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SPECIAL REPORT



Prepaid: Lining up for growth

An in-depth look at prepaid trends
in the United States and globally

By Dan Meyer and Matt Kapko



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The hottest word in the wireless industry nowadays is prepaid with just about every operator turning their attention to a market segment that was neglected for years.

This year has seen financial results from operators showing an increased dependence on customers eschewing contracts to bolster their customer growth numbers. During the first quarter alone, virtually every domestic operator posted stronger growth from prepaid customers than from more lucrative postpaid consumers who typically swap signing a two-year contract in exchange for an upfront subsidy on their shiny new mobile devices. Wireless carriers added nearly 2.8 million net prepaid subscribers during the first quarter of this year, while postpaid customer growth was basically flat.

How did this happen? How did a customer segment that for years was not considered worth a concerted effort to court suddenly become the “it” segment for a \$100 billion industry?

Analysts in general have been predicting just such a thing for years now, noting that the wireless industry eventually would reach a point where everyone who wanted a mobile device and could afford to purchase one under a contract would do so, leaving future growth dependant on reaching those customers who for one reason or another could not procure a traditional wireless offering. While the prepaid market has been served by various providers since the inception of mobile services, it’s only recently that the industry has focused greater interest on the segment.

But, it’s not just customers who lack the credit score for postpaid service that are bolstering the prepaid ranks. Postpaid customers looking for a bit more control over their monthly spending are also making the move to prepaid service plans.

According to a recent Federal Communications Commission survey, 30 million Americans have experienced bill shock, which it defines as a sudden increase in people’s monthly bills that isn’t caused by a change

in service plans. Most of this shock has been attributed to early termination fees that customers must pay if they want to cancel their service while still in their contracts.

According to a PriceWaterhouseCoopers consumer survey earlier this year, the downturn in the economy triggered an increase in consumers moving toward prepaid plans. On average, use of prepaid minutes increased more than 147% in the past four years, from 270 minutes in 2006 to 667 minutes in 2009.

Laying the groundwork

The move away from traditional postpaid customer growth first was seen several years ago when carriers aggressively began to promote “family plans” that allowed customers to add lines to their accounts and share in the traditional offerings of postpaid plans for a reduced cost. Most of these offerings allowed customers to add a line for \$20, which eventually dropped to as low as \$5 per line. Carriers managed to recoup some of the lost revenue of having

a single new customer addition by charging more for the bucket of family-plan minutes than what it charged for single lines. So instead of a single customer paying an average of \$60 for a bucket of 900 anytime calling minutes, two lines would share a bucket of 700 calling minutes for \$70. If that family plan needed a larger bucket, the next higher tier typically would spike up to \$90.

These family plans also provided a number of advantages for carriers, including tying members of a family to a plan for the term of the contract as well as allow parents to add children who did not have the credit or were not legally able to sign a contract on their own.

These plans proved wildly successful and drove strong growth for carriers for several years. Some estimates claim that nearly 70% of current domestic postpaid customers are on such plans.

Nationwide scope

Domestically, the prepaid market received a shot in the arm in early 2009 when Sprint Nextel Corp. subsidiary Boost Mobile unveiled a \$50 per month plan that included unlimited calling, messaging and web access, all without a contract. The carrier originally trialed the offer in select markets using its CDMA network as a competitor to offerings from Leap Wireless International Inc.'s Cricket and MetroPCS Communications Inc. But for its nationwide debut, the carrier relied on its neglected iDEN network, which had been hemorrhaging postpaid customers ever since Sprint Corp. acquired Nextel Communications Inc. in 2005.

While there were similar offerings that included unlimited calling, messaging and web access from a number of providers before the Boost offering, most were limited in scope and network breadth. The move was an instant hit for Boost and Sprint Nextel, which spent the rest of the year soaking up prepaid customers who eventually were able to outnumber the postpaid customers the carrier was losing.

Seeing the writing on the wall, rivals began trolling the prepaid waters looking to ride the wave Boost Mobile managed to catch.

Within months a number of similar offerings began to flood the market. Prepaid stalwarts MetroPCS and Leap bolstered their unlimited offerings with new features and expanded coverage. T-Mobile USA Inc. revamped its entire rate plan structure to emphasize its prepaid offer-

ings that – while giving up the handset subsidy sought by postpaid users – provided those forgoing a contract with lower per-monthly charges.

The most dynamic reaction may have been undertaken by Tracfone Wireless Inc., which managed to form a partnership with Verizon Wireless for nationwide network access and Wal-Mart Stores Inc. for broad distribution of its Straight Talk service. The offering provided customers with unlimited calling, messaging and web access for \$45 per month, undercutting the \$50 price point established by Boost. In addition Tracfone received permission to use the Verizon Wireless name for branding the service.

