

## ASSIGNMENT 6: ECONOMICS

DUE DATE: 22 SEPTEMBER 2014

Read the extract below and then answer ALL the questions that follow:

**VIRGIN HITS OUT AT MTN, VODACOM**

*Assignment*  
AFTER a seven-year war and only half a million subscribers to show for it, Virgin Mobile has blamed bigger rivals MTN and Vodacom for their unregulated anticompetitive behaviour.

Now, Virgin Mobile CEO Jonathan Marchbank says his floundering operator has given up competing with Vodacom and MTN and switched tactics to building a loyal brand following.

In an interview with Business Times, Mr Marchbank, who has been at the helm for 10 months, said smaller operators were battling to enter the retail market against companies with much larger marketing cheque books.

"Because [Vodacom and MTN] have an existing base, it's clear they basically control the retailer.

"If you as a smaller player go to retailers to offer choice to consumers, the retailers say it will take away from the trailing revenue stream that they already have from Vodacom and MTN because they'll be dividing sales into four different carriers rather than two different carriers," said Mr Marchbank.

This anticompetitive behaviour made it harder for the likes of Virgin Mobile to compete effectively.

But Dobek Pater, an analyst at Africa Analysis, said operators had to have good subscriber numbers to begin with and Virgin only has about 500,000 people signed up.

"When you are a smaller operator, you cannot offer those economies of scale and be able to develop products and services that appeal to that particular market segment, so the retailer would be reluctant to sign a contract with you," said Mr Pater.

But even though Virgin Mobile has nabbed only 1% of the market, it has no plans to close shop.

It hasn't been helped either by repeated shake-ups in its own shareholding, which has slowed down growth. Cell C was an original 50% shareholder in Virgin, but surrendered its share in 2011 in an effort to focus on its own operations, while Richard Branson's Virgin Group in the UK increased its stake to 55%. The other 45% was held by an investment company called Calico Investments.

Calico has sold out and that 45% is now held by Allied electronics group, while the other 55% is held by Virgin Mobile Middle East Africa, made up of various companies, with the biggest shareholder being the UK Virgin Group.

Effectively, Mr Branson's Virgin Group has decreased its stake from 55% to just 11%.

Mr Marchbank would give away no numbers, but said Virgin was breaking even on a month-to-month basis. The shareholders, he said, were still financing big projects. "Right now, our focus is on revenue growth and not profitability, so we have cash from our shareholders."

It has also seemed confused about its retail strategy. After launching, Virgin opened a number of retail stores with the typical flashy Branson marketing hype. But when Mr Marchbank joined the company last August, Virgin was in the process of closing down all 27 stores. Many saw this as a sign of financial problems, but Mr Marchbank said it was part of a deliberate strategy to position itself as a "boutique" store.

Virgin has 10 boutique stores, with plans to increase this footprint by the end of the year.

Mr Pater said this might be a positive strategy. "They can survive if they develop a market niche and have a loyal following for their brand or services. They may be able to attract those customers," he said.

Unlike Vodacom, MTN, Cell C or 8ta, Virgin Mobile has not built its own network, preferring instead to pay Cell C a fee for piggybacking on its network infrastructure.

Recently, some subscribers were left frustrated by technical problems caused by a "system upgrade".

On May 2, Virgin explained that subscribers may have issues with its airtime, data and SMS services. But eight days later, they were still struggling to make calls, send SMSes and use the internet.

Vanda Harries, marketing manager at Virgin Mobile, said there had been "a few bumps along the way, which we are dealing with on a case-by-case basis, but there are certainly no global issues".

But with the explosion in data demand in South Africa, network quality will become increasingly important for consumers and this reliance on Cell C's network may become Virgin's Achilles heel.

Mr Marchbank said the company had renegotiated its contract with Cell C as the previous one was driven too much by voice and SMS traffic. Mr Marchbank estimates that Virgin Mobile contributes 95% to Cell C's wholesale revenue targets, which opens up the door for volume-based pricing.

"If I can drive more data, I can get much better pricing from Cell C. So it's enabled us to go out with data bundles and we're up to 300MB of data," said Mr Marchbank.

As voice revenue drops, cellular operators are feeling the heat.

In this environment, Mr Pater said, keeping costs under control becomes a big focus. "Because they are a mobile virtual network operator, they pay a wholesale rate to Cell C to use their network and the game now [in mobile telecoms] is moving towards cutting input costs."

Virgin Mobile needed to cut costs on the network side and become a more efficient operation in other areas, said Mr Pater.

To illustrate the value of comparing across networks, here's a look at the different special offers available for Samsung's new flagship smartphone, the Galaxy S III.

Vodacom has the S III on its new Smart Light contract for R329 per month (Valid until October 6). This offers 75 off-peak minutes per month, 20 anytime Vodacom-to-Vodacom minutes, 100 SMSes and 100MB of data. The per minute billing means the Smart Light contract is anything but smart (the other smart price plans do offer value).

MTN is offering the Galaxy S III on its AnyTime 350 contract at R499 per month (until September 30). This has R350 of airtime value, 50 SMSes, 75MB of data per month.

Cell C's S III offer is R429 per month on its Straight Up 100 contract, which is bundled with 100 minutes, 100 SMSes (or MMSes) and 100MB of data. This is also valid until the end of September.

