

## **CHALLENGES FACED BY MERGERS & ACQUISITIONS IN INDIAN TELECOM SECTOR**

- SAKSHI GUPTA<sup>1</sup>

### **ABSTRACT:**

The process of mergers and acquisitions has gained substantial importance in today's corporate world as a way of corporate restructuring. With the liberalization of the Indian economy in 1991, the telecom sector has become very attractive for mergers and acquisitions. India is the world's second-largest telecommunications market, with around 1.19 billion subscribers as of September 2018. It has a very strong telecom infrastructure. The entry of Reliance Jio in September 2016 has disrupted the whole sector with majority players undergoing consolidation phase. Major Players in India now are: Airtel, Vodafone- Idea. This article would discuss the challenges faced by Mergers and Acquisitions in the telecom sector in India currently and way ahead for the same.

### **INTRODUCTION:**

The process of mergers and acquisitions has gained substantial importance in today's corporate world as a way of corporate restructuring. The government bodies initiated this concept and the Indian economic reform since 1991 has opened up a plethora of challenges both in the domestic and international spheres. The increased competition in the global market has prompted the Indian companies to go for mergers and acquisitions as an important strategic choice. Till recent past, the incidence of Indian entrepreneurs acquiring foreign enterprises was not so common. The situation has undergone a sea change in the last couple of years as acquisition of foreign companies by the Indian businesses has been the latest trend in the Indian corporate sector. The trends of mergers and acquisitions in India have changed too, over the years across various sectors.

The various factors that played their parts in facilitating the mergers and acquisitions in India are favorable government policies, buoyancy in economy, additional liquidity in the corporate

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<sup>1</sup> Student, LL.M , National Law University Jodhpur

sector, and dynamic attitudes of the Indian entrepreneurs are the key factors behind the changing trends of mergers and acquisitions in India. Even though mergers and acquisitions (hereinafter referred as M&A) have been an important element of corporate strategy all over the globe for several decades, there is an ongoing global debate on the advantages/ disadvantages of M&As on various sectors in general. The Indian M&A landscape is no different. M&A's have become an integral part of the Indian economy and daily headlines. For any sector, inorganic growth through M&A continues to be an attractive option, same applies for the sector under study, that is, the Telecom Sector.

India is the world's second-largest telecommunications market, with around 1.19 billion subscribers as of September 2018.<sup>2</sup> It has a very strong telecom infrastructure. The Indian mobile economy is growing rapidly and will contribute substantially to India's Gross Domestic Product (GDP), according to report prepared by GSM Association (GSMA) in collaboration with the Boston Consulting Group (BCG).<sup>3</sup> The country is the fourth largest app economy in the world. Major subscribers are Airtel, Vodafone-Idea, BSNL, MTNL and Jio. Vodafone- Idea topped the revenue market share with 32.8 per cent followed by Bharti Airtel (30.1 per cent ) while that of Jio was at 26.1 per cent.<sup>4</sup>

Reforms implemented by Telecom Regulatory Authority of India (TRAI) and Department of Telecommunications (DoT) post liberalization have also drastically altered the business environment in the Indian telecom sector. This sector has emerged as a significant performer in the Indian services domain. The telecom companies have opted for Mergers and Acquisitions (M&A) as a strategic tool to enhance their performances.

This article focuses on the challenges faced by mergers and acquisitions in the telecom sector in India currently and way ahead for the same.

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<sup>2</sup><https://www.ibef.org/industry/indian-telecommunications-industry-analysis-presentation> (Last accessed on January 13, 2019)

<sup>3</sup><https://www.ibef.org/industry/telecommunications.aspx> (Last accessed on January 13, 2019)

<sup>4</sup><https://www.businesstoday.in/sectors/telecom/airtel-vodafone-idea-show-recovery-in-metro-cities-jio-top-telco-in-adjusted-gross-revenue/story/294918.html> (Last accessed on January 13, 2019)

**CHALLENGES:**

The first challenge is the lengthy approval timeline for the process of mergers and acquisitions. The realm of M&A in India is interspersed with a rigmarole of legislative requirements that includes approvals from the relevant regulators, procedural bottlenecks and seemingly never-ending compliances. Legal challenge is the quantum of time consumed to seek regulatory approvals, which can never be estimated correctly and is laced with its unique practical impediments.

Second and the major challenge being faced currently is the entry of Reliance Jio in the telecom sector, which has acted as a game changer for the whole sector. At the time of soft entry of Reliance Jio in 2016, leading players in Indian Telecom sector were Bharti Airtel, Vodafone, Idea Cellular, Aircel, Telenor, Reliance Com, MTS, Tikona and Tata Teleservices. On account of aggressive pricing from Reliance Jio including initial free offers for six months led to the industry's worst price wars with falling revenue and profits for the remaining companies, which resulted into piling of debt, which is still pending. This has also resulted into consolidation in the telecom sector, which is now left with four dominant players -Bharti Airtel, Idea -Vodafone India, Reliance Jio and BSNL. If Reliance Jio continues with this strategy for some more quarters, there is a possibility that Bharti Airtel and Idea- Vodafone may go bankrupt. If this apprehension happens, then Reliance Jio would become the only major player in the telecom industry and would set pricing as per their terms and conditions.

