



M-Commerce Vendors See Opportunity in Prepaid Micro Credit

Very small prepaid top-up denominations and electronic recharging will greatly expand mobile markets in developing countries

Mobile penetration within upper and middle-income groups in Asia is near saturation. Therefore, the bulk of future user growth will have to come from lower income segments, which is why prepaid micro credit is rapidly gaining popularity in parts of Asia. Instead of purchasing airtime credit in blocks of \$5, \$10 or larger amounts, prepaid micro recharge allows users to top-up as little as \$0.50 to their accounts each time. By greatly reducing this entry cost, mobile services become accessible to a much wider market.

Mobile commerce vendors—Valista in particular—are honing in on the opportunity. Companies like Valista, Encorus, and Qpass traditionally help carriers bill for wireless data and add functionality to the billing system, including the ability to settle with content providers. The micro-prepaid plan also requires settlement between partners—in this case, the tiers of distributors, each of which gets a small commission for selling the prepaid account replenishment.

SMART, the largest mobile operator in the Philippines pioneered the service, launched its Smart Load service in May 2003. Since then, SMART has experienced tremendous customer growth. In the last three quarters of 2003 it added 2.65 million net new users, compared to 1.9 million in the corresponding period in 2002. Its main competitor, Globe Telecom, has also seen its customer numbers jump significantly following the introduction of a similar service.

The key to Smart Load's success has not been low denominations alone, but also its distribution. Instead of buying a scratch card or vouchers, users top-up to their accounts through agents equipped with a special SIM card that can transfer call credit to other users via SMS. By avoiding traditional prepaid cards and their related production, distribution and administration costs, operators are able to offer lower recharge denominations at acceptable profit margins.

Agents only need to purchase the special SIM card at 100 pesos (\$1.78) and an initial credit load of 300 pesos (\$5.35). They then receive a 15% commission on all credit sales. This simple and rewarding retail model has resulted in a network of more than 400,000 agents, approximately 80% of which are micro-businesses, including neighborhood stores and students acting as roving agents.

As of March 31, 2004, roughly 85% of SMART's prepaid users were using Smart Load, and in the first 3 months of the year it accounted for 59% of reload sales. Taking the model a step further, SMART launched Pasa Load in December, which allows prepaid users to transfer as little as \$0.035 cents (the cost of a single SMS) to one another's phones, effectively making every prepaid user a potential SMART airtime credit distributor.

Trend Impact

Other Asian operators have since launched similar micro-credit services, including Indosat, Telkomsel and Excelcom in Indonesia, AIS in Thailand and India's Bharti Tele-Ventures. We expect many more will follow, since the benefits to operators are manifold:

- A larger addressable market due to lower entry costs
- Reduced fraud and theft of physical vouchers
- No risk of default: even agents prepay for recharge credit
- Lower churn: customers stay on the same network as friends and local agents
- Fewer deactivations and consequent churn: customers can afford more regular use
- Greater traffic: calls that would otherwise be deferred due to a lack of credit and sufficient funds are made immediately

- Expanded credit distribution network comprised of customers and community agents

However, there are a few drawbacks. With mobility made accessible to the lower end of the market through lower denomination reloads, carriers can expect:

- An increase in their prepaid user base relative to postpaid
- An overall decline in ARPU
- A certain amount of lost revenue, since credit is no longer purchased in large denominations with a proportion remaining unused before expiration

SMART, for instance, has seen its ARPU decline from 416 pesos (\$7.41) in the first quarter of 2003 to 383 pesos (\$6.83) in the first quarter of 2004. During the same period, prepaid users have grown to account for 98% of its customer base. Nevertheless, the mass influx of new customers has more than mitigated any financial loss—during the same quarterly period SMART's prepaid revenues grew by 37% (compared with 8% growth for postpaid), while operating margins increased from 36% to 46%.

Based on historical growth trends, the introduction of prepaid micro credit added an estimated 4% delta on top of SMART's annual customer growth rate in 2003, with an even greater impact expected for 2004. With mobile penetration still in single digits in markets such as India, Indonesia, Bangladesh and Vietnam (with a combined population of 1.5 billion), a huge mobile opportunity still exists in Asia. However, with \$10 being the equivalent of a week's wages in some parts of these countries, this potential can only be tapped through greater affordability.

Recommendations for Vendors

- **Qpass should develop a micro-prepaid product for global expansion.** Valista already has a lead, supplying the carrier Globes in the Philippines with a micro-prepaid solution. Besides Asia, Valista now has its sights set on the Middle East, Latin America and Africa. Qpass is expanding from the United States and attaching the European market by helping carriers with premium SMS and prepaid premium content. When the company is ready for further geographical expansion, it will need a micro-prepaid product as part of its solution suite.
- **Consider micro prepaid even in Europe and the United States.** Peer-to-peer top-up is an economical distribution scheme in markets with large, low-income segments. However, peer-to-peer top-up is also a convenient recharge option that prepaid communities in all markets may prefer. Consumers may like the idea of "borrowing" airtime from friends.
- **Billing vendors can capitalize on the opportunity too.** The pure-play, m-commerce vendors highlight their affordable partner relationship management (PRM) solutions and focus on all aspects of a payment. The large billing vendors can argue that their prepaid top-up solutions (including micro prepaid) are more integrated into all aspects of the carriers' infrastructure, including billing and CRM.
- **Device manufactures should make entry-level handsets designed for Asian markets.** Given limited subsidization by operators in the region, handsets usually cost from \$300 to \$500, making this the single greatest barrier to further mobile adoption.
- **Large vendors should provide micro-credit solutions at minimal or no cost with prepaid platform and infrastructure upgrades.** An enlarged market serves vendors interests as well, through higher handset sales, infrastructure expansion and platform license fees.

Recommendations for Carriers

- **Dominant operators in more developed markets should take an indirect route to micro credit.** Targeting the low-end market dilutes your brand and risks cannibalizing existing prepaid revenues. Creating a sub-brand or partnering with an MVNO mitigates some of this risk.
- **Provide affordable entry-level handsets, or increase handset subsidies and encourage the development of a second-hand device market.** The initial high cost of a mobile terminal is a huge obstacle to greater mobile adoption
- **Keep airtime rates reasonable and expiration periods fair.** It is pointless to allow low denominations if the amount equals 10 seconds of talk time or expires before the customer has a chance to use the credited amount.

- **Don't use too many tiers of distributors.** Yes, you will save on the costs of distributing prepaid cards, but the electronic distribution method also has costs. If carriers only have to pay out three distributors (at 2% each), the total (6%) is less than the cost of card-based prepaid.