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Solon Telecoms White Paper

Micro lending – service innovation in the mobile sector

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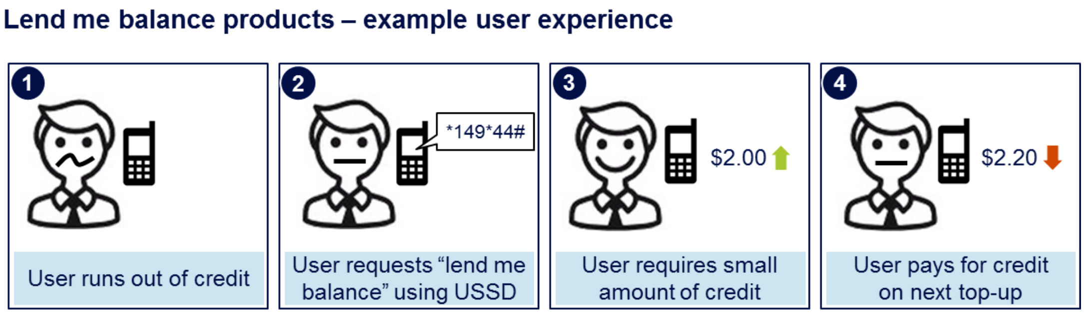
Driven by hyper-competitive markets and stagnant ARPUs, developing-world mobile operators are looking to outsourcers to run new services for them: one of the most successful products has been lending airtime. We estimate $19bn of airtime was lent in 2014 globally, with platform providers taking as much as five per cent of this in service fees. With their entry into the financial services arena, platform providers are now a powerful complement to the existing mobile financial services platforms of the MNOs.

What is Airtime Credit Services (ACS)?

ACS platforms enable mobile operators to sell airtime on credit, 24/7, to their prepaid customers through a proprietary platform which works on a USSD or app interface. MNOs report that credit sales of airtime can account for 25% of revenue in some markets with consumers driven primarily by the convenience of needing emergency airtime rather than cashflow constraints.

FIGURE 1



Most MNOs use a third party provider (e.g. ComzAfrica, Simbrella, Upstream or MoDe), while a small number of operators have developed an in-house solution (e.g. Vodafone, Orange and Millicom). MNOs typically operate a revenue share with their platform provider with the platform bearing credit risk and SLAs in return for 50% of the revenue generated from the service. Consumers typically pay 10% of the lent balance as a service fee to the operator (so the platform provider takes 5% of the lent balance).

Platform providers must buy bulk airtime from mobile operators and lend it out to users and their choice of funding model radically alters their return on capital. We have observed three primary business models through which third party providers can finance the purchase of airtime:

- By **paying in cash** – lowest return on capital with large working capital required to finance growth;
- By **asking the operator to lend the airtime in return for a bank guarantee** – medium return on capital, but requires availability of bank guarantee;
- **Vendor financing** – where the operator lends airtime to the platform operator – highest returns on capital depending on cost of vendor financing.

What is the size of the market?

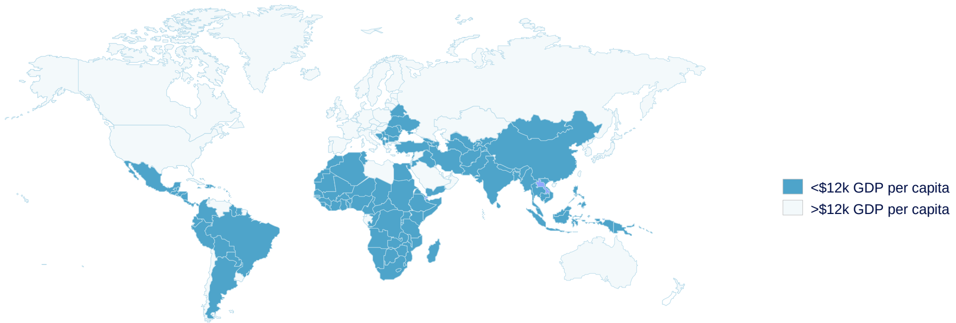
We estimate the global potential for ACS service fees (the amount charged to end users) to be $1.9bn in 2014. This equates to ~$19bn of lending. The majority of the value is concentrated in the Asia Pacific region ($1.2bn). However, not all of this potential is yet realized with many significant areas of under-penetration including India and China.