Another challenge is that with only three major players in the market (excluding BSNL) remaining, there are chances that these companies may form cartels to hike price, thus may able to create an environment of monopolistic competition resulting into disadvantage for the end-customers.

The telecom market has a strong barrier to entry, as this requires huge Capital Expenditure (CAPEX) and Operating Expenditure (OPEX) costs. The industry is saddled with a debt of around Rs4.5 trillion, and also owes close to Rs. 3 trillion in spectrum payment charges.<sup>5</sup> With rapidly declining revenue, the operators are finding it difficult to service their liabilities. The

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<sup>5</sup><https://www.livemint.com/Industry/rws5uR2FeOti3o3nU7AirL/The-shakeup-in-Indias-telecom-sector.html> (Last accessed on January 20, 2019)

government is also getting concerned about the financial health of the sector and has formed an inter-ministerial group to look into the problems facing the industry. The Telecom Commission has offered a welcome relief to debt-laden telecom firms by giving them six more years to pay for spectrum purchases and lowered their interest burden. Post-consolidation, the industry is likely to turn healthier and more stable than it was one year ago. Still, challenges remain.

Inadequate regulations have the potential to dampen investment and innovation in the telecom sector and this is what the Indian Telecom Sector has also witnessed. Traditionally, global players had all business models converge to a centralised way, but in India, with dynamic shifts, they have had to change keeping competition in mind and this has not been very favorable. For example, in 2016, UK's Vodafone Group wrote off £4.4 billion in its India business. Among others, Telenor exited the country, selling its Indian unit to Airtel, also Japanese firm Docomo left when its legal tussle with the Tata Group got sorted. As on today, all the global players have either been sold or have merged.

Another challenge is of the loss of Revenue from OTT (Over the Top Service Providers). The telecom industry which requires high capital investment is losing business and revenue from the Over The Top service providers such as Skype, WhatsApp, Viber etc. OTT services provide the ability to call and text at zero costs and only use the data provided by the telecom operator. OTT services are substitutes of voice call and SMS through the carrier. The telecom players have complained that since the OTT players provide the same service as the incumbents - they should be charged to the same regulation and costs as the telecom industry, which at present, they are not. They also demanded a share of revenue from the OTT, as these services make use of data provided by the carrier.

However, the wave of merger & acquisition in the telecom sector could be negative for O&M Vendor/tower companies like Indus Towers, GTL, ATC, and Bharti Infratel as merged entities will cut down on overall cell sites. The existing footprints, a Vodafone-Idea, BhartiAirtel (including Telenor) and RCom-Aircel- Sistema (combined entity) have a large number of tower overlap, potentially leading to lower network operational expenditure and improved margins, in addition to faster rollout of coverage potential.

Adjusted Gross Revenue or AGR, the basis on which levies and charges are calculated for telecom companies, is a contentious issue in the telecom industry and under litigation. It comes up when license fee or spectrum usage charge needs to be ascertained, or when the Comptroller Auditor General (CAG) reviews accounts of telecom companies and finds revenue to be under-reported. While the government has sought for all kinds of revenue to be included in what it defines as AGR, carriers say that the purview should be limited to only revenue from telecom services. So, this remains as an issue of contention.

Last challenge being the loss of revenue to Government of India on account of transfer of ISP license to Unified License. An ISP license holder can only provide data services to customers. If under any scheme, whether a merger and acquisition (M&A) or otherwise, spectrum of an ISP is proposed to be used to provide voice services by moving to a UL regime, then the difference in license fees between a UL license and an ISP license should be paid to the government for each of the telecom circles involved. While this principle is well understood by DoT and all the stakeholders, it is not stated explicitly in the M&A guidelines and as a result is being misused by companies to delay the payment of legitimate dues to the government.

#### **CONCLUSIONS AND SUGGESTIONS:**

One of the most profitable industries in the World is “Telecom” and it is rapidly growing day-by-day. At present around 5.8 billion mobile users that are equal to nearby 81% of the World population and out of it around 75% customers are in the worlds highly populated Countries India and China. As a result companies in the sector find it strategically desired to enter new markets by merger & acquisitions and or forming an alliance with existing strong players in the market. The current mergers in Indian Telecom Sector also get the momentum by floating the dream project “Digital India” by the government. In line with above, the Indian Government has been quite pro-active in its energies to transform India into a global telecommunication hub. The government has enabled easy market access to telecom equipment and a fair and proactive regulatory framework that has ensured availability of telecom services to consumer at affordable prices.

Today’s mergers & acquisition in India has phased out the Multi-national companies from the Indian Telecom Sector and the competition started between Indian entities engaged in

telecommunication business. Most foreign players like NTT Docomo, Telenor etc. have exited due to the inconsistent government policies. They come to the country looking forward to a bright market however, but are disappointed and let down by the government policy and behavior. For example, Japan's NTT DoCoMo Inc. struggled to get its money back after a joint venture with Tata Teleservices Ltd. went bad; the government simply refused to let Tata pay its Japanese partners and even ignored an arbitration settlement in London till it was forced to allow the payments by a Delhi court.

