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India's Regulatory Landscape – As Unpredictable as Ever!

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Despite well publicized efforts by the Indian government to trim red tape, the country remains one of the toughest places to do business on the planet. The World Bank confirmed as much, ranking India 130th among 190 nations in their 2017 report on how easy it is for private companies to follow regulations, trailing countries such as Nepal, Iran, Nicaragua and Tajikistan. India had several achievements including cutting the time to getting a power connection by over 60%, but other countries are making even greater improvements and hence India isn't gaining ground.

The Government along with regulators needs to establish clear policies that are applied consistently over time helping create an environment conducive for private investment to realize a reasonable return on invested capital.

Astounding lack of clarity

The telecom industry lived through a period of opaque and ever-changing rule making earlier this decade including cancellation of licenses (arguably justified to make bad actors pay for their crimes), lack of an M&A policy in an era where India was the only country in the world with 13 wireless network operators, repeated and ever-increasing demands by the government for the right to offer 3G roaming services, re-farming one's own spectrum to offer new services, one-time spectrum charges and excess spectrum charges. Amidst increasing regulatory burden and worsening outlook for the industry, every single international operator that entered the Indian market in the 08/09 period has already exited or is in the process of exiting the market after taking huge write-downs, including Batelco (Bahrain), Etisalat (UAE), DoCoMo (Japan), Sistema (Russia) and Telenor (Norway). Repeated episodes like this will keep the cost of equity high and suppress FDI, despite India laying claim to be the fastest growing major economy.

Reliably inconsistent

The latest hit to telecom incumbents is the 57% cut in mobile termination rates announced in late September and effective October 1st 2017. While this is positioned as a consumer-friendly move, the tariffs in India are already the lowest in the world. Compounding this are high spectrum costs and taxes on network operators and so the benefit is unlikely to be passed to consumers in the form of lower tariffs. However, it is certain that a huge transfer of value from larger incumbents to smaller operators and newcomer Reliance Jio will happen. This is against the backdrop of the previous 30% cut in 2015 when no roadmap for further cuts was provided and additionally, the methodology to compute costs and justify the reductions are dramatically different. Network operators make investment decisions over 5-10-year horizons and therefore need far greater visibility and consistency in the regulatory landscape.

Investors in other industries also routinely face reversal of policies. In late September 2017, the Railways Ministry announced a review and potential cancellation of the $2.5B contract awarded in 2015 to GE for supplying 1,000 diesel locomotives over a 10-year period. GE has ostensibly invested $200M to stand up a factory and claims it is on track to start delivering domestically manufactured locomotives in early 2018. The reason for the contract review is the Railways Ministry's new plan to have 95% of locomotives running on electricity by 2022, up from 44% currently. It is unclear if even preliminary diligence has been done to assess the cost and feasibility of electrifying 10's of thousands of Kilometers of track and supplying the needed power. What justifies such a dramatic change in policy in under three years? Furthermore, this raises more questions on the level of diligence and planning done prior to award of this contract.

Anything but conducive

Considering the sea of red ink accumulated by smaller telecom operators, overall profitability of the industry has been poor for the past several years. This has only deteriorated since the launch of services by Reliance JIO. Vodafone, Idea and RCOM, India's #2, #3 and #4 operators respectively all have seen EBITDA margins plunge in the 2nd half of FY 2017 ranging between 23% and 25%. The return on invested capital measured as EBITDA margins less CAPEX is well under 10%, not much different from a relatively safe investment in government bonds or a bank deposit. What then is the incentive for investors and operators who contend with regulatory, operational and political risk to invest in growing their business?

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