Tracfone, which is owned by Latin American-based operator America Movil, is a prepaid veteran, having offered a variety of traditional prepaid services using network agreements with various network operators. However, those services have historically resulted in the company posting very low average revenue per user of around \$10 per month.

Since its launch last year, the Straight Talk service has become a dynamo for both Tracfone and Verizon Wireless.

For Verizon Wireless, the service has allowed the carrier to continue focusing its core brand on the more lucrative postpaid customer base, while the margin-thin prepaid service can be shared with Tracfone. Verizon Wireless noted that during its first-quarter financials that nearly 1.3 million of its 1.5 million total net additions were through its reseller partners, a number analysts noted was made up predominantly from Straight Talk sales.

The analysis was reinforced by America Movil, which said its Tracfone subsidiary added just over 1 million customers during the quarter and ended the quarter with more than 15 million total customers across its prepaid offerings. America Movil also reported average revenue per user of \$11 for Tracfone, which further highlights the razor-thin margins common in the prepaid space.

Wait and see

Few would question the phenomenal growth in the prepaid market over the past several quarters with nearly every operator posting stronger growth from its prepaid operations than postpaid. However, the nation's two largest operators, Verizon Wireless and AT&T Mobility, are content to sit on the sidelines of that increasingly competitive battle, at least for now.

Speaking at a recent J.P. Morgan Technology, Media and Telecom Conference, executives from both Verizon Wireless and AT&T Mobility said they were not ready to dive deeper into the prepaid space.

"It's something we monitor, something we're watching," said Verizon Communications Inc. EVP and CFO John Killian. "I wouldn't say it's a big concern right now. It's the lower end of the market. We do not see – we see a little bit of move from our postpaid base, not much. And we still see the ability for others to take postpaid customers away from other carriers."

Killian noted that this did not mean that the carrier was completely ignoring the prepaid space and that it would make adjustments as needed.

"[Verizon Wireless CEO] Lowell [McAdams] is looking at that right now in terms of – and there could be a little bit of modification in some of our prepaid offerings," Killian added. "But it's not a broad-based assault on the prepaid market. It will be some tweaks to some of the pricing, some of the offerings, probably making sure the marketing of it is more prominent in terms of the Verizon network and the network quality behind that. But, I don't think you will see us from a retail prepaid perspective trying to be the leader in the prepaid market."

Verizon Wireless earlier this year began offering customers no-contract plans priced at a \$5 premium on their contract offerings. That means prepaid unlimited voice plans run \$75 per month compared to the \$70 per month the carrier charges its contract subscribers. Customers who add unlimited messaging are charged at \$95 month. The carrier said the same \$5 premium applies to voice-bucket plans of 450 and 900 minutes per month.

The prepaid move brought Verizon Wireless closer to the now-standard \$50 per month for unlimited voice calling without a contract, but is still \$30 more per month than network partner Tracfone's Straight Talk plan, which uses the same network.

William Ho, VP of Consumer Services at Current Analysis, noted the new prepaid plans could lure some customers looking at the less-expensive offerings from regional carriers, but who are attracted to the Verizon Wireless brand.

"Rather than compete directly with the possibility of cannibalizing its postpaid base, the use of MVNO proxies to disrupt growth leaders Boost Mobile, MetroPCS and Leap bring in the side benefit of additional wholesale revenue," Ho wrote in a

recent report. “However, this approach is not without risk as unfettered MVNO use of the Verizon Wireless network could potentially compromise ‘the most reliable wireless network’ if wholesale customers and postpaid customers contend for the same resources.”

Speaking at the J.P. Morgan event, AT&T Mobility President and CEO Ralph de la Vega took a similar approach to the subject, noting that the carrier was more interested in revenue and margin growth and that was coming from postpaid data services, not prepaid voice.

“There is an insatiable appetite for data,” de la Vega said. “We don’t see that with voice.”

AT&T Mobility late last year goosed its Pay As You Go GoPhone prepaid offering with the launch of an unlimited talk and messaging option for \$60 per month. The offering undercuts its unlimited postpaid offering by \$10 per month.

So, what’s the catch for those looking to join AT&T Mobility and seeing the significant price difference between its contract and no-contract offerings? The GoPhone plans are only available on a limited number of devices from AT&T Mobility, though the GoPhone SIM should be compatible with nearly all of the carrier’s devices. And phones acquired with a postpaid contract include a larger subsidy and corresponding lower price. Also, network coverage for the GoPhone service is limited to the carrier’s native network, while the postpaid offering includes coverage through roaming agreements.

“It is a fine line for AT&T to stay relevant in prepaid calling but not ‘give away the store’ with a product that has good margins, is competitive, and does not cannibalize postpaid users,” Current Analysis noted in a report. “The \$60 Talk & Text plan is \$10 (or more) more expensive than many competitors’ plans, but AT&T hopes that its premium brand will help pull in less price-sensitive customers who believe in the carrier’s network message and image.”

