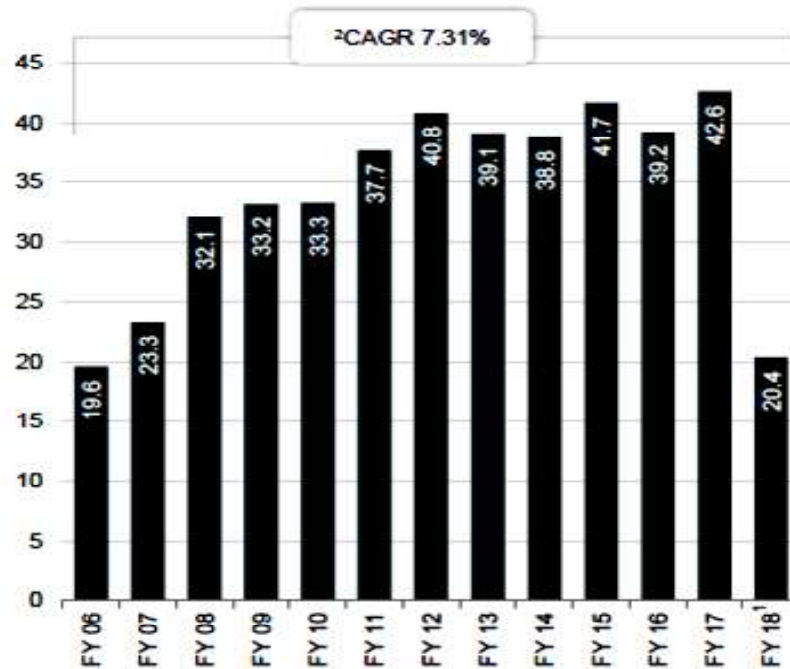


Figure 1: Telecom sector revenue (Source: IBEF,2018)