8.ta's S III offer is on its Contract 3 for R438 per month. This contract has 60 bundled minutes (to other networks), 230 minutes to other 8.ta numbers or to Telkom landlines, and 25MB of data per month.

Virgin Mobile has the S III on its Classic 300 contract. R300 a month gets you R100 of anytime airtime, 50MB of data and 50 SMSes.

The comparison table below, compares the five different special offers mentioned above. Green-shaded cells are the best value (among those on offer), while red cells are the most expensive (or least value).

The trickiest comparison is the out-of-bundle rates. MTN's are downright punitive, especially in off-peak times. Vodacom tries to sugarcoat its peak rates, buy offering a lower on-network rate (for calls to Vodacom numbers). Its out-peak rates are competitive (as are 8.ta's), but the peak rates mean these contracts will be far pricier than others.

Be very, very wary of the out-of-bundle rates. These will mean you'll end up spending hundreds of rands more on your phone contract every month, especially if you're on a contract that is too "low" for your usage.

Also, this comparison shows that the cheapest contract (per month) is not necessarily the best value. Ironically, the most expensive contract also offers some of the least value.

	Vodacom	MTN	Cell C	8.ta	Virgin Mobile
Price per month	R329	R499	R429	R438	R300
Airtime	75 off-peak, 20 anytime on-network	R350	100 min	60 min + 230 8.ta/Telkom min	R100
Per minute/second	Per minute	Per second	Per second	Per minute	Per minute
In-bundle rate	N/A	R1.95 per min	99c per min	N/A	R2.35 per minute (1st 5 min per day), R1.55 thereafter
Out-of-bundle rate (peak)	R2.70 per min (R1.75 to Vodacom)	R2.35 per min		R1.75 per min (95c to 8.ta)	
Out-of-bundle rate (off-peak)	95c per min (90c to Vodacom)			95c per min	
SMSs (included)	100	50	100	0	50
SMS (out-of bundle)	80c (35c off-peak)	75c	50c	50c	60c
Data (included)	100 MB	75MB	100 MB	25MB	50 MB
Data (out-of-bundle)	R1 per MB	R2 per MB	99c per MB	R1 per MB	60c per MB

It's important to note that these aren't the only contracts the S III is available on. These are the *promotions* currently being run by operators. The same is (obviously) applicable to any other phone and this is the crucial distinction. Use the special offers available to your advantage. Compare, compare, compare!

Also, Vodacom and MTN are reworking and simplifying their contract offers, so expect to see this table look very different in a few months' time.

Finally, the fact that three out of the five networks are trying to force customers on to per minute billing in 2012 is disgraceful. The network operators are counting on you to use only a fraction of a minute (or 1.5 minutes, for example), so that they score with the rounding up. There are very clever actuaries working this out at the networks. Per minute billing is nothing but to your disadvantage. Therefore, the choice (based on *these five special contract offers*) is really between two network operators. And the winner is rather obvious.

Adapted: [www.itweb.co.za](http://www.itweb.co.za)

**QUESTION 1**

- 1.1 With aid of evidence in the given article, comprehensively discuss the market structure in the South African mobile telecommunications industry. (25)  
(10)
- 1.2 What type of barriers to entry exists in this industry and how did Virgin Mobile manage to enter into this industry? Justify why it is beneficial for existing firms to attempt to create such barriers. (15)

**QUESTION 2**

- 2.1 What typical measures have been adopted by the South African government to combat potential abuse of market power by large organisations like MTN and Vodacom? (25)  
(15)
- 2.2 Discuss the kinked demand curve in the context of the mobile telecommunications industry in South Africa. (10)

**QUESTION 3**

The main heading in the Business Times section of the Sunday Times of 2 February 2003 read: 'Telkom tightens its grip on monopoly.' In the article it was stated that: 'The delay in licensing a second national operator is a blow to consumers who have been awaiting the benefits of a competitive market.'

- 3.1 Do you think Telkom had a monopoly in 2003 and if so, in which market(s) did it act as a monopolist? Motivate your answer with the theoretical characteristics of this market structure. (15)
- 3.2 What are the benefits of this type of market which is being referred to in the Virgin Hits out at MTN, Vodacom article. (10)

**QUESTION 4**

Economists say that firms maximises profit by producing a level of output where marginal cost (MC) is equal to marginal revenue (MR). The CEO of Virgin Mobile responds, 'That's a lot of nonsense. I do not even know what marginal cost and marginal revenue mean. How can I be doing something I don't even know about?'

- 4.1 Explain to him fully the profit-maximising/loss minimising rule within the context of a perfectly competitive market structure. (15)
- 4.2 Explain how the profit-maximising/loss minimising rule may be applied under the three (3) scenarios viz. economic profit, normal profit and economic loss. (10)

**Assignment Format**

- Word Limit: Your assignment (excluding index, cover page, list of references and appendices) must not exceed 6000 words. Your assignment should include a Table of Contents page.
- Text: Font: Arial or Times New Roman (12), Spacing: 1½ lines. All text must be justified at each margin.
- Your answers must include any theories, charts, tables, appendices or exhibits necessary to support your analysis and recommendations.
- References - At least 10 sources of reference (textbooks, journals, press reports, internet, etc) must be included in your list of references. The Harvard system of referencing must be used.
- You MUST use theory/literature to support your discussion/observation and opinions. Do not merely extract information from the Case Study.
- Ensure that readings are not merely reproduced in the assignment without original critical comments and views.