Both carriers are on basically solid footing in their stances. Verizon Wireless reported that direct customer additions for the first quarter totaled just 288,000 subscribers, compared with 1.3 million additions through its third-party partners, which analysts noted was composed mostly of Tracfone’s Straight Talk prepaid service. AT&T Mobility was a little better off on the postpaid front, noting it added just over 500,000 direct postpaid subscribers during the quarter, though its indirect channels contributed nearly 1.4 million customers.



Verizon Wireless has as of yet only dabbled in the prepaid space, using instead a partnership with Tracfone Wireless and America Movil to target the growing market.

All in

While Verizon Wireless and AT&T Mobility have been cautious with their prepaid moves, Sprint Nextel and T-Mobile USA have been aggressive. Both carriers increasingly have relied on the segment to boost their customer growth and thus altered many of their plans to attract prepaid customers.

Sprint Nextel is betting heavily on the prepaid market; the carrier said it expects 70% of net additions this year to be customers who choose to go without contracts.

“This is the year that prepaid moves to the forefront of the wireless industry,” said Dan Schulman, president of Sprint Nextel’s prepaid group, during the recent revamping of its prepaid lineup. “In the first quarter of 2010, more than half of the mobile gross additions in the U.S. selected prepaid, and we predict that approximately 70% of the net adds in 2010 will choose plans without a contract.”

In addition to Sprint Nextel’s Boost Mobile offering, the carrier offers three additional brands targeting the prepaid market.

The carrier recently unveiled its Common Cents pay-as-you-go service that provides a traditional prepaid plan for customers. Voice calls are billed at 7 cents per minute with the hook that calling minutes are rounded down to the nearest minute instead of up as is done with other calling plans. The service also provides for text messaging priced at 7 cents per message sent or received.

Distribution for the offering is through Wal-Mart Stores using both their retail locations – 700 stores at launch – and online storefronts and puts the offering in the same channel as Straight Talk. The Common Cents offering will also be available through a dedicated web site.

According to Bob Stohrer, VP of marketing for Sprint Nextel’s prepaid brands, the

Common Cents offering targets consumers looking for a traditional prepaid service and not interested in the growing number of unlimited offerings hitting the market.

In addition, Sprint Nextel continues to offer its Assurance service, which it picked up when it acquired Virgin Mobile that provides a free phone and 200 calling minutes per month to qualified customers in a handful of states.

The offerings sit next to the carrier’s Virgin Mobile service, which recently dropped its pay-as-you-go option and voice-centric focus for a more data-centric model that targets consumers looking at data and messaging services first, and voice second. Sprint Nextel recently began to phase out the postpaid offerings from Virgin Mobile’s plate that it acquired when it bought Helio L.L.C. in 2008. Stohrer said Virgin Mobile will continue to support customers currently on its pay-as-you-go service, but that over time it will look to migrate those customers to other plans.

“The other brands are more about monthly unlimited offerings,” Stohrer explained. “This allows Virgin and Boost to more effectively target their specific audiences.”

Stohrer noted that Boost Mobile is a “straight forward, no BS, unlimited talks plus data and messaging” service targeting the 18-49 year old demographic. Virgin Mobile is “all about beyond talk that leads with unlimited data and then lets you pick your talk options” targeted at a slightly younger 18-35 year old demographic. Common Cents’ demographic is the 25 and older crowd looking for a more traditional prepaid offering, which still represents roughly half of no-contract customers, according to Sprint Nextel.

“From a competitive standpoint, Boost has great momentum and at its core is competitive against other prepaid

unlimited players like Metro and Leap,” Stohrer said. “Virgin sits in the prepaid space, but is looking to capture customers migrating from postpaid that are looking for more value.”

Analysts have generally been positive on Sprint Nextel’s aggressive play in the prepaid space. “We are taking a very positive stance on the Sprint Prepaid Group’s multi-brand segmentation strategy, because it is betting that wireless prepaid growth will fuel corporate revenue,” Current Analysis’ Maily Whitesell noted in a research report. “They added that the new Common Cents offering along with the new focus of both Boost Mobile and Virgin Mobile will require a reaction from its competitors.

“Boost Mobile and Virgin Mobile provide alternatives to Tracfone’s Straight Talk and Net10 Unlimited,” Maily added. “It is certain that unlimited carriers such as MetroPCS and Leap will also be affected, in addition to smaller MVNOs with smaller marketing muscle such as Page Plus. The Common Cents brand, with its landmark, simple 7-cent proposition, threatens all pay-as-you-go providers, especially Net10, as it usurps that carrier as the low-cost provider – an important distinction, especially to higher-churning and price-sensitive users.”

