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ROLE OF FDI IN INDIAN TELECOM INDUSTRY

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Role of FDI in Indian Telecom Industry

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The Indian Telecom services sector is one of the fastest growing sector in the world. India has become the fifth largest network in the world in terms of number of telephones after China, U.S.A., Japan and Germany with 100 million telephone subscriptions by April 13th, 2005. India's tele-density is 9.17 per cent compared to China 55 per cent and more than 100 per cent in case of U.S. A., Japan and Germany. The total number of mobile shares in India was 50.8 million with global system for mobile communications (GSM) sector alone accounting for over 48 million connections.

Analysts expect that the mobile industry in India probably grow at a compound annual growth rate of 31 per cent by 2008 — that is the highest growth in Asia Pacific region. Two key factors are responsible for this great growth are: one, the availability of cheaper handsets with better functionality, which lowered the entry barrier and perfectly suited to Indian conditions such as dust resistance, battery capacity, etc. and the second, a significant dip in tariffs from a level of around Rs.16 a call and chargeable incoming call to a low tariff regime of Rs. one a call and handsets too have undergone sea change.

With the liberalisation in the Indian Telecom Industry, the industry is subjected to an intense competition, especially within the cellular services. Competition is likely to keep subscription growth high and pressure on prices. It also requires operators to increase capital investments to expand services. The government has also increased the limit of foreign direct investment (FDI) in telecom providers

from 49 per cent to 74 per cent. This change may also give many players access to more capital in general and foreign capital in particular for expansion of their network, thus, increasing competition.

The Indian telecom service sector is becoming one of the fastest growing sectors in the world. The Government of India recently increased the limit on FDI in telecom providers from 49 per cent to 74 per cent. The higher FDI has led to the increase of urban tele-density.

Meanwhile, according to Reserve Bank's 2003 study on the financial performance of the FDI companies for the period 1999-00 to 2001-02 indicates that the performance of private limited FDI companies is much different from that of public limited FDI companies. Imad Moosa (2002) has explored the 22 plus characteristics, determinants and effects of FDIs. In addition, a number of other studies have examined the relationship between inward FDI and economic growth in the developing host countries. A generally accepted conclusion is that FDI has played a significant role in promoting economic growth in host country through providing a package of capital, managerial skills and technical skills.

Alleman (2002) observes that most infrastructure investments can positively affect the economy in three ways. 1. It can reduce the cost of production. 2. It can increase the revenues. and 3. It can increase employment through both direct and indirect means. On the other hand, Eggleston (2002) shows how basic telecommunication infrastructure can create a 'digital divide' by making

market efficient through information dissemination to isolated and information-deprived locals and improving the living standards of the world's poor, which, in turn, accelerates growth.

Jain and Sridhar, (2003) pointed to improve rural tele-density by reducing the cost of access loop for providing telecom services using technologies such as wireless local loop. It is also imperative to improve the economic activity of the rural areas using telecommunication related to services so that the rural population has enough disposable income to purchase telecom services mentioned by Soultter (1999).

Methodology

The basic objectives of the study are to review the growth of telephony in India in terms of tele-density and to assess the role of FDI in this sector. That linking FDI to the parameters of the reduction of tariffs, increase of tele-density, and higher FDI automatically brings telecom services into the areas (rural India) not being served earlier has been analysed. This paper is based on secondary data collected from records of Department of Telecommunications (DOT), Telecom Regulatory Authority of India (TRAI), annual reports, Economic Surveys of Government of India, newspapers and research journals etc. The study period covers from January 1999 (After NTP '99) to April 13th 2005. To study the penetration of telecom services, annual growth rates calculated and presented in Bar, Pie, Scattered charts and tables. This paper, besides, covers milestones in telecom sector, FDI inflow, and sector-wise FDI inflow, country-wise inflow and tele-density and fall of tariff liberalisation in telecom sector and the role of FDI in terms of national security.

