Fact Sheet

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"Low Income does not mean No Income"
A Vodacom Initiative

Mobile telephony has undoubtedly transformed communications in almost every country of the world over the last decade and a half. Where historically traditional landline phones were accessible and used almost exclusively by middle and higher income segments, mobile telephony has made it technologically and financially viable to provide access to telecommunications to lower income segments as well, and the response from this market exceeded all expectations. Over the last few years mobile phone companies across the globe have often measured spectacular growth rates in terms of subscriber numbers. In Africa in particular, the market has not nearly reached the saturation levels of more well-established markets. In fact the industry expects the African market in particular to reach 250 million subscribers or a quarter of the continent's total population by 2010[1]. This would amount to a 100% growth rate in the space of five years.

This fact sheet will focus on one example of how Vodacom, the leading mobile phone operator in South Africa, has been tapping opportunities at the Bottom of the Pyramid (BoP) income segment in South Africa through a micro-franchise model dubbed the Community Phoneshop.

Situational information

a. Corporate ID[2]

Vodacom was established in 1993 as a 50-50% joint-venture between the state-owned national phone company Telkom and Vodafone, a UK-based private company, as the first mobile phone operator in South Africa. In June 1994, the first commercial calls were made on cellphones, shortly after the country's first democratic elections[3]. Over the next few years the mobile phone market grew exponentially, and today Vodacom is one of South Africa's most valuable companies with an estimated market value of R 150 billion [4].

"In theory, practice and common sense terms... most routes out of poverty start with enterprise."

Kurt Hoffman, Director, Shell Foundation

1 HARISSON Rebecca, Final frontier for hungry cellphone firms, Business Day, 06 December 2005.

2 VODACOM Annual Report 20073 X, Vodacom customers increase to 34 million, Business Day online, June 9th, 2008. Also available on http://www.businessday.co.za/articles/topstories.aspx?ID=BD4A781646

3 http://www.africanwireless.com/vodacom_history.htm

4 STONES Lesley, Vodacom opts for outsiders, The Weekender, April 26-27 2008, p 9

Key Figures[5]

- No. of Employees: 6000, of which 4500 in South Africa
- Turnover:48.2 bn Rand in 2007
- Market Share: 55% in South Africa, 24 million domestic customers, 34 million in total.

b. Case background

Many rural and urban areas in South Africa had little or no access to telecommunications during apartheid. State operated Telkom SA held a monopoly over the communications network in the country, with a backlog in supplying fixed lines across the country, and there was little effort to reach the BoP segment.

When mobile phone operations started in 1994, South Africa had not only entered a new era in technological terms but also politically. The freshly elected democratic government's main mandate was to transform the lives of underprivileged South Africans. In this regard, Vodacom's initial 1993 licence was reviewed with additional clauses requiring it to provide affordable cellular communications to underserviced areas[6]. The new terms required Vodacom to provide 22,000 phones to previously underserved areas within 5 years, while the mandate would be supervised by the Independent Communications Authority of South Africa (ICASA)[7].

The initial challenge to accessing the rural and low income markets was the cost of cellular phones. An ad-hoc system emerged where individuals with cell phones would rent out the phones on a call by call basis, charging several times the actual cost of the call. Vodacom recognised these entrepreneurs as potential retailers of communication and started looking for ways to formalise this process[8].

Later on, Vodacom would find that what began as a government mandate (although arguably their intention from the beginning), became one of their most profitable enterprises. In 2004 more than half of the traffic on Vodacom's mobile networks came from its 4400 entrepreneur-owned phone shops[9].

The demand for telecommunication from within the BOP may also be driven partially by South Africa's historical and current patterns of fragmented families and migrant labour. For example a BoP family in South Africa may be divided between some members living in the rural areas and others working in the urban areas. Part of the success of Vodacom's strategy could be in recognising the potential to link these two sectors through heavy investment especially in previously underserved areas.

2. Reaching the BoP – the business case for Vodacom

The single biggest factor in the business case is undoubtedly the huge market potential at the BoP. As mentioned, Vodacom's initial venture to reach the BoP is originally regulatory, with the original operating licence requiring Vodacom to providing mobile telephony services to low-income segments. Given the exponential growth of the mobile telephony market, such government prompting was arguably hardly necessary. The untapped, unmet demand for telecommunication in underserviced communities is significant, and its potential was recognised early on: back in 1996 for example, the Transkei region of the Eastern Cape had 19,000 landlines for a population of over 4 million[10].

