

ENIL Response to Consultation Paper on Reserve Price (RP) for auction of FM Radio channels in New Cities

There are several very important points made in this consultation paper. These are points that the radio industry has struggled to explain to the Government. We are grateful that TRAI has expressed them so forcefully:

- 1) Revenues generated from the auction process are incidental to the larger objectives: 1.8 reads *“The Authority recognizes that the primary purpose for the auction of additional FM Radio channels is to give a boost to the FM Radio movement in the country so as to contribute to development of society, fulfill the entertainment and information needs of the citizens, and promote socioeconomic activity. The revenues generated from the auction process are incidental to these larger societal objectives.”*

Again in 2.1, it is said *“The primary purpose of auctioning FM Radio channels is to boost the FM Radio movement and expand its outreach. The expectation is that FM Radio will contribute towards development of society, fulfill the entertainment and information needs of citizens, and promote socio-economic activity. The revenues generated from the auction process are incidental to the realization of these larger societal objectives”*.

And as if to further reinforce this most important point yet again, point 2.10 states *“It is important to reiterate that the revenues generated from the auction process are only incidental to the larger societal objectives. It is essential that the estimated RP for a channel in a city enables price discovery”*.

- 2) FM radio will help enhance economic activity: Building further on how the arrival of FM radio can actually contribute to development of society, point 2.11 mentions *“The availability of private FM Radio services in Tier-3 cities will enhance economic activity, generate employment and promote cultural activity that, in turn, will positively impact the overall growth and development of these areas. While there is direct revenue generation that will accrue to the Central Government from proceeds of this auction, FM Radio broadcasting will also enhance indirect revenue generation for the Central/ State Governments and Local bodies in the form of taxes, levies and other benefits because of the resultant increase in economic, social and cultural activity”*. This means that the policy regime must support and encourage the growth and spread of FM radio services across the length and breadth of the country.
- 3) The Reserve Price formula used for Phase-2 cities is flawed. The paper indicates as much when in 2.5, it is stated that *“However, this yields inconsistent and/or irrational results”*. And *“It is unreasonable to expect, even after a gap of almost 10 years, that the prices set for Chandigarh and Panaji are reasonable reserve prices for Shahjahanpur and Ratlam respectively. Similarly, the reserve prices of Cuddapah and Neyveli worked out above appear to be out of sync (far too low) with the revenue generation potential of these cities”*.

- 4) The downside risks of a low Reserve Price are very limited. In point 2.39, in the context of setting low Reserve prices for “other cities”, it is mentioned that “*The inherent design of an ascending e-auction process would anyway ensure that the true market value of the FM Radio channels in each city is discovered during the process of auction.*” Equally strongly, point 2.10 mentions “*Fixing a very high RP may discourage prospective bidders possibly leading to a situation where demand does not match supply i.e. some channels remain unsold. Efficiency of allocation would not be realized in the process. It would also defeat the larger societal objectives of the FM Radio expansion policy*”.

These four major points set the tone for a discussion on the subject of Reserve Prices. In an era when auctions are considered to be the best and most fair way of allocating national resources, it is important to pause and remind oneself of the larger objectives – that it is not revenue maximization, but the achievement of overall social and cultural objectives. Nowhere is this truer than in the case of media, especially of a low-cost, advertising-dependent medium like radio – where differentiated content catering to diverse segments of the population, including the underprivileged, must be facilitated and in fact ensured. A single minded pursuit of high bid prices, either through high RPs or otherwise, will ensure that this objective fails.....and that a Marathi channel never comes up in Mumbai or a Punjabi one in Delhi.

The fourth point above is the most important of all. As evidence of the fact that high RPs can lead to channels remaining unsold, just look at the experience of Phase-2. As many as 135 frequencies in 69 cities have been left idling for the last 9 years (since the auctions in Jan 2016). If the RP in Phase-2 had been set at 10% of the maximum bid (rather than 25%), then most of these might have been allotted. The government would have made revenues, directly through OTEF and annual license fees, and indirectly through taxes of various types. The people would have benefitted from more programming diversity as those who paid less might have experimented with smaller formats. In Hyderabad for instance, there are only 4 channels against the possible 8 and in Patna only 1 against the possible 5. Such a loss of public interest can be attributed solely and solely to high RP in Phase-2.

These 135 frequencies have been offered for auctions in the 1st batch of Phase-3. However, they have again been saddled with very high RPs – in fact four times higher than in Phase-2. It’s strange that while high RPs led to many frequencies remaining un-allotted in Phase-2, the government thought it wise to increase RPs drastically in Phase-3. Radio industry players believe not more than 50% of these 135 frequencies are viable at these RPs. If this is proved true in the March/April auctions, the government will find itself in a bind. How will it allot these un-allotted frequencies? Will it lower the RPs then? If these frequencies eventually go at lesser valuations than the previous ones, how will the government answer to the complaints of earlier bidders who were compelled, for no fault of theirs, to pay higher values? It’s important therefore that the government not fall into the temptation of keeping RPs too high, and instead remind itself that the RP is just the starting point of the auctions.

