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As the year gathers pace, spare a thought for the mobile network operators (MNOs) for whom the festive season is traditionally a time when mobile subscribers buy a phone for a loved one or upgrade. This cyclical peak should be good news for MNOs, giving them new subscribers and increased market share.

There is, however, a sting in the tail. Because this sector is so competitive it is common market practice for the MNOs to subsidise the cost of the mobile phones for post-paid contract subscribers (phones for pre-paid subscribers are not typically subsidised).

Indeed, the MNOs recoup the cost of the handset over the life of the post-paid contract, typically between 18 to 24 months but in some markets up to 36 months. Before smartphones began to dominate the handset market (in the US smartphone use has increased from 44% in 2011 to 57% at the end of 2012) this did not represent a cashflow challenge: the wholesale mobile phone unit cost in 2002 was USD 50 compared to USD 400 (and more) in 2012 for a smartphone.

Now, with the higher costs for top-of-the range smartphones, it takes the MNOs far longer to recoup the cost of the handset (this is most obviously reflected in the market shift to longer post-paid contracts). The higher smartphone unit cost has a negative impact upon the free cash flow, profitability and net debt of the MNOs.

In December 2012 T-Mobile US (TMUS) announced that they have reached an agreement with Apple to sell iPhones in the US. This positive announcement was slightly tempered by the impact on TMUS’s working capital: due to subsidisation of the iPhones (post-paid contracts in the US account for 79% of mobile connections), there will be a one-off working capital hit of between EUR 300m and EUR 600m in 2013.

This shift away from feature phones to smartphones and variations of smartphones such as the “Phablets” (hybrid sized devices sized between a smartphone and a tablet) continues unabated. Vodafone has seen smartphone adoption by its subscribers in Europe increase by 50% YoY in 2011/12.

How can Citi Transaction Services help MNOs and their suppliers with these working capital challenges and reduce the cost of acquisition and retention of subscribers?
Supply chain financing
Early payments, improved Days Sales Outstanding (DSO) and freeing up buyer credit lines are key areas of focus for original equipment manufacturers (OEMs). Buyer-centric supply chain financing (SCF) offers suppliers a diversified non-recourse source of liquidity, at attractive discount rates that are largely determined by the buyer’s cost of funding. This allows suppliers to pro-actively manage working capital and reduce down their Days Sales Outstanding (DSO), thereby improving working capital.

For buyers there are a number of benefits:

• Supports the buyer’s supply chain, especially for Small and Medium Enterprise (SME) suppliers that do not have such ready access to capital. SCF programs engender and encourage closer working relationship between buyer and supplier, enabling the buyer to become a “preferred buyer”.
• Facilitates commercial terms discussions between the MNO’s procurement team and the supplier’s sales team, on both pricing and harmonisation of payment terms.
• Allows sellers to reduce credit concentration on buyers, enabling increased sales.

There are a number of secondary benefits, such as improved invoice approval processes, increased collaboration and improved working practices amongst the buyer’s key stakeholders (treasury, accounts payable and procurement).

SCF is a win-win for both suppliers (reduced DSO) and buyers (supports supply chain; facilitates commercial terms discussions with suppliers) and has real applications within the capital intensive telecommunications ecosystem, which is reflected in the growing adoption of SCF programmes among the telecom majors.

One of the early adopters of SCF was Vodafone, who launched its SCF program with Citi in 2010. The enclosed Vodafone case study highlights the benefit of a global, scalable solution with five Vodafone entities live on the program within six months of go-live.

Prepaid Cards application for MNO
In recent years Citi’s Prepaid Card solution has proven an invaluable tool for cash-backs and financial promotions for corporate clients and it has excellent applications for both MNOs and handset manufacturers.
Typically for post-paid contract subscribers, they are most likely to upgrade their handsets when the contract finishes, either with the existing MNO (subscriber “retention”) or by churning to another MNO (subscriber “acquisition”).