In addition to these growth opportunities, customer loyalty is created early on. Experience suggests that once they are signed up, customers tend to stick with their initial service provider. As evidence of this, the recent introduction of portability of phone numbers has had only a very marginal impact on the number of subscribers: Vodacom reports gaining almost 17,000 new customers and losing about 23,000 over the first five months of number portability, out of a total customer base of 24 million[11]. As the market leader in South Africa, Vodacom is therefore naturally in a very good position to build a solid, loyal customer base at the BoP which will over time provide steady revenue for the company. This brand loyalty is also especially relevant in the long term with regards of those sections of the BoP which eventually move higher up the income pyramid.

3. Challenges

- Entry barriers

The high cost of calls and handsets constitute an obvious entry barrier to accessing low income communities. Vodacom's community phone shops adress this challenge by offering discounted calls to

5 X, Vodacom customers increase to 34 million, Business Day online, June 9th, 2008. Also available on http://www.businessday.co.za/articles/topstories.aspx?ID=BD4A781646
6 RECK Jennifer & WOOD Brad, WORLD RESOURCES INSTITUTE, What Works : Vodacom's Community Services Phoneshops, August 2003, p9
7 & 8 RECK Jennifer & WOOD Brad, WORLD RESOURCES INSTITUTE, op. cit., p4 & p9
9 & 10 World Resources Institute, South Africa: 2007 P6
11 VODACOM Annual Report 2007, p37

the BoP without having to own a cell phone. Vodacom also introduced 'call per second' billing which gained popularity within the BoP, and further reduced the cost of calls. Cheaper handsets are also becoming increasingly available on the market.

- Security costs and logistical challenges

The lower income groups in South Africa are arguably even more affected by high levels of crime and insecurity than other income segments. In practical terms, insecurity and crime levels add costs in terms of securing installations and equipment, and in some cases affect business operations[12]. An additional difficulty is logistical: poor infrastructure and in some cases the remoteness of low-income rural communities increase the cost of installing containers for phoneshops and reception masts.

- Rising food and fuel prices

In 2004 South Africa's low income communities spent an average of 57% of their income on food, followed by electricity and fuel[13]. Recent price increases for all three items are very likely to have an adverse effect on other non-essential expenses on goods such as telecommunication services. While it is possibly too early to measure the real impact of these price increases, research suggests that communication has nevertheless become a priority among the BoP. Low income communities were spending an average of 1.2% of their disposable income on communication. This exceeds other essential services such as medical and dental (1%) and approaches the percentage of income spent on education (1.7%) This confirms the growing significance of the use of communication technologies amongst the low income communities[14].

4. The response from Vodacom: the Community Phoneshop

Facing these challenges, Vodacom's main response has been the Community Phoneshop concept, a micro-franchise model which has proved hugely successful since its beginnings in the mid-nineties as part of its commitment to provide public cellular phones through a subsidized community outreach program.

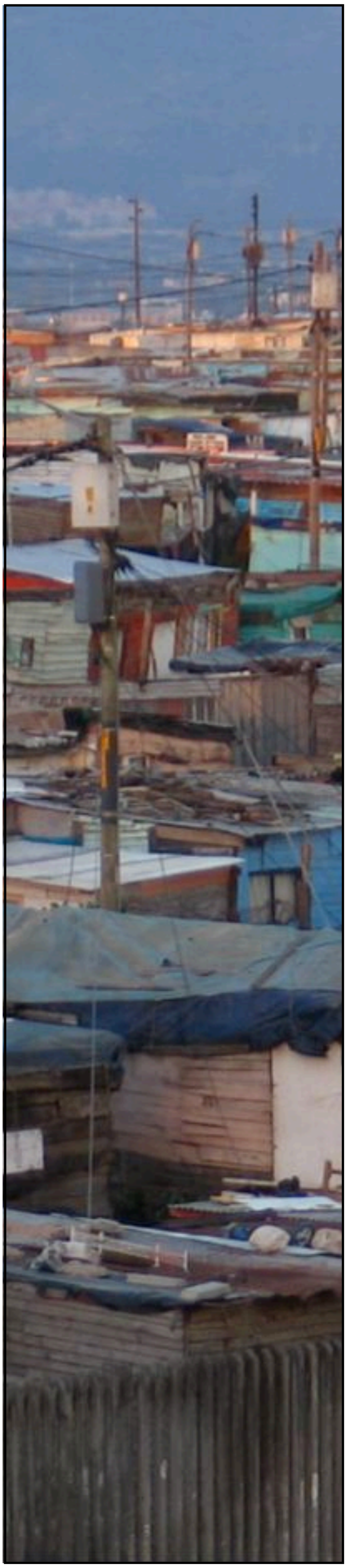
In its essence, the community phoneshop is designed to function as a local phonebooth, equipped with 5 to 10 phones and housed in a spaza shop, a garage or a shipping container for example. In this model, the phoneshop is owned and managed by a member of the community, and the relationship between the shop owner and Vodacom is one of franchisee and franchiser. Vodacom sells pre-paid airtime at discounted rates, which the community shop owner then sells on to his or her customers.