Before commenting on the methodology developed by TRAI to calculate RPs, we would like to mention a few guidelines that TRAI may want to follow in setting RPs. Fundamentally, we believe that low RPs are better than high RPs. If one has to err, it should be on the side of lower RPs. As the TRAI has appropriately mentioned, e-auctions will anyway ensure that the true market price is determined, even if the RPs are set too low. The guidelines are as under:

Guidelines for fixing Reserve Prices:

1) Reserve Price is merely the starting point of bidding:

An impression exists that the RP is the price at which the license will be given away to a bidder. In fact, this is not true at all. **The RP is merely the starting point of bidding, not the ending point.** The price at which a license is give away doesn't depend on the RP, but on the fee determined by the auction process.

2) A low RP is better:

A low RP is better because:

- a) It encourages more bidders to bid: When the RP is small, even small bidders feel encouraged to participate. Bidding is more "inclusive" with regional players, non-media entities and small broadcasters also entering the fray. Bidding doesn't remain the preserve of the rich, wealthy corporates. **A low RP busts crony capitalism by making the whole process more participative.**
- b) leads to more accurate determination of "fair market price": **Higher participation leads to more intensive bidding.** This helps determine the market price for the spectrum more accurately than auctions conducted with only a few bidders in the race. **It is in the government's interest that the license fee be fair - neither too high, nor too low.** If the license fee is too high, then the winner typically tends to cut on operating costs and investments with the intention to recover some of the excess costs. As a result, service quality suffers and with that, consumer satisfaction. A case in point is telecom services in recent times. A report in The Hindustan Times dated 9th November, 2014 (*Call drops spell trouble for mobile phone subscribers....*<http://tinyurl.com/nt6tapw>) mentions "*lack of investments by telecom companies*" as one of the reasons for "*frequent call drops, patchy connections and difficulty in getting through*". A very low license fee on the other hand means obvious opportunity loss to the government.
- c) it Leads to higher OTEF: **Because of higher bidding intensity, it is most likely that the final OTEF would in fact be higher if the RP were kept smaller.** This was clear from the 3G and BWA auctions of 2010 when the government received bids totaling Rs 67,700 crores and Rs 38,500 crores respectively. This was possible because the RPs were kept "reasonable" at Rs 3,500 crores for a pan-India licenses. The low RP attracted as many as 9 serious bidders leading to intensive bidding.

Thus the idea that a low RP would fetch the government a low OTEF while a high RP would reward it with a higher OTEF is bizarre.

3) RP can even be zero:

Since the RP is merely the starting point of bidding, it can even be set at zero. **A zero RP does not mean that the license will go away at zero** as already explained above. **The only way the license will go away at zero price is if the demand is far lower than the number of licenses available. If this is indeed true, then that's the market reality and the government must accept this reality.** Since airwaves are public

properties, and must be deployed for public good in the best possible way, a zero license fee should be seen as being the best way to achieve public good. In the 1998 and 2002 guidelines for ISPs for example, the DoT had completely waived off license fees till 31st October 2003 and charged only Rs 1 per annum post that date (*source: TELECOM REGULATORY AUTHORITY OF INDIA: Recommendations On Definition of Adjusted Gross Revenue (AGR) in License Agreements for provision of Internet Services And minimum presumptive AGR, 1st May, 2014*). Even in Phase-2 auctions, the TRAI had refrained from announcing any RPs in the one-step tendering auctions, even though they could have easily specified one in the form of a "floor" price. The absence of the floor price led to many small bidders participating, and this in turn led to a highly successful auction process. The government made more than Rs 1,300 crores in OTEF, and the roll-out happened without any glitch.

4) RPs don't need to be "inflation indexed":

Again, since RPs are only the starting point of bidding, there cannot be any indexation on grounds of inflation. An auction automatically factors in the effects of inflation. For example, if the market opportunity in a city has expanded in 2015 in comparison to 2006 or 2011 (partly as a result of inflation), then the auction held in 2015 will yield a higher discovered market price. **This is the beauty of auctions; they take into account *all* changes in market conditions that take place between two points of time. In fact, the government should not even attempt to index RPs because if it does that, it will struggle to find the right means to do the indexation.** Should the indexation be based on inflation, or population growth in a city, or change in economic status of a city or something else? As an example, if inflation is 5%, but a particular city has grown very rapidly, then even indexation at 5% per annum will keep the RP too low. On the other hand, in another city where economic growth has been slow, a 5% indexation will be too high. **The only way to arrive at the right market price is through the auction process, because bidders know exactly how a city's market potential has changed.**

5) If anything, RPs in FM radio should go down with time, not up:

Unlike mines or telecom spectrum or oil/gas, the future value of FM spectrum keeps decreasing with passage of time. This is because all mainstream media (MSM) like newspapers, TV and radio are under a vicious attack from "online" media. The deleterious effect of online on newspapers has been visible for over a decade in the US and other western countries, where the internet has spread far and wide.