Technology early adopters will upgrade their handsets at the earliest opportunity; however for most subscribers having the latest handset is not a priority. For these subscribers incumbent MNOs can protect their subscriber base (and reduce A&R costs) by paying them a retention incentive with a Prepaid Card. For instance, rather than upgrading their handset or migrating to another MNO, the incumbent MNO pays EUR 50 cashback to the subscriber to sign up for another two year contract, thereby leaving device choice in the hands of consumers.

Reciprocally, this method of customer retention is also applicable for customer acquisition. Mobile number portability, SIM only contracts and Bring Your Own Device (BYOD) when porting your number from one MNO to another allows subscribers to switch between MNOS. Within this subscriber-friendly model, acquisition strategies, such as cashbacks delivered through a Prepaid Card, deliver a consumer-focused and cost efficient mechanism for MNOs to increase subscriber acquisition.

**Consumer incentives for handset manufacturers**

Handset manufacturers, in sharp contrast to the MNOs, want mobile subscribers to refresh their handsets as often as possible.

As smartphone sales continue to accelerate (Samsung expected 30% growth in the smartphone market in 2012), so competition amongst the Original Equipment Manufacturers (OEM) to sell their smartphones has intensified. Consumer incentives (“Buy this phone and receive USD 50 cashback!”) using a Prepaid Card allows the OEMs to differentiate their product and incentivize subscribers to choose their product over rival smartphones.

Last year, Citi provided a leading device manufacturer and its software partner with the Citi Prepaid Card to use as an innovative cashback mechanism for mobile subscribers choosing to buy their smartphone. The Prepaid Card was linked to the online app store which meant spend of the cash reward was directed back to the online store thereby increasing after sales revenue.

**Supports top-line sales**

Cashback offers enable OEMs to not only maintain full retail prices thereby retaining top line integrity but can also serve as a fantastic lever to pull in the fallow period just before new models are released — OEMs will often experience a quarterly fall in sales before new smartphones are released as consumers await the release of the new handset. A cashback offer on the outgoing model can be used to support its sales and cross-sell own device ranges.

Adoption of this type of consumer incentive has been extremely popular in the consumer electronics space, particular for Digital Imaging, Audio Visual and Televisions. The attached video provides an excellent overview of Samsung’s recent highly successful consumer cashback campaign which had a number of success factors:

- Ability to cross-sell other Samsung products (spend back)
- Detailed spend data on consumer spend patterns
- Powerful branding opportunity
- Reduced cost versus traditional cashback mechanisms (bank transfer, cheque)

**Conclusion**

MNOs are facing real headwinds with:

- Increased acquisition and retention cost driven by increasing adoption of smartphones
- Macroeconomic challenges
- Increased regulation of roaming costs and Mobile Termination Rates

Supply chain financing is a tremendous tool for MNOs to not only support their supply chain but also to facilitate commercial discussions, and thereby allow both MNO and supplier to actively manage working capital.

Prepaid cards are a consumer friendly, cost efficient tool for MNOs to proactively manage their A&R costs and protect bottom line profits.

For the handset manufacturers, Prepaid Cards allow them to differentiate their products and to incentivise consumers to select their smartphone over rivals, smooth sales of handsets in otherwise quiet periods and drive top line sales.

Please contact your Citi representative to discuss these or related subjects.
In a highly saturated UK market, Samsung was looking for a new way to connect with its consumers and reinforce its market presence and decided to use a product that would deliver an altogether more responsive, more targeted solution to help achieve its goals: Prepaid Cards.

Samsung chose Citi Prepaid Services to launch its UK-based customer cashback promotion. With this product customers who purchased select Samsung Smart Blu-ray Players or Freesat and Freeview Personal Video Recorders would be eligible to receive an incentive reward up to the value of £50.

This new approach would provide multiple opportunities for Samsung to communicate directly with its customers, reinforcing its brand in the process.

Previous cashback promotions had “rewarded” Samsung customers’ through a much slower delivery mechanism: cheque payments. But the new solution would transform this into something much more valuable because Samsung would be able to reward its customers instantly.