Prior to liberalisation in telecom market during the mid-1991, the provision of telecom services in India

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Table-1 — Milestones In Telecom Reforms

1984	Manufacturing of subscriber terminal equipment to private sector.
1985	Telecom was constituted into a separate department with a separate board.
1986	MTNL and VSNL created as corporations.
1988	Government introduces in-dialing scheme. PABX services only within a building, or in adjoining buildings.
1989	Telecom Commission formed.
1991	Telecom equipment manufacturing opened to private sector. Major international players like Alcatel, AT&T, Ericsson, Fujitsu and Siemens entered equipment-manufacturing market.
1992	Value-added services sector opened for private competition.
1993	Private networks allowed in industrial areas.
1994	Licenses for radio paging (27 cities) issued.
May 1994	National Telecom Policy announced.
Sep. 1994	Broad guidelines for private operators' entry into basic services announced.
Nov. 1994	Licenses for cellular mobiles for 4 metros issued.
Dec. 1994	Tenders floated for bids in cellular mobile services in 19 circles, excluding the four metros, on a duopoly basis.
January 1995	Tenders floated for 2nd operator in basic services on a circle basis.
July 1995	Cellular tender bid opened.
August 1995	Basic service tender bid opened; the bids caused lot of controversy.
January 1996	Rebidding takes place for basic services in 13 circles. Poor response. The Telecom Regulatory Authority of India (TRAI) formed by ordinance.
October 1996	LOIs being issued for basic services.
March 1997	The TRAI Act passed in Parliament.
June 1998	Several VAS available through private operators. The first private basic service becomes operational.
March 1999	'New telecom policy announced
July 2000	First private ISP gateway inaugurated
May 2001	FDI limit in ISP enhanced (74% with gateway and 100% without gate way)
April 2002	First license for Internet telephony granted
January 2005	The state owned BSNL, MTNL have launched 'Broadband' services of 256 kbps @ Rs 500 per month
February 2005	FDI ceiling increased from 49% to 74 %
13th April 2005	Indian telecom sector crosses 100 million customers

Source: Culled from different research papers.

Table-3 — Sector Wise Fdi In Telecom

S.no	Services	(Rs in million)	
		FDI	%
1	Basic telephone service	3937	3.96
2	Cellular Mobile telephone	26646	26.78
3	Radio Paging service	910	0.91
4	E-mail service	688	0.69
5	V Sat service	281	0.28
6	Cable TV network + Internet	1704	1.71
7	Satellite telephone services	481	0.48
8	Radio trucking services	71	0.07
9	Manufacturing and Consultancy	15784	15.86
10	Holding companies	48420	48.66
11	Other Value added services	227	0.23
12	Automatic Route	361	0.36
TOTAL		99509	100

Source: TRAI 2004

solely within the state-owned operator, the department of telecommunication (DOT). But after the liberalisation, DOT, as an operator, has been split into Barath Sanchar Nigam Limited (BSNL), Mahanagar Telephone Nigam Limited (MTNL) and Videsh Sanchar Nigam Limited (VSNL). Following market liberalisation, basic services are now offered by BSNL, MTNL, and private operators.

At present there are nine operators providing basic wire fewer services in India. These comprises cellular local and long distance services offered by cellular operators through second-generation (2G) digital standards-global system for mobile communications (GSM) and Code Division Multiple Access (CDMA). Currently, there exists intense competition in wireless services, with 147 players in 22 service areas. Currently, National Long Distance (NLD) operators can provide only inter circle long distance services, except where they enter into mutual arrangements with access providers for carriage of intra-circle traffic. Presently, only four companies provide NLD services in India. Meanwhile, the milestones brought by economic reforms in Indian telecommunication sector have been presented in Table-1.

Table-1 shows that the Indian Telecom sector was wholly under Government ownership until 1984. But after that, it allowed manufacturing of subscribers terminal equipment to the private sector. The key driver for change in sector was the National Telecom Policy announced in May 1994. This policy paved the way for private sector participation in telecom sector. In 1997, the setting up of TRAI separated the regulatory function also into the hands of private sector. However, policy making and operations continued to be with the Department of Telecommunication (DOT). New Telecom Policy, 1999 (NTP'99) significantly focused on creating an environment which would enable continued attraction of foreign investment in the sector and a low creation of communication infrastructure by leveraging on technological development.

In May 2001, FDI limits on International Service Provider (ISP) enhances to 74 per cent with gateway and 100 per cent with pot gateway and internet telephoning services were launched in April 2002. Quite interestingly, 'Broad Banding' services were launched by BSNL and MTNL with a speed of 256 caps at the cost of Rs. 500 per month and the FDI ceiling enhanced to 74 per cent from 49 per cent on February 2, 2005. As on April 14 2005, telephone connections crossed the 100 million in India.