The next medium to come under attack will be FM radio. In the US, FM radio growth rates have already slowed, as online broadcasters like Pandora have grown. Pandora today has more than 200 million registered users. More than 75 million of these are regular users of the service. In comparison, there are about 300 million listeners of FM/AM radio in the US. **Clearly, the gap between online and traditional radio is reducing.** What is happening in the US today is bound to happen in India in a few years. Already, thanks to the mobile revolution, internet usage in India is soaring. **For most major online brands, be it Facebook or Google or YouTube, India is already amongst the top 3-5 countries in the world.** A recent IAMAI (Internet and Mobile Association of India) story titled "*Mumbai Tops With Highest Number Of Internet Users, Delhi Registers Highest Growth*" (<http://tinyurl.com/o78ffqr>) indicated that our metros are already getting saturated with mobile-based internet access. In Mumbai, there are 16.4 million internet users while the same figure in Delhi is 12.5 million. **With such a large user base, and with**

growth rates ranging from 25-50% per annum, it is a matter of time before online radio starts impacting revenues and consequently value of conventional FM radio.

This worry already weighs heavily on the minds of radio broadcasters. It should on the government's as well. The government in fact must demonstrate exemplary smartness in acknowledging this reality. **It should consider doing three things 1) conducting auctioning off all available frequencies rapidly without wasting any more time 2) reducing channel spacing to 400 KHz and auctioning those additional frequencies also at the earliest and 3) increasing license period to 30 years so as to realize maximum potential value today.** The 3rd point is particularly important. **If licenses are given only for 15 years, and re-auctions conducted at the end of that period, there will be almost no value left. But if licenses are offered for 30 years today, then bidders may be willing to pay a higher sum because of the attractiveness of the license period.**

6) Linking Phase-3 RPs to "maximum bid" of Phase-2 is wrong:

Phase-2 auctions were based on a different methodology: One-step tendering. Or should we say, one-step "blind" tendering. Blind in the sense that no bidder knew what the other bidder would bid in its one attempt.....and therefore it had to decide its own bid blindly. In contrast, in an ascending e-auction, the bidder knows at each step what other bidders are bidding (the bid value for that step) and can decide whether to bid further or not. Blind also because bidders had no idea of the market potential of the market in most new towns, and hence again made an assumption and bid blindly. Today of course, the bidders have a far better idea of what the market potentials are.

As a result of this blind nature of bidding, different winners ended up paying different amounts for the same license. As mentioned earlier, TRAI had refrained from specifying any Reserve Fee or floor price. The Reserve Fee was determined *post-auction*, and set at 25% of the maximum bid. It was used not in the conventional manner as a starting point, but interestingly, as an ending point - a "cut-off" to determine who was to be disqualified. **As a result of this cut-off fee, a bid-range of 75% of the maximum bid was considered as a valid range. The lowest winner could be 75% lower than the highest bidder.** As examples, the highest bid in Delhi was Rs 31.4 crores and the lowest successful bid Rs 10.3 crores (67% off the highest) and in Bangalore, the highest was Rs 21.6 crores while the lowest successful bid was just Rs 6.0 crores (72% off the highest).

Clearly, both winners - the top and the bottom - had a different perspective of the market. The higher bidder believed that the market potential was higher. The lower bidder believed that the market potential was lower. As mentioned earlier, this happened because both bid blindly, not having any experience of the radio market. As later seen, the highest bidder (in most cases) lost money for several years before turning profitable just before the license period ran out. At an overall 10-year level, the highest bidder either returned negative or only marginally positive IRRs. All this is easily verifiable. Listed companies like DB Corp (My FM), Reliance Broadcast (Big FM), Sun TV (Red FM), HT Media (Fever FM), Next Media (Radio One) and ENIL (Radio Mirchi) - are all available for a study. If this is correct, **then surely there is no sense in perpetuating the mistake made by the top bidder of Phase-2 by setting its highest bid as the reserve fee in Phase-3.**

Ascending auctions are multi-step in nature, and hence bidders have many opportunities to evaluate their bids. Also in 2015, there is far more information available about market sizes than ten years back. All of this points to the fact that **if RPs are too high, the auctions will simply fail. In fact, the TRAI has itself pointed this out in its objections to the RP formula....that auctions could be jeopardized.**

Clearly then, linking the highest blind bid of one sole bidder in a tender-style auction to the RP of a totally different auction style, viz. ascending e-auctions, is blatantly wrong.

7) Setting RP at maximum level only helps incumbents:

The only possible logic for using the maximum bid as the RP is to protect the incumbent who bid the maximum. For if the RP was lower, and if the final bids also ended up lower, then this incumbent might feel cheated. And it might resort to legal action. This incumbent could argue in the courts that if it had a chance to bid again, it would have had to pay lesser.