This micro-franchise model has been a resounding success: by May 2008, almost 90,000 such ventures were operating under the Vodacom brand all over South Africa, among them 4,246 out of specially equipped shipping containers. The advantages of the micro-franchise model include the following:

- Lower management and infrastructure costs for Vodacom
- Shop owners are in an ideal position to assess and respond to the needs of local communities
- Shops succeed or fail under their own management, empowering the owners of the micro-entreprise and providing them with a huge incentive to succeed
- Vodacom can build a large distribution channel and brand recognition in a crucial market while minimizing its own financial and business exposure

Vodacom also provides some form of training and support, an important consideration given that the typical shop owner comes from a disadvantaged background with limited financial and business knowledge. However, it has outsourced this training to external providers who run basic training programmes covering topics such as goal setting, financial statement development, staff management and human resources management. Vodacom deliberately shuns away from the "spoonfeeding" concept, the approach being rather one of allowing shop owners to run their business with maximum autonomy, while always remaining available for advice when needed.

Perhaps the most crucial element



12 RECK Jennifer & WOOD Brad, WORLD RESOURCES INSTITUTE, op. cit., p15
13 &14 Bureau of Market Research, Unisa. 2004a. Total Household Expenditure in South Africa by Income Group, Life plane, Life Stage and Product. Research Report No 326. Pretoria.
15 RECK Jennifer & WOOD Brad, WORLD RESOURCES INSITUTE, op. cit., p5
16 KWENA MOYO, Vodacom Foundation, Telephone interview on June 3rd, 2008
17 & 18 RECK Jennifer & WOOD Brad, WORLD RESOURCES INSTITUTE, op. cit., p2 Ibid., p12
19 RECK Jennifer & WOOD Brad, WORLD RESOURCES INSTITUTE, op. cit., p2
20 & 21 Ibid., p7

ensuring the success of the franchise model is the pricing. In terms of the requirements set by ICASA, the rate per-minute is set at 30% of the commercial pre-paid rates, meaning that customers using community phoneshops can make calls at a 70% discount. This price differentiation has naturally been a crucial factor in reaching the BoP income segment. And because the phoneshops sell pre-paid airtime, customers purchase exactly the amount of airtime they need or that they can afford.

Success is also measured through the creation of a new class of entrepreneurs: in terms of the franchise arrangement shop owners earn 33% of the profit generated. In 2003, this translated in an average income of R 9000 per month for the owner of a centrally located township site, a substantial income boost in most cases for the shop owners from previously disadvantaged communities.

Conclusion

Mobile telephony has arguably had a bigger economic impact on the daily lives of lower income groups than any other industry over the last 15 years. In South Africa and across the developing world, mobile telephony has helped create thousands of micro-entreprises and has made a major contribution to economic growth and the upliftment of low-income segments of the population. Africa in particular has benefited enormously as the spread of mobile telephony has unleashed a wave of wealth-creating entrepreneurship, even among some of the poorest people.

In South Africa, partly as a result of regulatory pressure, the strategy adopted to develop the BoP market seems to have focused on differentiated pricing. In effect, this amounts to a cross-subsidy model by which discounted tariffs in the lower income segment are supported by higher tariffs in the “traditional” mainstream market. While this has certainly succeeded in terms of providing access to telephony services, the South African BoP market seems to have been slower than other emerging markets in catching on to other innovative services, such as money-transfer and payment services. There seems to be a case for developing that market: according to the 2007 FinScope survey for the FinMark Trust, roughly 60% of South Africans over the age of 16 have a bank account and 66% of them have access to a cell phone. Yet only 4% use their cell phones for banking. An attempt to encourage cell phone banking was initiated by Vodacom, which offered free cell phone banking until April 2008. The importance of developing this market should not be underestimated as experience in other emerging markets has shown that the economic leverage provided by data services is spectacular.

Perhaps the main challenge to further increasing the company’s BOP clientele is high tariffs. Even discounted call rates in South Africa are comparatively expensive compared to other emerging markets: phone operators in India, for example, charge an average of $0.02 per minute, while in Africa the price is between $0.20 and $0.50 per minute. The low cost of calls in India has been driven by fierce competition between mobile phone operators and an intentional strategy to absorb a greater clientele through access to cheap communications, rather than exploiting the need for communications by charging higher prices but still limiting their base, as has been the case in South Africa. MTN recently introduced MTNZone, which offers considerable discounts (up to 95%) on MTN to MTN calls depending on the time of day that they call. This move has been recognized as the beginning of a price war between the competing providers. However it is unlikely that Vodacom’s influence in the BOP will be significantly damaged because of the convenience they provide through the Community Service initiative, their established infrastructure in previously unreached areas and their connection to low income markets through specific targeting and communication.

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