Sprint Nextel’s Stohrer acknowledged the potential for overlap between Boost Mobile and Virgin Mobile in some segments, but countered that the carrier would rather have some overlap instead of any gaps in its offering.

Stohrer added that the carrier would also tout the nationwide reach of Sprint Nextel for all of its prepaid offerings, noting that benefit is especially important when compared to competing offers from MetroPCS and Leap. The carrier is also looking at further integrating its distribution efforts for the Boost Mobile and Virgin Mobile offerings to take advantage of Boost’s reach in some of the bigger retailers and independent wireless locations and Virgin Mobile’s reach in mid-sized retailers.

Having heavily modified its pricing plans late last year in favor of its prepaid offerings, T-Mobile USA recently updated the offering to now include unlimited calling and texting options. The move looks to be essential for the nation’s No. 4 carrier, which recently said it lost 77,000 customers during the first quarter, including a loss of 118,000 postpaid customers. T-Mobile’s unusually poor showing of only

41,000 prepaid net additions could not counter the postpaid loss.

The new plans offer unlimited calling and messaging for \$50 per month, or unlimited messaging for \$15 per month and voice calls charged at 10 cents per minute. The unlimited voice and messaging offering lines up with similar plans from rivals Boost Mobile, Straight Talk, MetroPCS and Leap’s Cricket service, though those carriers typically include unlimited data services and other features with their offerings.

The plans also slot in below T-Mobile USA’s Even More offerings, which allow unlimited talk and text messaging for \$60 per month without a contract, but a wider selection of devices at unsubsidized prices or \$70 per month for the same devices at a subsidized price.

The selection of devices for the prepaid service is limited to just four basic models ranging between \$20 and \$40, none of which include a QWERTY keyboard. The carrier does offer a prepaid SIM card for \$7 that can be used in any T-Mobile USA or unlocked device.

“T-Mobile needed to make their prepaid portfolio more competitive in light of the multiple competitive prepaid unlimited offerings out there,” explained Current Analysis’ Ho. “It is a tough road they’re on to trying to capture a higher-ARPU unlimited calling customer while preserving margin and not cannibalizing the postpaid base.”

T-Mobile USA also continues to offer its traditional, pay-as-you-go service that begins at \$10 for 30 minutes ranging up to \$100 for 1,000 minutes. Text messaging on those plans is charged at 5 cents to receive and 10 cents to send.

Regionals fight back

Looking to maintain their positions, established regional players in the prepaid market like MetroPCS and Leap have made recent moves to bolster their plans, increase device selection and boost coverage.

During this year’s CTIA event in Las Vegas, Leap unveiled new plans that provide for nearly nationwide voice calling for \$30 per month. The new plans updated the carrier’s previous offering by providing for home calling in the top 125 markets across the 50 states, Washington, D.C., and Puerto Rico, thanks to new roaming agreements with unannounced partners.

Cricket’s previous offering was limited to calls placed from markets that were either covered by the carrier’s native network or

through a roaming agreement with fellow unlimited calling provider MetroPCS.

Leap said customers can add unlimited text messaging and other features at \$10 increments culminating with its \$60 Premium Plan, which includes virtually all of Cricket’s offerings, including 100 roaming minutes for calls made from outside the expanded coverage area. Leap said those calls would regularly be charged at 25 cents per minute.

The new plans undercut similar nationwide offerings from rivals, including Boost Mobile’s \$50 per month plan that includes unlimited voice, messaging and data services, as well as that from Tracfone’s Straight Talk service that provides for unlimited voice, messaging and limited data services for \$45 per month. Cricket throws in nationwide text messaging, unlimited picture messaging from its home network and unlimited web use for \$40 per month.

MetroPCS altered its rate plans earlier this year with new offerings that the carrier said would provide customers with better control over their wireless bills. The new plans begin at \$40 per month and include unlimited domestic calling, messaging and data services as well as all regulatory fees and taxes. Stepping up \$5 in price brings unlimited international text messaging, directory assistance and other features; \$50 per month adds MetroPCS’ navigation service Loopt GPS service and e-mail access; while \$60 per month throws in unlimited international calling.

For its smartphone users, MetroPCS offers a \$50 per month plan, which includes all of its features except for a \$10 extra charge for international calling, and a \$60 per month plan for customers using Research In Motion Ltd.’s BlackBerry device. The carrier still lacks the broader coverage provided by Leap and its larger rivals, but is moving quickly to launch its LTE network by the end of the year and has been very aggressive in offering smartphones to prepaid consumers.

Device pricing

One challenge for continued prepaid growth is how carriers and handset makers plan to handle device subsidies. On traditional postpaid plans, carriers have been willing to fork over hundreds of dollars in subsidies on devices in exchange for customers signing a contract tying them to service for a specific time period or to pay a cancellation fee if they choose to leave before the contract expires.