However, if the incumbent were allowed to bid and acquire another frequency - as Phase-3 policy allows - then this argument fails. For the incumbent would also be able to bid with a lower RP and take advantage of it.

8) The lowest bid of Phase-2 could be the RP:

If a Phase-2 benchmark HAS to be used, then it can only be the lowest bid of Phase-2. The reason is simple. Before using any Phase-2 benchmark, one has to convert the bidding methodology from one-step tendering (Phase-2) to ascending e-auctions (the method of Phase-3 auctions). **If Phase-2 auctions were conducted as ascending e-auctions, then by the very nature of these auctions, the lowest bid would have been the final bid.** At this lowest point, the supply and demand would have become equal and the auction would have stopped. This is not a random point but one that draws from the ascending auctions methodology. It is scientifically provable. In fact, if "lapsed" frequencies (those not taken up in Phase-2) are also considered (2 in Mumbai, 1 in Delhi etc), then the final bid would have been even lower than the lowest successful bid as recorded in Phase-2 auctions!

As an example, the lowest bid in Delhi was Rs 10.3 crores and the bid that failed (because of the "cut-off" fee) was Rs 3.1 crores. Had ascending e-auctions been conducted in Phase-2, all bidders would have had to pay Rs 3.1 crores only because at that point, supply would have equaled demand.

This is a very important point that the Government completely ignored in framing the current Phase-3 RP. It failed to equate the bidding methodologies before using Phase-2 as a benchmark. TRAI must now correct this flaw.

9) With 400 KHz separation, an even lower RP is needed:

TRAI has twice recommended that the channel separation should be reduced from 800 KHz to 400 KHz. If this were done, several new frequencies would be released and auctions would happen under

conditions of adequate supply. In such a situation, the RP would have to be kept even lower than the lowest bid (or the failed bid) of Phase-2 as mentioned in point 8 above.

As an example, take the case of Delhi. As mentioned in point 8 above, all 9 winners would have paid Rs 3.1 crores each as their OTEF. Now consider the effect of reducing channel separation to 400 KHz. Let's say an additional 5 channels get released in Delhi as a result of this action (even though, theoretically 9 new channels should get released, in practice, only 4-5 would get released because of network design across neighboring territories). Now if the same principles were applied to this new scenario, then clearly, the fair RP should be $\text{Rs } 3.1 \text{ (failed bid)} * 9 \text{ (existing frequencies)} / 14 \text{ (total number of frequencies available now)} = \text{Rs } 2.0 \text{ crores}$.

As another example, take the case of Bangalore. Here the highest bidder paid Rs 21.6 crores and the lowest successful bidder paid Rs 6.0 crores. There were three failed bidders, who all bid below the cut-off fee of 25% of Rs 21.6 crores = Rs 5.4 crores - these players bid Rs 3.1 crores, Rs 2.1 crores and Rs 2.0 crores. With this, the Bangalore market settled with 7 broadcasters and one lapsed frequency. Ideally, had e-auctions been followed in Phase-2, Bangalore would have had 8 broadcasters, and each of them would have bid Rs 3.1 crores, the bid of the 8th bidder. Now consider the effect of 400 KHz of Bangalore. Let's say here also 5 new frequencies become available. Then the fair Reserve Fee should be $\text{Rs } 3.1 \text{ crores (failed bidder)} * 8 \text{ (existing)} / 13 \text{ (total number of frequencies available now)} = \text{Rs } 1.9 \text{ crores}$.

It is clear from these examples, that if 400 KHz separation is accepted by the Government, then the RP should be lowered even further than the lowest successful bid of Phase-2.

Comments on TRAI's suggested methodology:

Q1. Do you agree with the proposed approach/ methodology for determination of the valuations of FM Radio channels in 253 new cities in Phase-III? You are welcome to suggest an alternative approach/methodology with justifications.

Answers to Q1:

Clearly, the method suggested by TRAI appears to be faulty, as it fails what is often called the "smell test".

The whole reason for this review of the present RP by TRAI was that the Authority itself felt that auctions would be jeopardized if the RP was not revisited. The logical inference of this was that TRAI thought the RPs were too high. **Which is why it's rather surprising that TRAI has actually come back with a formula that actually increases the RPs from the existing levels.** As an example, TRAI's new RP for Ambala is Rs 1.5 crores, whereas it is Rs 1.26 crores as per the current formula. Likewise, TRAI's new RP in Latur is Rs 3.56 crs while it is Rs 3.51 crs as per the current formula. Even in the other two examples mentioned in the consultation paper (Dhanbad and Mahesana), there is only a very slight reduction in RPs. Clearly, this could not be what TRAI set out to achieve.