According to the working group of Tenth Five Year Plan on Telecom sector, an investment of Rs.1,60,000 crore is required to be made in this sector during the plan period, despite having foreign direct investment (FDI) Rs.99,508 crore. Even if domestic capital of this magnitude is available though it is doubtful, it would certainly be at the expense of investment in other sector where foreign investment may not enter readily. Clearly, then, foreign investment should be welcomed as means of adding to the cover all capital formation in the country. The telecom growth can be ensured through bringing down the cost of services. In the long run, prices will be come down only if the cost of delivering these services comedown, which requires upgradation of technology in telecommunication and capital infusion or FDI.

The economic model followed by India after independence relied much on import substitution and selective foreign capital inflow, both through portfolio investment and FDI route. This change radically with liberalisation measures of post-1991, both portfolio and FDI were not only allowed but also actively encouraged. The Foreign Investment Promotion Board (FIPB) was also created to approve FDI proposals speedily in most sector, particularly infrastructure.

Role of FDI in India

In case of India, the role of FDI in easing financial constraints becomes critical. According to Planning Commission, at current levels of efficiency in the economy, the increase in investment needed to achieve the overall

growth in Telecom sector. Since this addition to investment cannot come entirely from domestic sources, a substantial portion will have to be funded through FDI. Ultimately, FDI can enter India through two possible channel. 1. From the automatic route under which companies receiving FDI needed to inform RBI within 30 days of receipt of funds and issue of shares to the foreign investor. 2. For sectors that are not covered under the automatic route, prior approval is needed from FIPB.

FDI-Telecom Sector

The telecom service sector in India has been explosive in growth over the last two years. Revenue growth in the sector touched 16 per cent in 2003-04 and it is likely that a similar growth rate will be sustained in 2004-05, too. The mobile phone subscriber base grew to 41.46 million in April, 2005 from 13 million in March 2003. This rapid growth ultimately necessitates a sharp price in capital investment over the next few years. So far FDI inflow into the telecom sector \$ 2.6 billion between August 1991 and July 2004. Further, the industry estimates put up a quantum of investments required in the sector over the next four years at about \$20 billion. A substantial portion of this investment is to come from FDI. The FDI ceiling in telecom sector is as follows: A) FDI up to 100 per cent permitted for the following. i) Manufacturing of Telecom equipment, ii) Internet service (without international gateways), iii) Infrastructure Providers (category-1), iv) E-mail services, v) Voice mail services, vi) Call centres and IT enabled services.

B) FDI up to 74 per cent: i) Internet service (with international gateways), ii) Infrastructure Providers (category-II) and iii) Radio paging services.

C) FDI hiked to 74 per cent from 49 per cent: The Government of India recently hiked FDI cap in the telecom sector to 74 per cent from 49 per cent. The current FDI ceiling is allowed in certain services such as basic, cellular, Unified Access service, national/international long distance, Vast, Public Mobile Radio trunked Services (PMRTS), Global Mobile Personal

Communications services (GMPCS), and other value-added services.

Table-2 shows the actual inflow of FDI in telecom sector from 1993 to 2004. Table-3 shows the sector-wise actual inflow of FDI in Telecom sector on cumulative basis from August 1991 to March 2004.

Table-2 — Year Wise Fdi Inflow In Telecom In India

Years	(Rs in Million) FDI inflow
1993	20.60
1994	140.20
1995	2067.40
1996	7648.30
1997	12451.90
1998	17756.40
1999	2126.70
2000	2885.80
2001	39709.00
2002	10815.00
2003	3014.00
2004	874.20
Total	99509.50

Source: Telecom Regulatory Authority of India, July 2004

Rural-Urban Tele-Density

While it is perceived that there is sufficient competition in the urban areas, particularly for mobile telephony, telecom networks are yet to penetrate into the rural areas where around 72 per cent of Indians reside. Despite various policy stipulations, rural tele-density in India increased by a negligible 4 per cent in the last financial year from 1.49 phones per 100 persons in 2003-03 to 1.55 phones per 100 person in 2003-04 and as April 13, 2005 to 1.7 phones per 100 persons. During the same period, the urban-tele-density went up to 27 phones per 100 persons. Sadly, 85,228 villages are yet to be connected even by a basic telephones. As greater reliance is being placed on market-based policies, there is a natural concern that these may not address the basic issue of universal access to telephones and may further marginalise the rural areas and remote areas.