The Citi team worked with Samsung to create a flexible, Samsung-branded prepaid card solution with clear advantages over the more conventional – and far less dynamic – voucher system.

Samsung recognised that working with Citi would “provide our valued customers with a flexible, convenient and immediate form of payment. Customers’ use of the Samsung branded card would further expand our brand name within the AV market and impact it in a positive way”, says Russell Owens, Head of AV, Samsung Electronics (UK) Limited.

In fact, Samsung has reported an impressive 137% increased in holiday sales over last year thanks to the Samsung-branded card, which also gave the company the opportunity to cross-sell other product lines for the first time.

The solution has received positive feedback on social media and technology expert blogs for the immediacy of the card value as a premium prepaid product and has won an industry award at the 2013 Paybefore Global Awards: Best Prepaid, Incentive, Reward, Rebate or Loyalty Card Program category.

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The overwhelming success of our prepaid solution is best showcased by our client Russell Owens, Head of AV for Samsung UK.

Please click on the video link below, which shows a short interview with Russell Owens.

http://www.citibank.com/transactionservices/home/sa/a2/prepaid_card/samsung.jsp
Vodafone wanted to support its valued suppliers through a Supply Chain Finance program that would enable them to access funds earlier than would have been available under the terms of contractual arrangements. This would improve the working capital of Vodafone’s suppliers – making its supply chain more robust – while leaving traditional funding sources untouched.

Following a Request for Information (RFI), Citi was appointed in early 2010. Citi’s experience, as a major Vodafone payment bank, and understanding of Vodafone’s existing infrastructure/SAP platform interface was an important factor in the decision process.

The solution
The solution is fully integrated and allows invoices to be processed at Vodafone’s shared service centres: once three-way matched (purchase order, goods receipt note, invoice) any supplier who has been ‘onboarded’ can access funding immediately. It leverages Vodafone’s existing SAP/bank file-based connectivity for vendor payments, put in place through the company’s EVO Global Transformational Program, to discount supplier payments.

As Neil Garrod, Vodafone Group Treasurer, explains, “Vodafone’s ongoing business transformation program ‘EVO’ has put the majority of investment into a single instance of SAP, supported by offshore shared service centres. Furthermore, the implementation of the Vodafone Procurement Company (VPC) has centralised the procurement from a single entity. These are both common objectives for corporates. What we and Citi have achieved with the SCF solution is the next step – to leverage the treasury and cash management opportunities brought about by this centralization – to the benefit of Vodafone and its suppliers. As such, we anticipate this being of relevance/interest to many corporates.”

The solution delivers optionality to Vodafone; based on its own cash profile it can choose to invest in the program. Should it choose not to, Citi funds the program using its balance sheet and has the ability to deliver additional capital through the investor community. Any invoices sold by suppliers to Citi would be collateralized by them into securities and sold on to interested parties as short-term liquid investment products.

In summary
- The supply chain finance (SCF) solution supports suppliers in challenging credit markets by providing them with access to a new source of liquidity.
- Allows suppliers to access funding at attractive rates.
- Assists Vodafone Procurement Company (VPC) and its Supply Chain Management team in facilitating commercial negotiations with suppliers.
- Fully integrated solution: straight through processing (STP) from Vodafone’s accounting platform to Citi platform allows onboarded suppliers to access funding immediately.
- Global platform: enabling simpler/quicker supplier on-boarding and economies through a consistent and scalable solution.
- One global contract to govern SCF for all participating operating companies in all jurisdictions.

“SCF has given Vodafone suppliers an alternative route of obtaining cash early at rates which can be attractive compared to bank financing and which has in turn been a driver behind Vodafone’s own working capital improvements.”

Neil Garrod, Vodafone Group Treasurer

A version of this article was first published in Treasury Today’s Adam Smith Awards 2011 publication.

Left to right: Mark Tweedie, EMEA Head Corporate Client Sales Management, Treasury and Trade Solutions, Citi Transaction Services, and Neil Garrod, Vodafone Group Treasurer