Mergers and acquisitions are powerful indicators of a robust and growing economy. The legal framework for such corporate restructuring must be easy and facilitative and not restrictive and mired in bureaucratic and regulatory hurdles. The biggest obstacle in the way of completing a merger or an amalgamation remains the often long drawn out court procedure required for the sanction of a scheme of arrangement. The recommendations of the JJ Irani Report are of particular significance in this regard. The Report has recommended that legal recognition to 'contractual merger' (i.e., mergers without the intervention of the court) can go a long way in eliminating the obstructions to mergers in India. The report also recommended that the right to object to a scheme of merger/ acquisition should only be available to persons holding a substantial stake in the company.

The giant telecom sector comprised of 9-10 mobile operators in each circle, few years ago, but today with prevailing consolidation wave they are just reduced to 3-4 players. As per HSBC global research report, a three- player market is good enough to generate the optimum balance of competition and investment based on European research.<sup>6</sup>

Consolidation might benefit sector-level average revenue per user and return on equity.

**Pros:**

- steady long-term realizations
- growth in capital efficiency
- better service to customers

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<sup>6</sup><https://www.peoplesmatters.in/site/interstitial> (Last visited on 19th March 2019).

**Cons:**

- increased pricing discipline
- massive job cuts
- less discounts as competition dwindles

The Indian consumer is the biggest beneficiary of market consolidation because the tariffs are at lowest today and India has gone up in penetration. In the long term consolidation is expected to be positive for the industry as it would restore some pricing power and give better negotiation with vendors/ suppliers. Consolidation would bring increased pricing correction for Telco's. Subscribers can hope to be benefited from service providers that are on a stronger footing to invest in network expansion and quality of service. Consolidation has proved to be beneficial for the consumers as of now, since they have to pay lower prices for the services, but in the long run, there is an apprehension that we may see cartelization amongst these three major players, which could lead to an aggressive price hike. Government needs to ensure that this is kept under check.

Also, efforts should be made by the government to strengthen BSNL/ MTNL so that it doesn't lose its position to the major players and to ensure there is a fair competition in the market. The once dominant public sector companies have been reduced to marginal players due to years of political interference and typical bureaucratic style of functioning. Even as the private players grew rapidly, the two PSUs languished without clear direction from the Government. The Centre needs to recognize that the time of reckoning is at hand for BSNL and MTNL. The Centre must unshackle their managements and provide the resources, financial and otherwise, to compete with the private players.

The telecom industry is heavy investment drawn industry; it has huge costs, that is why we see so many M&As in the sector to meet the costs as well as synergy and infrastructure benefits. While consolidation will bring regulatory challenges with it, the hard truth is that this growth may not translate into any meaningful increase in revenue for telecom operators due to tariff wars. Alongside, the cost of acquiring spectrum, the basic raw material needed to provide data services, has been going up. Since 2010, the industry has bid Rs. 3.5 lakh crore to buy

spectrum, which is much higher than its annual revenue of Rs. 2.6 lakh crore.<sup>7</sup> The options for telecom companies are clear: either they dig deep into their pockets to survive or exit from the business. Successful cost reduction efforts and efficacy of spectrum liberalization in improving broadband capacity would be key steps by the government to make things moving. Since, the market is turning out to be “unsustainable” due to aggressive competition and it may soon become detrimental to the government’s flagship initiatives such as Digital India. However, this being said, there is no denying that the consolidation would prove beneficial to the Telecom Industry as the market consolidation is likely to help ARPU per User, Return on Equity and encourage infrastructure-based competition. The industry will see consolidation benefits of reduced competitive intensity, stable long-term realizations and significant improvement in capital formation. Telco mergers allow for meaningful synergies on costs. One easy way is network rationalization like the combined entity of Vodafone and Idea will have the freedom to shut each other’s sites wherever they overlap. The Telecom industry is in a bad financial health and also it is being highly taxed so there is a need to rationalize the tax structure, as rationalization of the taxation structure would eventually lead to fostering innovation.

M&A in Telecom sector is likely to grow in the coming times due to a lot of factors, especially the reforms by the New National Telecom Policy, 2018. Analysts say that M&As in the Indian telecom space could pick up pace because on the one hand domestic players are looking at foreign money to fund expansion plans and on the other international operators are exploring ways to move into emerging markets with their home market reaching saturation. There is a need that the regulators are supposed to be transparent and accountable to customers and the focus of the regulator is to defend, promote consumer’s choice and quality. There is still an insufficiency in the spectrum for the existing operators. There is a need for a holistic converged regulation that will propel the telecom sector to keep pace with technological advancements and bring in more reforms. There is still a region of complexity in the segment of market for the network. Overall, the future of M&A in telecom sector looks bright.

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<sup>7</sup><https://www.thehindubusinessline.com/opinion/editorial/bigger-is-better/article9594792.ece> (Last accessed on February 10, 2019)

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