Despite Rs. 99,509 core FDI, the tele-density has increased hardly 4 per cent and left 72 per cent of the villages unconnected. Further, it has augmented the gap between Urban and Rural. Thus, that the higher FDI has led to the increase of urban tele-density has been proved and, nonetheless, in case of rural tele-density it has been disproved.

Fall in Tariffs

Market reforms undertaken in the past decade have certainly enhanced affordability of the telecom services, as is being reflected in the growing subscriber base. In particular, competition in the mobile segment has resulted in phenomenal growth, taking the overall tele-density to 9.17 per cent as of April 13, 2005, and drastically, reducing the waiting lists. An increase in the number of service providers has led to a remarkable fall in tariffs even in the face of inflation. In particular, tariffs for services have dropped from Rs. 14.5 per minute in March 1998 to Rs.0.77 per minute in March 2004. Thereafter, the NLD and ILD rates have also dropped in the wake of the private operator's entry and increased competition. The fall in tariffs and equipment costs have led to a substantial increase in the overall subscriber base and 100 million connections were made in India by April 13, 2005.

The introduction of competition of competition in International Long distance Services (ILD) by providing a license at Rs. 25 crore against Rs. 500 crore helped to reduce ILD tariffs far more significantly than NLD tariffs.

It is also to be noted that the increase in tele-density and promotion of household having access to a telephone will give a clearer indication of the performance of telecom sector after liberalisation. Similarly, the drastic fall in long distance tariffs has no implication for those without access to a telephone. In fact, the reduction in Access Deficit Charges (ADC) announced recently is yet another move towards dropping call charges and encouraging telephone subscribers to use their services more than before. The collections from ADC go to the fixed line operators who provide ordinary connectivity to areas deficient of access. However, the same objective — that of providing subsidy for rural connectivity — is also served by the Universal Service Obligation (USO). It is, therefore, imperative that eventually ADC and USO charges

are combined. This will substantially reduce the cost of long distance and international calls. And, thus, that the liberalisation with foreign equity (FDI) has led to the reduction of tariffs significantly in mobile and long distance services has been proved.

Criticism

Large investments are indeed required in the telecom sector. However, the connection that such investment would materialise only by FDI or increasing the FDI cap from 49 per cent to 74 per cent is suspicious. Obviously, it had been further argued that the "constraint to growth is not lack of capital but the cost of services, and this can be adequately addressed through an appropriate regulatory environment". An important reason why Indian telecom companies have failed to raise large amounts from the capital market (through initial Public Offerings) is the sense of uncertainty that plagued this sector. Private telecom companies and the government, including the regulator, TRAI, were almost always at loggerheads with one another and frequently embroiled in litigation. The telecom companies and the TRAI both claim that Indian tariffs are among the lowest in the world. With the latest technology available to service providers, it is not clear how FDI will help lower tariffs further or why such investments would be considered "cheap" capital or capital that is more easily accessible.

Suggestions

1. TRAI should have a light on illegal rerouting of international calls as local calls rather than imposing penalties (for instance Rs. 150 crore fined on Reliance).
2. Liberal entry policy of FDI can go long way in encouraging foreign investment in infrastructure but not hacking the FDI cap from 74 per cent to 100 per cent.
3. The majority directors on the board including Chairman, Managing Directors and CEO should be resident Indian citizens.
4. The Share Holder agreement (SHA) should incorporate this condition and envisage the conditions of adherence to license agreement.
5. Resident Indian promoter should hold at least 10 per cent equity of the license company.
6. No remote access should be provided to any equipment manufacturer or any other agency outside the

country for any maintenance/repairs by licensee.

7. India not as much an export or FDI target as first wherewithal to instill confidence among investors and buyers.

8. India needs to strengthen domestic manufacturing units and niche market. Hence, increasing FDI cap is not a panacea for increasing higher rural tele-density etc., it is not a sturdily suggested that Indian government should concentrate on basic needs such as water, electricity and work rather than telephones and foreign participation.

Conclusion

The Indian telecom service sector is becoming one of the fastest growing sectors in the world. As such, India has become the fifth largest network in the world in terms of number of telephones after China, USA, Japan and Germany, crossing more than 100 million telephone subscriptions by April 13, 2005. The Government of India recently increased the limit on FDI in telecom providers from 49 per cent to 74 per cent. The higher FDI has led to the increase of urban tele-density. Nonetheless, the liberalisation with foreign equity (FDI) has led to the reduction of tariff significantly in mobile and long distance services.

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