The fundamental problem with RPs remains. If RPs for Dhanbad and Latur are determined by TRAI's new method to be Rs. 5 crs and Rs. 3.56 crores, there is something very fundamentally wrong. The whole

Dhanbad FM radio markets size is a maximum of Rs 2 crores per annum, to be divided between 3 broadcasters. How can the RP then be so high? Likewise, there is no way that the RP for a tiny city like Latur can be higher than that for a much bigger town like Nashik, which under the flawed Phase-3 formula, is already very high at Rs. 3.5 crores. Equally, how can the RP for a tiny city like Dhanbad be so much higher than for Ranchi, which is the capital of the state, and which has an RP of only Rs. 0.6 crores as per the present formula?

Upon analyzing the TRAI method, we find some merit in the way “region” has been replaced by a combination of “per capita GSDP”, “per capita Gross Revenues” and “listenership”, even though in our opinion, the region still matters. As is well known to radio broadcasters, the South is the best region for radio, followed by the North and West. But getting three estimates of valuation based on the three variables, and then taking the average is still a good way to arrive at the final valuation. Using “average of successful bids received in Phase-2” instead of “highest bid of Phase-2” is definitely more logical. Keeping the RP at 80% of this final valuation prima facie looks to be a logical approach.

However, there are specific reasons why the suggested method makes the RPs jump back to where they were already. Some of these are:

- 1) TRAI has used the period difference between Phase-2 and Phase-3 licenses (10 years v/s 15 years) to bump up prices by a factor of 1.5. In our view, this is an error for the following reasons:
 1. Firstly, with the rapid advancement of digital streaming (just see the aggressive marketing being undertaken by brands like Gaana.com and Saavn.com), **it is a matter of time before FM radio revenues are negatively affected by digital streaming companies.** In our estimate, the impact of digital streaming will start to be felt by the year 2019-20 when the growth in FM revenues will slow down by a quarter or so from this year, and for the next 3 years. From 2022-23, there will be a further dent to FM revenue growth, which could turn flat (zero), or even negative. This expectation is based upon the projected growth in digital connectivity – more than 600 million internet users will likely exist by 2019-20 and many more by 2022-23. In fact, the penetration of digital in urban areas is already very high and could go beyond 75% very soon. The net result of this is that whether it is a 15 year or 10 year license, there is no extra benefit that radio broadcasters get beyond 2022-23. In fact, it is our strong belief that if auctions were held even 10 years from today (the original license period), the government would get much lower (perhaps even negligible) OTEF then. **The smarter thing for the government to do would be to make the license period 30 years....and extract whatever additional value it can right now itself.**
 2. Secondly, in any case, the additional 5 years come up at the end of the initial 10 years. And in any discounted cash flow (DCF) model, the importance of the last 5 years is minimal. Discounting is typically done at 16% (internal hurdle rate), while “organic” revenue growth (on a same station basis) on a long-term basis is around 8-10% only. Hence a straight bump up by 50% is wrong. Mathematical analysis shows this should be between 29-33% at 8% and 10% revenue CAGR respectively.
- 2) TRAI has used the “much time has elapsed since 2006” logic, and used the growth in WPI to bump up RP by a factor of 1.798. But this is flawed too.

1. Radio pricing has actually *fallen* since 2006, not risen. For most radio broadcasters, the best year in terms of pricing was FY09. Toward the end of FY09, courtesy of the Lehman crisis, radio prices (as also other media prices) crashed by 30-50% almost overnight. For ENIL, the network pricing in December 2008 was Rs 12,000 per 10 seconds (gross including 10% Service Tax). Today, we struggle to sell at Rs 10000 per 10 seconds (with a higher 12% Service Tax). **So there's no inflation.....in fact, there is deflation in radio.** The only way radio companies have been able to grow revenues is by increasing volumes. And with no more volumes available now, growth in the future is bound to be muted.
 2. Linking up with the point made above about the onslaught of digital streaming, it is our considered view that pricing will come under further pressure in future years.
- 3) Even considering Phase-2 average values amounts to perpetuating past mistakes:

1. **One of the most important reasons why Phase-2 bid numbers are unusable is that they were decided to a very large extent by the number of frequencies that were put up for auctions then.** As an example, take the city of Kochi (population of metropolitan area 21 lacs as per 2011 census). The maximum bid received was Rs 10.12 crores. Compare this with Chennai (population of metropolitan area 86.96 lacs as per census 2011) where the highest bid was a more reasonable Rs 12.6 crores. The reason for this peculiar behavior? There were just 2 frequencies on offer in Kochi while there were 7 in Chennai. It's a matter of some conjecture (and mathematical modelling!), but had 7 frequencies been made available in Kochi also, the max bid would not have settled higher than $Rs\ 10.2 * 2/7 = 2.9$ crores. So should R 2.9 crores be taken into consideration or Rs 10.2?

As another example, the highest bid in a small city like Chandigarh (population 10.55 lacs as per 2011 census) was a mind boggling Rs 15.6 crores. Again, Chandigarh had only 2 frequencies on offer. Should TRAI consider Rs 15.6 crores at all?