Source: Leap/Cricket

Leap's Cricket service offering has aggressively targeted the prepaid market in large and mid-sized markets, including Chicago.

These contracts or fees have allowed carriers to recoup that upfront subsidy, and if a customer sticks to the life of the contract, profit handsomely over the term.

But with no contract or cancellation fee tied to prepaid plans, carriers in many cases require customers to pay the full price for a device or partner with second- and third-tier device makers in an attempt to bring more affordable devices to market.

Carriers also are beginning to stock smartphones, which typically have been left to the realm of high-end, postpaid rate plans. MetroPCS has been offering a BlackBerry device for some time, while Leap has said it plans to launch both a BlackBerry and a Kyocera Wireless Corp. smartphone using Google Inc.'s Android operating system later this year.

Boost Mobile is also rolling out an Android-powered iDEN device, while Virgin Mobile's device lineup is chock full of feature-packed smartphones.

Analysts seem particular bullish on the Android platform in the prepaid space, noting the OS' open and free architecture seems ready-made for the razor-thin no-contract model.

"Android will be free (although Google will want some of your privacy for that freedom), and with Google Maps and Latitude, you also get free navigation," noted Jim Patterson CEO and founder of Mobile Symmetry, in a recent column for RCR Wireless News. "Google builds on their operating system expansion, Qualcomm sells a few

more chipsets, and the developer community adds a few more million potential buyers to their audience. ... Google Android on Virgin Mobile USA. Android on MetroPCS. Android on Cricket. Android on Boost. Android on Straight Talk. Where will this leave AT&T and Apple? Where will this leave traditional prepaid services? Can it happen in time for the 2010 holiday season?"

Larger carriers in general have kept their prepaid device selections to entry-level models that they typically can sell at low prices even without a subsidy. Verizon Wireless and AT&T Mobility are prime examples of this as their branded prepaid services are limited to only a handful of basic devices.

T-Mobile USA has taken a different approach offering all of its devices to its no-contract customers with the only stipulation being they are not offered the subsidy offered to postpaid customers.

Beyond voice

While voice services have seen the broadest range of activity during the past 12 to 18 months, carriers also are starting to merge mobile data services into their no-contract offerings.

Sprint Nextel's Virgin Mobile brand is one that has moved aggressively into the space recently reconfiguring its rate plans to center on data services, with voice as a secondary feature. The brand's plans begin at \$25 per month for unlimited data

and messaging and include a bucket of 300 anytime calling minutes.

"The way youth and young adults communicate has changed dramatically over the past few years," the carrier said, citing data from Nielsen on postpaid users ages 18 to 34 from 2007 to 2009. "Minutes of talk dropped over 10% while messages sent and received grew by more than 150%. The amount of data usage within this group grew by over 1,800% during the same time period."

As such, Virgin Mobile's \$25 Beyond Talk plan includes unlimited data offerings and 300 minutes of voice calling; the \$40 Beyond Talk plan offers the same data offerings but includes 1,200 minutes of voice calling and the \$60 plan ups the voice plan to an unlimited number of minutes. BlackBerry data service can be added to any of the plans for \$10 per month more. Also, the carrier said the price plans will include regulatory fees and taxes, although some sales tax may still apply.

Virgin Mobile introduced four new devices to accompany the Beyond Talk plans. Customers can buy a BlackBerry Curve 8530 for \$300; an LG Electronics Co. Ltd. Rumor Touch for \$150; an LG Rumor 2 QWERTY for \$90; and a Kyocera Loft QWERTY handset for \$70.

"Virgin Mobile has broken from the pack, however, with its Beyond Talk pricing. This plan includes unlimited 3G data and messaging plus 300 anytime minutes for \$25 per month. Straight Talk, its closest competitor and Verizon Wireless post-paid (which includes no voice) have their limitations. And, with an affordable BlackBerry \$10 adder, it's a winner for their devoted fans (\$35/mo. vs. \$60/mo. prepaid and \$80/mo. postpaid – the phone pays for itself vs. the post-paid world in six months), noted Mobile Symmetry's Patterson.

Leap was one of the first to move mobile data services into the prepaid space, and looks to be set to further expand the offering.

Speaking at a recent investor conference, Leap's CEO Doug Hutcheson said the carrier is encouraged by recent data pricing changes in the industry that have shown some upward mobility. Leap also has begun to test different pricing plans for the service, ranging in data transmission from 1.5 gigabytes to 10 gigabytes and at prices points from \$40 to \$60 per month. Leap currently offers a pair of pricing plans for its mobile broadband

service including 5 GB of service for \$40 per month or 10 GB for \$50 per month. Unlike some larger rivals, Leap does not charge overage fees for customers going over their allotted bucket of megabytes and instead throttles down the speed of the service to those users.

