

Prepaid wireless takes off

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Consumers are abandoning traditional subscription plans, which may curb growth for AT&T, Verizon Wireless, Sprint, and T-Mobile.

It looked, for a while, like the wireless industry might shrug off the worst of the recession. AT&T (T), the biggest U.S. phone company, in January reported a respectable 13.2% increase in fourth-quarter wireless sales, fueled by strong subscriber gains. Things were looking up this year, too. Surveys showed consumers would rather reduce purchases even of food and clothing before ditching cell phones.

It was nice while it lasted. Fresh survey data show that U.S. consumers are rapidly switching to cheaper calling plans, often choosing so-called prepaid packages that give carriers smaller, less predictable revenue streams.

On Mar. 19, Washington think tank New Millennium Research Council (NMRC) released results of a survey showing that 17% of Americans have already switched from contract-based plans to cheaper prepaid services in the past six months due to concerns about their jobs and the recession. Those sticking with contracts are migrating to cheaper plans and cutting such extras as texting and e-mail. "Millions of Americans are on the verge of discontinuing expensive cell-phone plans," says Graham Hueber, a senior researcher at the Opinion Research Corp., which conducted the study commissioned by the NMRC.

Fewer minutes, less texting

Other evidence also suggests consumers are taking a closer look at their wireless bills. Of 2,151 U.S. cell-phone users surveyed online by JupiterResearch in November, one-third were considering cutting back on wireless spending and the number of minutes and texts they use. In February, Sprint Nextel (S) indicated that "economic uncertainty" was partly to blame for a sales decline and customer losses in the fourth quarter.

One maker of air cards, Sierra Wireless (SW), announced on Jan. 29 it would lay off 10% of its workforce amid a drop in fourth-quarter revenue. "We are going to see more and more of this in the U.S. and the rest of the world," says Carrie Pawsey, senior analyst at researcher Ovum.

Of course, some carriers are faring better than others. "Despite the economic environment, we grew revenues in 2008, and I expect 2009 will be another year of overall revenue growth and solid progress for our company," AT&T Chief Executive Randall Stephenson said during the company's January earnings call. AT&T wouldn't say whether it's seeing an impact from the worsening economy now.

And fewer data cards, too

But consumer cutbacks are sure to catch up with carriers in the coming months, and those reductions could result in slower revenue and customer growth. Of U.S. consumers who have wireless contracts, almost 40%, or 60.3 million, are likely to curtail cell-phone spending to save money if the economy worsens in the next six months, according to the NMRC survey. Some 41% of survey respondents are considering paring back on extras like text messaging. Many already are scaling back on data cards for computers, which, according to wireless industry consultant Chetan Sharma, contribute about 12% of carriers' data revenue.

Even smartphone users, typically among the most profitable customers, may soon trim usage. As professionals in finance and other industries continue to lose jobs, Sharma estimates that

10% to 20% of the people who own these souped-up, Web-surfing phones may downsize plans this year.

Smartphone users typically pay \$70 to \$200 a month for wireless service. As they reduce spending, U.S. wireless data revenue may grow only 15% this year, vs. 38% in 2008, Sharma estimates.

Carriers that specialize in prepaid calling may be among the few beneficiaries of cutbacks. Now, only about 15% of Americans use prepaid wireless plans, which can cost 50% to 75% less than contract-based plans. In contrast, 68% of Britons already use prepaid plans. "There's clearly a lot of additional movement that could take place," says Allen Hepner, a scholar at the NMRC. "Thanks to the recession, the U.S. marketplace is undergoing fundamental changes." Indeed, prepaid may grow to 20% of the market by yearend, Sharma estimates. In the fourth quarter, prepaid customers accounted for 57% of new subscribers at T-Mobile USA, up from 23% a year earlier.

Widespread defections

Some consumers are leaving the four largest carriers—AT&T, Verizon Wireless, Sprint, and T-Mobile—for smaller, prepaid carriers. In the fourth quarter, MetroPCS (PCS) saw net subscriber additions surge 74%, to 519,519, from a year earlier. In the same quarter, Sprint Nextel lost 1.3 million customers, most of them postpaid. Sprint executives are hopeful that the industry will nevertheless fare better than other areas of the economy. "We believe wireless has become so important in people's lives, we won't see as much impact as other industries."

Providers of prepaid calling, typically considered the domain of younger callers or those with bad credit, are taking steps to make their plans more alluring by adding features and better phones. Such services as MetroPCS and Leap (LEAP) are available in more markets. On Mar. 9, Leap expanded into Philadelphia. Nowadays, users can purchase not only voice but also data plans that permit texting and e-mail.

And prepaid phones have turned from clunky to cool. On Mar. 10, MetroPCS introduced Research In Motion's (RIMM) BlackBerry Curve 8330 smartphone, which features a Qwerty keyboard and rich multimedia capabilities, in many of its markets. For only \$50 a month, without a contract, users of the device can talk, text, browse the Web, and send multimedia messages and e-mail. Steps like that are helping foster loyalty. Leap's monthly subscriber turnover declined to 3.8% in the fourth quarter, from 4.2% a year earlier.

Developing war in price cutting?

Contract carriers are responding by updating and rolling out new prepaid plans and lowering prices. This year, T-Mobile USA began offering a \$50-a-month unlimited voice plan to longtime subscribers to prevent them from leaving.

But the recent flurry of cheaper, unlimited plans from T-Mobile, Boost Mobile, Alltel, and Zer01 Mobile raises a red flag for Sanford C. Bernstein analyst Craig Moffett. "As growth slows, pricing [war] risk rises," he wrote in a recent report. As more carriers start offering unlimited voice calling and data plans, they increasingly will have to compete on price.

The hope for some within the industry is that when economic prospects improve, "people will go back to postpaid" calling plans, Sharma says. But the more attractive prepaid plans become, the harder they will be to shake.

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