This brings up another important point that TRAI may want to consider and recommend to the government. The network planning undertaken by the government in 2006 was flawed. **Why would cities like Delhi or Mumbai have only 9 private FM frequencies, while a small city like Jabalpur have 4?** It is this "randomized" allocation of frequencies that skewed the bidding in 2006. If there had been only 2 frequencies in Jabalpur but 18 in Mumbai, that would have been a better allocation of scarce spectrum. That would also have made the bids more realistic. If an error was made, why perpetuate this?

In fact, the learning from this is that when new frequencies become available under the 400 KHz regime, the distribution of these new frequencies should be done keeping market potential and needs into account. **For example, if 9 new frequencies are made available in the Delhi area, then as many as 6-7 should be given to Delhi city, and only 2-3 to smaller towns in the neighborhood of Delhi.** If instead, the government gave only 2-3 to Delhi, and kept 6-7 for the smaller towns around Delhi, it would be misallocating resources. TRAI may want to make a reference to this in its recommendations.

2. Here is another reason why Phase-2 prices should not be factored in. The bids of Phase-2 have proved to be unviable for the bidders. TRAI can access financial statements of most broadcasters since the time of their launch from RoC. An analysis will show that every big and small broadcaster has lost a huge amount of money in Phase-2.

Accumulated losses of some of the big broadcasters run into hundreds of crores. It's only of late that they have managed to turn PAT positive, but they have still not been able to recoup accumulated losses. This means that their promoters have generated no returns....in fact, they have actually lost capital. Why then should we continue using these numbers as a benchmark at all?

- 4) TRAI has used averages of existing D category towns and applied them to new D category towns:

On account of inadequate sample sizes, some statistical errors might have crept in. **For example, there were just 8 towns in the "DJ" cell, 3 in "DK" and 4 in "DL" from among the current towns. Average derived from such small samples have been applied to 177 new towns of DJ category, 252 of DK and 246 of DL.** Because of the small sample size of existing towns, skews have developed. For eg. Shimla (Rs 126 lacs), Panaji (Rs 171 lacs) and Karnal and Hissar (Rs 90 and Rs 61) lacs have skewed the averages in the D category. These are the most important cities in their respective states of HP, Goa and Haryana. Now bids in these cities are sought to be applied to many more new cities.

Further, in Phase-2, the D category towns were described as towns with a population of 3-5 lacs. In terms of 2011 census, the populations of these cities must have risen further. So the cut-off of the earlier D cities can be assumed to be 4 lacs. Most new D category towns in Phase-3 however are from the 1-3 lacs population bucket as per 2011 census (cut-off 1 lac). **If benchmarks set in Phase-2 are to be used, then rather than using "average", we should use "one-fourth of average" to take into account differences in populations.**

- 5) TRAI has assumed continuous long-term economic growth in the future:

While it is true that the long term economic growth prospects of India are good, it is also a reality that there can be negative surprises in the future....like the one we have seen since the Lehman crisis in FY09. This has made planning for 15 years very complicated. **The only way to take economic volatility into account is to bring in a "skip year" every 4th-5th year.** This means that one must budget for a zero-growth or even negative-growth year every 4 or 5 years. If this is done, the market valuations no longer remain that optimistic. A savvy regulator like TRAI must consider this factor, and build it into the RP model.

- 6) TRAI has conflated mobile penetration with FM listenership:

While it is true that FM radio listenership happens largely on mobile handsets, it is not true that higher mobile penetration leads to more FM radio consumption. IRS (Indian Readership Survey – the most comprehensive study on radio listenership across the country) data indicates that FM radio penetration is barely 25% of the population in a city like Delhi or Mumbai, while we know from TRAI data that mobile penetration is 100% or even more. This same pattern is borne out in most cities. In fact, nationally the FM radio penetration is barely 160 million (just 10% of the

population) while the national mobile penetration is some 900 million (or 75% of the population). To use mobile penetration data is thus flawed.

There is a reason as many people don't consume FM radio as they should. There simply isn't enough content diversity to interest different segments of society. A Marathi radio station in Mumbai could possibly pull in an additional 30-40 lac listeners, but because advertisers prefer to advertise on Hindi stations, no broadcaster wants to run a Marathi channel. Likewise, if there could be a Tamil radio station in Mumbai, it could attract another 5-10 lac listeners. Worldwide, FM listenership is high in markets where there is a variety of content offerings. In the US, where radio penetration is upward of 90%, the number of channels in any major city is upward of 40 (full city coverage) with another 40 also available (with a limited coverage) in different parts of the city and its neighborhood. It's worth evaluating why there is a Tamil channel in Singapore, but none in Mumbai or Delhi. Clearly, it is not mobile penetration, but content availability that will expand FM radio listenership.

This is why it is important to expand the availability of channels in every city. More channels will lead to more content diversity. As a starting point, the government must release new frequencies under the 400 KHz channel separation plan. This can potentially increase private channels in a metro to 18. Then, **the government must ask AIR to either launch 8-10 channels over its unused spectrum, or force it to release it to the private sector.** And finally, the government must ask others (we are told there are walkie-talkie service providers, the Defense Forces etc.) to vacate the FM spectrum so that more FM services can be launched. This will allow our major cities to have 30-40 channels.