While Virgin Mobile and Leap have targeted the prepaid mobile data space, other carriers are taking a more cautious approach, limiting the amount of data transmission available to customers. Verizon Wireless, for example, offers prepaid customers up to 1 megabyte of data transmission for \$50 per month, which is only \$10 less than the 5 GB postpaid customers can select.

Beyond the traditional operators, some see potential in this space from some of the larger retailers that have seen a strong uptake of more traditional wireless voice services. Mobile Symmetry's Patterson said that a retailer like Wal-Mart could spread out into the mobile data space by offering a branded service through a mobile virtual network operator agreement with either a traditional carrier on a capped service or

with Clearwire Corp. for unlimited access to its WiMAX service.

"You have to wonder what Wal-Mart is cooking up on the data front," Patterson wrote. "My guess is that they are saying, 'If Cricket can do 200,000 net adds with \$40 per month broadband, I wonder what we can do with \$30.'"

"Prepaid mobile broadband is quickly transforming into the primary option among carriers looking to boost their data usage levels and expand the applicability of their services," noted Deepa Karthikeyan, senior analyst at Current Analysis in a recent report. "One only needs to look at the activity levels in this space over the past few months to get a feel for the frenzied movement across national as well as regional carriers trying to grasp this opportunity to increase their revenues and spike up their subs."

World view

While comparisons can and should be drawn across the Pacific and Atlantic Oceans, it would be short-sighted to sim-

ply say the U.S. market is moving more in line with the prepaid-like practices of its counterparts in Europe and Asia. By taking an American-centric view of the wireless space, it's easy to label most of the globe as dominantly prepaid.

It's worth pointing out that there are many factors and complexities that play into the prepaid and postpaid ways of wireless operators in every country. This helps explain why the U.S. market is seeing such a shift toward prepaid today.

A vast majority of net subscriber additions in the United States are being drawn into the mobile pool thanks to prepaid offerings, but there are key differences between what prepaid means in the United States and what it means almost everywhere else. America has two flavors of prepaid: pay-as-you-go plans and flat rate all-you-can-eat plans.

"In the United States, prepaid seems to be predominantly with flat rate all-you-can-eat voice, as offered by Leap Wireless International Inc., MetroPCS Communications Inc. and Boost Mobile (a subsidiary of Sprint Nextel Corp.). Outside the United States, prepaid is invariably pay-as-you-go, as offered by Tracfone Wireless Inc. and GoPhone (from AT&T Mobility). There are some similarities and some marked difference between these two approaches," Keith Mallinson, analyst and founder of Wise-Harbor, told RCR Wireless News.

Most of the prepaid business outside the United States is tied to SIM cards, which can be purchased with a predetermined amount of credit on board. Customers simply replenish their accounts (which are tied directly to a refillable SIM card) as needed. As Mallinson points out though, "the price per minute on that type of prepaid tends to be quite high and it promotes disuse."

The flat-rate flavor of prepaid does almost the exact opposite. With an unlimited offering, customers are encouraged to use minutes and call or text away to their hearts' content. As such, the per-minute rates for these types of plans tend to be very low.

"The bucket postpaid that we have largely here (in the United States) is slower in the penetration rate and uptake, but it really drives usage," said Roger Entner, SVP of research and insights in The Nielsen Co.'s telecom practice.

While the United States continues to move down two parallel tracks, the pay-as-you-go model is the only variant of prepaid being used abroad. Of course, there are

RIM's Blackberry Curve has become a popular option for carriers looking to add smart phones to their lineup.



Source: Virgin Mobile USA

unique reasons for the difference in prepaid positioning and strategy, but much of it comes down to regional economics and a cash-versus-credit-based approach to finances.

“The prepaid that we see in the U.S. is appealing to people that have contract phobia, who want predictability in their expenditure, who don’t want a contract, and who can’t get a contract because they can’t do a credit check,” Mallinson said.

On the flip side, many countries are almost exclusively subject to cash on-hand reserves that shift every day. Typically, the more reliant a country is on cash the greater chance the regional wireless industry has been built around a prepaid model.

Although a majority of wireless customers in many countries in Europe, Latin America and some parts of Asia are on prepaid, at least one analyst tells RCR Wireless News that it would be a mistake to put everything outside the United States in the prepaid column.

“The assumption that the rest of the world is prepaid is highly misleading,” said Nielsen’s Entner.

Prepaid statistics outside the U.S.

The most recent data from Nielsen puts the scope and reach of prepaid in the international space into greater perspective. The share of prepaid in each European country is not purely broken down by latitude, but it does seem to play a factor.

“Basically the further south you go, the higher the prepaid percentages,” Entner said.