We estimate the global market is growing fast (9.2% CAGR) and we forecast it will reach almost $3bn by 2019 driven by the growth in global mobile penetration and population growth ($30bn of lending).

Based on our experience and evidence from several markets, we estimate the market is concentrated in countries with GDP/capita at less than $12k.

FIGURE 2

Airtime credit service fee potential in 2014



		Asia-Pacific	LatAm	Africa	Europe	Middle East	Total
Airtime credit value lending	*$m*	12,394	2,789	2,573	694	580	19,030
Airtime credit service fee potential	*$m*	1,239	279	257	69	58	1,903
Share of total		*(65%)*	*(15%)*	*(14%)*	*(4%)*	*(3%)*	-

1) Assumes no market potential in countries where GDP per capita > $12k p.a.
Source: IMF, Solon market model, Solon

The credit scoring algorithm – the 'secret sauce'

Our analysis shows the success of ACS platforms is driven by five main criteria:

1) Activity rate (i.e. active users divided by active MNO subs) – this is largely out of the control of ACS outsourcers;
2) Qualification rate (i.e. share of qualified users) – driven both by MNO preferences and by the credit scoring algorithm deployed by the platform provider;
3) Number of transaction per user – this is largely out of the control of ACS outsourcers;
4) Transaction value – driven by the appetite for risk of the outsourcer and the preferences of the MNO host;
5) Bad book level – driven both by qualification criteria and by the strength of the credit scoring algorithm.

Many providers claim to have a 'secret sauce' credit scoring algorithm which helps them select eligible customers. In reality we find most providers use three variables to qualify users:

- ARPU;
- Tenure (i.e. how long the customer has been active on the network);
- Date of last call/top-up.

Opportunities and threats for ACS providers

In order to continue to grow, ACS platform providers will have to evolve beyond their traditional airtime lending businesses. We see expansions in three primary directions beyond selling in new markets and to new MNOs:

- Evolving from micro lending of airtime to higher value cash loans enabled via MFS. In this trajectory, ACS providers have the opportunity to become the 'banks' of MFS, enabling electronic loans using the user data to which they have access to perform credit scoring;
- Becoming the credit bureaux of the emerging markets – by making use of the operator and behavioural data to which they have access, and developing much more sophisticated algorithms, they may be able to position themselves as the gateway to the only reliable credit scoring info in their markets;
- Becoming the enablers of mobile payment between recipients and payees – for example by integrating with utilities. We have already seen examples among companies with whom we have worked.

Our experience suggests that despite the nexus between ACS and the highly regulated financial services industry, there is little regulatory threat to the business model:

- The main regulatory impact is on the MNOs who are required to register SIM owners this covers the limited KYC requirements;
- There appears to be little future threat to ACS with regulators focussed on MFS and ensuring voice and data quality measures;
- Regulations concerning data protection are likely to evolve in the 3-5 years horizon.

However, the businesses active in this sphere will still have to address the fact that many of them have been built on single client relationships or single territories, and evolving beyond this is a significant challenge.

The MNO perspective

MNOs have been quick to adopt outsourced ACS services driven by three underling factors:

- Increasing competitive intensity means any service which reduces barriers to spending and is valued by customers is quickly adopted;
- Increasing complexity of service platforms means allowing an outsourcer to manage what is, in effect, a VAS platform can help to contain complexity;
- Corporate conservatism means opcos are rarely allowed to take the credit risk associated with ACS services, but are permitted to pass on that risk to third parties.

We believe this trend will continue, although we note that ACS providers will increasingly stray into the territory of the MNOs mobile financial services products.

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