But this is not a sufficient condition to grow FM listenership. What is also needed is for a single broadcaster to be allowed to operate more than one channel in a city. If ENIL were allowed a second channel in Delhi, it would surely launch something different from its current one – which is a Contemporary Hindi film music channel. It could launch a Hindi retro channel, or a Punjabi one, or a talk channel, or a youth channel or a Tamil channel or devotional etc. Thankfully, the Phase-3 policy allows broadcasters to own multiple channels in a city.

But for broadcasters to launch these “niche” channels, it is most important that the spectrum be available at a reasonable cost. Here is where a low RP becomes critical. Combined with a high availability of spectrum, a low RP will ensure niche channels become viable.

Consider an example from TV. There are a few large TV groups in the country. The Star group for example runs 25-30 channels. It has its flagship channels and it has several niche channels. It is these niche channels that have helped grow the TV market. The cost of operation for these niche channels is very low – partly because content is sourced economically from international markets and significantly also because government spectrum costs are minimal. Had the government charged hundreds of crores of rupees to these niche channels, they would have vanished in no time. Likewise, in radio, every stakeholder – the government, the regulator TRAI and the broadcasters must work actively towards keeping spectrum costs down.

In New Zealand also, auctions are conducted to allot spectrum, but in a recent exercise in extending the life of existing licenses, the radio industry paid just 80% of its annual revenues to the government. In India, even going by the TRAI migration formula, the industry could end up paying more than 100% of revenues. The main reason for this? High RP. **As an example, in**

Mumbai, if 9 broadcasters pay a minimum of Rs 35 crores (RP) for their licenses, that amounts to Rs 315 crores, more than double the size of the Mumbai private FM market.

7) TRAI has assumed that networking will be a factor in determining RP:

Networking is a key component in ensuring viability of small towns. We are grateful to TRAI for having recommended it to the government. But networking is not enough. Spectrum costs have to be kept small as well to make these stations viable. Consider the following example:

As per TRAI's consultation paper, the RP in Dhanbad is Rs 5 crores. Very simplistically, this translates to Rs 33 lacs per year. Now the basic cost of operation of a networked station is expected to be between Rs 30-40 lacs per year. **So the spectrum cost is as much as the cost of operation. In other words, 50% of the cost of operation of the station is made up of spectrum cost. This is simply too high.**

Here's another thing to consider. The total FM market size of Dhanbad isn't more than Rs 2 crores per annum as per our estimates. This is even though it is a B category town, perhaps because the overall radio revenues are low in the East. There are 4 frequencies in Dhanbad. Assuming all 4 are taken up, and assuming the market is divided 40:20:20:20 (a typical split pattern) between the four players, the #1 player will barely break even, while the remaining 3 will make losses. If revenues grow 10% per annum, and costs by just 6%, it will take more than 5-6 years for break-even to happen. And many more years to recover accumulated losses. Why will any bidder bid even at the RP then? Dhanbad is doomed for failure if auctions are conducted with RP of Rs 5 crores. Take the case of Latur. There are 3 broadcasters and the RP as mentioned in the consultation paper is Rs 3.56 crores, or Rs 24 lacs per annum. Add operating cost of Rs 30-40 lacs per annum (as a networked station), the total cost of operation is nearly Rs 60 lacs per annum. The total FM radio market size of Latur is estimated at just Rs 30 lacs per annum. Split this between 3 broadcasters, and it becomes clear that Latur will also surely fail.

Latur and Dhanbad show that networking alone is not enough. The number of channels needs to be reduced to just 1 or 2, and the spectrum cost must be made nearly zero.

There is one other aspect to be considered when considering networking. The benefits of networking arise only when the same kind of content can be transported across similar markets. This assumes that a broadcaster has several markets in its network in the same state/region. If this is not true, then there is very little opportunity to network. As an example, it is impossible to make Panaji a networked station unless one makes it English or Hindi. A Konkani/local station cannot be networked because there is no other similar market. Taking this further, if one has to network a small station like Jamnagar, it is assumed that there are other smaller stations available to network it with. What this means is that Jamnagar must never be auctioned alone. It must be auctioned in a bunch with other smaller stations of Gujarat. **TRAI must therefore recommend that small stations be auctioned as "bunched stations" so as to make the networking idea really effective.**

8) TRAI has used "Per capita GSDP" as an indicator of FM radio potential.

Unfortunately, this neglects the fact that different states behave differently, even if they have the same per capita GSDP. The South is generally considered to be the best market for radio.

This is because radio has been a regular habit there. In comparison, states in the West and North are less avid radio listeners. The East is a laggard in radio listenership and monetization. To blindly use per capital GSDP is thus wrong. The concept of region does assume importance in this context.