According to Nielsen’s latest figures, Germany counts 56% of all wireless customers on prepaid, the United Kingdom stands at 58% and Italy is at 83%. The majority flips on its side in France, where only 31% of the country is on prepaid. Austria is at 38% and then there’s Finland, which only counts 8% of its customers on prepaid billing plans.

At last count, China has 71% of its rapidly growing number of customers on prepaid and India’s market is dominated by prepaid at a rate of 89%. Singapore is split right down the middle with half of its customers on prepaid, and Taiwan’s market counts a prepaid penetration rate of 20%. South Korea, on the other hand, barely has 1% of its customers on prepaid, Entner said.

For all intents and purposes, most other countries in Asia, Europe and Latin America are at a prepaid penetration rate of 90% or greater, he added.

“Fundamentally, prepaid is the mobile market in most countries. Overwhelmingly, it is about prepaid,” Mallinson said.

“Prepaid is obviously the minor part of the market in the United States, Canada and Finland. It’s (even more) minuscule in Japan and Korea. Prepaid is very small in those countries and then when you get everywhere else it’s mostly prepaid. In developing countries and Latin American countries you’re talking about postpaid being a matter of a percent or so,” Mallinson added.

Dubious subscriber penetration rates

While the U.S. market is nearing a 90% penetration rate for wireless subscribers, it’s often considered “behind the rest of the world” at that rate, Mallinson points out.

While American carriers’ counterparts are enjoying penetration rates of 120% to 130% in some developed countries, it’s not because that many people are carrying two devices with them at all times.

“You see a lot of multi-SIM usage. There are some countries where they have 120% penetration, but only 40% of the country has a phone. This inconvenience that drives penetration is so unnecessary here,” Entner said.

“The reason it’s higher is because of the prepaid phenomenon,” Mallinson said.

“Even though the per-minute price is quite high (on pay-as-you-go plans), if you’re a low-rate user ... you can sustain that phone on a fairly low expenditure,” he added. “What they’ve managed to do is pick up the low-level users.”

The question of whether that’s a business that you want to pick up anyway is worth asking. Maintaining a large swath of low-usage customers for a few dollars a month of revenue per user, on average, is a tough sell, but they’ve made it work in Europe and elsewhere.

Cost structure is key, Mallinson said. Without a tight grip on operation expenses, it’s not possible to survive on extremely low average revenues per user.

There haven’t been any drastic moves in the U.S. market for low-level users, but as subscriber levels saturate on the prepaid front, more and more carriers may find that their pricing plans are cutting out potential customers. Mallinson said carriers might be forced to make a play for that money they are leaving on the table by targeting low-level users and pushing that penetration rate above 100%.

Still, it won’t come in the form of SIM-swapping that we see so much of outside the United States. Customers in smaller countries find it particularly appropriate

to swap SIM cards because international travel is that much more likely.

While there are reasons behind the inflated number of active SIM cards in many countries, customers in the United States are much less incentivized to follow suit.

“You either just take it on the chin and pay the high charges, or if there’s one place that you go to a lot, you get a SIM for that country,” Mallinson said. “Most people who are traveling abroad ... probably are dealing with one or two countries.”

Why prepaid reigns supreme elsewhere

As is often the case with the structural make-up of most industries, access to cash and credit plays the strongest determining factor in terms of pricing, business models and general consumer access to products and services. The wireless industry is no different.

Where cash economies reign supreme, wireless prepaid also reigns supreme.

But there are other factors at play just the same.

Carriers can and will exacerbate the issue by imposing higher fees and doing everything in their power to minimize the commoditization of voice minutes and data. Carriers have also blazed a trail for prepaid by establishing a wide network of physical and virtual locations where prepaid customers can refill their accounts with ease. Many ATM networks, for example, can now be leveraged as a potential refill station.

Moreover, the cost of implementing pay-as-you-go prepaid for a carrier is much lower. There must be systems in place to track usage, especially to cut off service when available credit runs, but there’s no requirement to maintain a database with details of every call. Therefore, credit control, bad debt issues, billing and customer support are much more of a non-issue with prepaid.

The calling-party-pays effect

Another phenomenon that has impacted the role of prepaid outside the United States is the system of calling party pays. The system of pinning all of the cost of a call on the party placing the call has been driven purely by carriers. It’s a system that has come under scrutiny by regulators and other watchdog groups.

The United States has its own variant called receiving party plays, but few carriers have employed free incoming calls and generally speaking, that doesn’t exist elsewhere.

Calling party pays, however, is much more the norm everywhere else. Carriers have conditioned customers to pay for both ends of every phone call that they initiate.

Calling party pays is yet again another example of carriers promoting disuse and it's a hallmark of wireless operations in Europe. The model has driven multi-SIM usage as well because carriers charge so much less for calls made entirely on their network.

