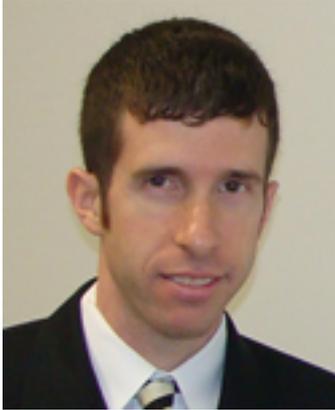


# Elimination of handset subsidies would represent tectonic shift

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Mobile-phone subsidies may go the way of the rotary dial if an [audacious plan](#) [1] by Telefonica and Vodafone bears fruit. The telecom giants are using Spain as the testing grounds for an experiment that could irrevocably change the relationship between consumers and mobile-service providers.

The cell-phone business model is simple: Service-providers offer heavily discounted devices in exchange for a long-term commitment (usually a 2-year contract). The arrangement is mutually beneficial, adhering closely to the axiom "give away the hardware to sell the software."

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Published on Electronic Component News (<http://www.ecnmag.com>)

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But with the mass proliferation of gee-wiz smartphones, telecom companies are spending an exorbitant amount on hardware subsidies. From 2009-2011, phone subsidies jumped more than 40% to reach \$48.5 million. According to Cellular-news.com, [operators spend](#) [2] about 15% of their revenue to subsidize the cost of mobile devices.

These same operators more than recoup the cost of the phone over the lifetime of the contract (which is usually at least \$70/month, counting the voice and data plans). But the global economic recession has dropped a sledgehammer on the telecom industry, and service providers are scrambling to keep up. Some have taken drastic measures.

Vodafone and Telefonica recently killed handset subsidies in Spain, and the success or failure of this experiment could have implications for the rest of Europe. And American telecoms are paying close attention - particularly since Vodafone owns 45% of Verizon Wireless.

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Predictably, the mass exodus of mobile-phone subscribers began almost immediately. In March, alone, Telefonica lost 170,000 mobile subscribers, Vodafone lost 90,000, while Orange, aka France Telecom (which maintains handset subsidies), gained 130,000 subscribers. Nationwide sales dropped 4.1% in the first quarter of this year compared with the same period in 2011.

Given the fiscal crisis and initial returns, this initiative seems incredibly short-sighted – more cash up front for a loss in customer loyalty...even if that "loyalty" is propped up by a contractual agreement. Fitch Ratings argues that, under this arrangement, the "cost and quality of the network would become the driving force in customers' buying decisions, rather than the desire for a new phone."

But the network already is the main selling point (at least in the U.S.). In the mid 2000s, AT&T enjoyed unique access to the Motorola RAZR, a true cultural phenomenon. But those days are long-gone. The Verizon iPhone closed the door on a huge competitive disparity, and handset exclusives are now few and far between. A tech-savvy consumer can usually find an equivalent device on any network.

Take note of Verizon's ad campaigns – "Can you hear me now?", "Don't be afraid of Dead Zones," "It's the network," etc. etc. And AT&T's – "Fewest dropped calls," "Raising the bar," "Your world. Delivered." Each of these PR ventures tout service (and its superiority over the competition's). Check out these recent Verizon ads, which advertise the company's 4G LTE service and don't even mention hardware:

The elimination of handset subsidies represents a lose-lose proposition for consumers. On the one hand, telecom patrons exhibit an intractable desire to pay for the **privilege** of signing a mobile-service contract. When I worked for AT&T (back when it was still Cingular), I witnessed customers – with lousy credit – drop \$1,000+ on "deposits" to qualify for a monthly rate (vs. the prepaid plans for those who couldn't afford the outrageous entry fees). Naturally, the monthly plans represented a significant bargain over the "Go-Phones." So numerous customers chose monthly rates (even with draconian deposits) over prepaid.

But to paraphrase Lance Armstrong, the "pain" was temporary. After a set period, telecoms returned the initial deposit (provided the consumer had paid his/her bill). Eliminating handset subsidies does nothing but add to the overall cost...for everybody. And you wouldn't get your money back. This could be advantageous for those with bad credit but, having worked in the industry, I can assure you that the bar is set very low. It's not hard to qualify for an unfettered service contract.

In accordance with a 2-year contractual agreement, I paid \$300 for my Verizon iPhone 4S. The full retail price is \$750. Absent the generous subsidies, I would've hesitated to pay nearly a month's rent for what amounts to a toy – even for a toy that I couldn't live without.

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The obvious benefit of handset subsidies is that they create – via contractual arrangement – a long-term relationship with consumers. Eliminate those subsidies, and you sever the correlated lifeblood.

This wouldn't be the first time, but telecoms are making an incredibly short-sighted decision that will have dire repercussions.

### **Source URL (retrieved on 10/25/2014 - 3:15pm):**

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[1] <http://www.ecnmag.com/news/2012/05/analysis-hard-telcos-get-stingy-mobile-give-aways>

[2] <http://www.cellular-news.com/story/54615.php>