9) TRAI has used “estimated listenership” as a surrogate for revenue potential:

But a quick look at the data enclosed in the Annexure shows that the revenue/listener varies widely across the country. On the one hand, there are markets like Jalandhar (Rs 968/listener), Mangalore (Rs 824) and Trivandrum (Rs 811) which are able to convert listenership into revenues very efficiently. On the other hand, there are markets like Kolkata (Rs 181) and Kanpur (Rs 169) which don't manage such good conversion. In a situation like this, to use this variable is questionable to say the least.

Summary: For a variety of reasons listed above, we do not believe that the TRAI recommended method for calculating Reserve Prices is correct. Even a cursory glance at the examples given shows that the RPs are too aggressive. Given the fact that an ascending e-auction will “by design” lead to the fair market price being determined, we feel the RP should be kept small – in fact as small as possible. Possibly even zero.

Our suggestions for calculating RP:

It is clear that setting RPs is a difficult exercise. There are far too many variables to be considered. There are anomalies of Phase-2 bids also to be taken into account. The impact of digital and deflation also have to be factored in. As shown above, the TRAI method has its flaws. We do not have a better “model” to offer. Hence, we would rather go back to the fundamentals of RPs – the smaller the better – and recommend something far simpler. **After all, e-auctions will ensure that the right market price is determined. Keeping this “keep it simple”.**

Option 1: Use the “lowest bid” of Phase-2 instead of “average”. The average divides the markets into two nearly equal halves – one above and one below the average. The markets below the average would find the RP too high. **However, if the lowest bids are used, then every market will find the RP to be reasonable. And, to repeat, the design of the e-auction will take care that the right market prices are determined.**

Option 2: If TRAI still wants to use “average bids of Phase-2”, **then the auction design should be changed from “ascending” e-auctions to “ascending/descending” e-auctions.** In an ascending e-auction, the bids keep going higher till the time there is “excess demand” (ED). If there is negative ED, bids cannot go down. However, if the RP is too high, then there will be a negative excess demand, and a conventional ascending e-auction will fail. However, if we allow for bids to decrease as well, then a negative ED will lead to bid prices falling from the RP. Either way, the e-auction will end only at the fair market price. In this situation, the RP is not the “lowest” bid price, but merely the “starting” point of the auction. It should be noted that bids may go down for a few rounds because ED is negative; however they may reverse directions and start climbing if ED turns positive. The reverse may also happen when bids rise initially and then fall later. What happens in a live auction will be known only on the day of the auction, but as bidders change their strategies and plans, bids can go both ways.

Option 3: Use the Reserve Prices of Phase-1 auctions. The auctions were similar in design to Phase-3 auctions, though they were not electronically conducted. While the bids in Phase-1 were sought for the 1st year license fee, and not for OTEF, the basic auction method remains relevant. For A+ towns, the RP was pegged at Rs 1.25 crores etc.

Q2. Do you agree with the proposal that the RP for FM Radio channels in a new city can be set equal to 0.8 times of the valuation of FM Radio channels in that city? If not, suggest an alternative proposal with justification.

Since we do not agree with the basic methodology itself, we do not find this factor of 0.8 relevant.

Q3. Do you agree with the proposed reserve price of Rs. 5 lakhs per city, for FM Radio channels in 11 border cities in Phase-III? If not, suggest an alternative proposal with justification.

We agree that the RP should be set small. We are also OK that it is delinked from any complicated estimation model. We find Rs 5 lacs RP to be OK, though we would prefer it to be even smaller – maybe Rs 1 lac or even lower.

Q4. Stakeholders may also provide their comments/ suggestions on any other issue that **may be relevant to the present consultation.**

We have raised several points in this note. These are repeated here:

- 1) Bunched auctions: TRAI must recommend that small stations be auctioned as “bunched stations” so as to make the networking idea really effective.
- 2) Ascending/descending e-auctions: In an ascending e-auction, the bids keep going higher till the time there is “excess demand” (ED). If there is negative ED, bids cannot go down. If this is permitted, then the auction will be transformed into an ascending/descending auction. This will ensure that irrespective of what the RP is (too high or low), auctions will never fail and the right market price will always be determined.
- 3) RP should always be kept very small. In fact RP can even be zero
- 4) No effect of inflation: Since radio prices have actually fallen for the last 6 years, there is deflation, not inflation in FM radio. Besides, the spread of digital streaming will further dampen radio pricing. Hence the 1.798 factor on account of WPI should be discarded.
- 5) 400 KHz scenario: RP should take into account the impact that addition of more channels has on revenues. When a market with 9 channels goes to 18 channels under 400 KHz scenario, then RPs must be halved, because number of channels has doubled. And so on.

Annexure
Revenue per listener

Name of City	ENIL est market revenue In Rs C	Listnership (Q4 IRS 2012) in lacs	Per Listner Rev (Rs)
Kolkata	75	41	181
Trivandrum	15	2	811
Kanpur	15	9	169
Jalandhar	15	2	968
Mangalore	7	1	824