Customers have also been dissuaded from using minutes in Europe because carriers have presented them with a cheap alternative in the form of text messaging. In Europe, text messages cost no more than a penny on average and it explains why SMS took off so much earlier there and with heavy adoption rates.

"The reason Europe was so strong on text messaging was because it was a voice replacement," Entner said.

Calling party pays has long been considered a cross-subsidy between the landline operators and wireless carriers. As regulators became increasingly inquisitive about connection fees and termination fees, the prices handed down to customers have ebbed and flowed over time.

A couple years ago there was debate about whether European carriers would actually lose money if not for the fees they collect under the calling party pays model.

"The entire system of calling party pays has been a bit of a cash cow for the mobile operators," Mallinson added.

Surviving on lower ARPU by design

ARPU is another factor that presents prepaid in a unique light outside the United States and a handful of other countries where it's less dominant. ARPUs tend to be lower on prepaid in international markets and because of the cut-throat competition, many carriers have been so aggressive with pricing that it's made prepaid any even less attractive proposition.

"It's the postpaid countries that have the higher ARPU," Mallinson said. "The U.S. carriers enjoy relatively good profitability" and they tend to not be as brutally competitive as their counterparts in other markets.

As the penetration rate of prepaid increases, ARPUs tend to go down because most of those "higher-hanging fruit" cus-

tomers are also the most price sensitive, Mallinson added.

On the whole, ARPU for postpaid customers is generally double to triple that of ARPU for prepaid customers, Entner said.

This helps explain why the top U.S. carriers – AT&T Mobility and Verizon Wireless – are re-doubling their efforts on postpaid and mostly getting into prepaid at arm's length through resale agreements.

"They are still looking at the high-value customers that stay a long time, spend a good amount of money and the growth for them here is still plentiful," Entner said. "It isn't necessary for them yet."

Meanwhile, AT&T and Verizon have been able to benefit from prepaid without having to invest much in the model or dilute their postpaid plans.

"It's not a separate market. It's not as if Verizon and AT&T can't do it. They have everything they need to do it. All they're doing is introducing a new pricing plan," Mallinson said.

Even Sprint Nextel, arguably the most aggressive tier-one carrier on prepaid, has carefully placed its prepaid offerings under entirely different brands.

"It's all about focus and if you look even at Sprint where they own the brands, they are separately set up," Entner added. "There's no shifting on focus."

Lessons to be learned at home and abroad

While there are structural, economic and cultural reasons for different pricing models in different countries, there are at least a few lessons that carriers can learn from their international counterparts.

"I think what Europe can teach us is to provide the right plan to the right people," Entner said. "What the Europeans learn from us is how to drive usage at a really cost-effective way."

Ho from Current Analysis, told RCR Wireless News it's all about the customers each carrier is trying to win.

"It goes back to carriers looking to acquire high-value users," Ho said. "With an all-you-can-eat product, you don't call customer service. That's what they're hoping for."

Meanwhile it's worth noting that "prepaid's complexion has changed," Ho added. In the United States there is a trend to get more postpaid-like handsets for prepaid customers and that could shift the percentage of U.S. customers on prepaid

substantially over time.

"I think Europe has a different focus. They don't have regional focus. U.S. is doing its own thing," Ho said.

If there is an Achilles Heel for prepaid – and it's likely not the same potential culprit of a couple years ago – it would likely play off a carrier's ability to manage churn and cost to acquire users, he added.

"The prepaid base is a fickle bunch and they would go and jump through the roof for offers," Ho continued.

Prepaid models are likely being strengthened thanks to the greater selection of smartphones available at full retail price. In essence, prepaid carriers have started to flip the issue of a contract on its head by charging customers exorbitant amounts for a top-of-the-line device that only works with their network. Expensive smartphones eventually could become just as much of a churn deterrent as contracts.

"Similar to postpaid, if you're happy with the service, why monkey around with anything else?" Ho posited.

Will U.S. go the way of Europe and Asia?

While the U.S. market can be seen by some to be following Europe's lead on the prepaid front, there is an emerging trend in Europe to follow the unlimited, all-in plans that we're seeing more in the United States.

"The flat-rate model only came about after it was here in the U.S.," Entner said. "If there is a trend in Europe then I would say it's going toward the buckets that we see here in the U.S."

The U.S. market won't ever go the way of Europe and Asia because of all about the credit cards that are linked to our accounts, Mallinson said. The growing reach of Apple Inc.'s iTunes is reinforcing the postpaid model in other markets as well.

"In some countries there's so little postpaid, it's likely to go the other direction," he said.

The prepaid segment has obviously blossomed into a market that nearly all carriers are now targeting with an aggressiveness not seen in the mobile industry for years. As long as customers continue to look at such options, that aggressiveness is not expected to slow. (◀▶)

RCR Wireless News Editor Tracy Ford contributed to this report.