Tower Sharing – Maximise the use of your resources

For telco operators facing intensifying market competition and mounting pressure on costs and pricing, the idea of tower sharing with other providers brings major attractions. Today, with the focus of telco operator market differentiation shifting away from network coverage and towards branding and service design, tower sharing is more firmly on the agenda than ever. As well as opening the way to potential reductions in both operating and capital costs, tower sharing can help an operator focus more effectively on marketing and customer satisfaction, by reducing the internal burden of asset management. Yet, despite these attractions, successful tower sharing deals remain few and far between, and efforts to set them up remain fraught with pitfalls and barriers.

PwC Indonesia can help.
Tower sharing should deliver lower costs. How can operators overcome the significant challenges associated with actually implementing this practice?

Operators' networks are expected to become irrelevant as a market differentiator yet operators are traditionally wedded to their networks. The value of their respective contributions is therefore an emotive issue which can have financial reporting, tax, regulatory and organisational consequences.

The precise structure and scope of each agreement will vary depending on the needs and positioning of the parties involved and the overarching regulatory regime. However, there are several considerations relevant to the successful negotiation and execution of deals which tend to be relatively consistent across markets.
Commercial considerations

Differentiation

The background of tower sharing dates back to the two-decade development of GSM (global system for mobile communications) services where the standard organisational model adopted by operators was a unitary, vertically integrated model, in which the core network, backhaul, and base stations were all owned and managed internally – the model which reflected a world in which network coverage was the key to market differentiation. That approach appeared to deliver good returns, with those operators possessing better coverage generally becoming more profitable more quickly. In the second wave of GSM deployment, the strategic focus shifted to driving rapid network deployment to close coverage gaps. Incumbents resisted this pressure and sought to protect their dominant position by land-banking sites and refusing to share tower locations.

However, the industry-wide scramble to gain competitive advantage and build greater customer satisfaction through ever-expanding coverage could not continue forever. Over time, as networks matured and their coverage grew, the gaps between operators narrowed to the point where each new investment in coverage provided minimal additional coverage benefit and could, in any case, be matched easily by competitors. Today, success in the mobile market is driven more by distribution, branding, and service design. The impetus given to mobile content by the iPhone has shifted the focus further away from the network - with operators’ span of control expanding into content and media in an attempt to control the value created in those new markets. Given these evolving competitive dynamics, both existing players and new entrants to the mobile market are examining different operating models and competitive strategies. With the network increasingly regarded as the underlying “plumbing” for mobile services rather than as a differentiating selling point, companies have started to question whether they really need to own and control the network in-house.

Since the beginning of the century, mobile operators have begun to relax their grip on their network infrastructure via ad hoc arrangements by operators to sublet space on their sites, which spur the emergence of specialist network tower-sharing companies, all marketed through a portfolio of properties on which they rented space to multiple telco operators. Then network outsourcing emerged, typically involving operators handing over the operational control of network deployment and operation to specialist third-party vendors. Network sharing is the next, and inevitable, step along this path.
The available cost savings

The levels of cost savings achievable through tower sharing can be substantial but may require some compromise in terms of service or coverage. The cost savings come from the removal of a number of base stations or other infrastructure where coverage is largely duplicated. Some of these sites may provide coverage that is unique, so consolidation may degrade the service in some places and trigger some customer complaints. Although the impact on customer satisfaction should be taken into account while building the business case and implementing tower sharing, the scale of the available savings means this consideration does not usually undermine the overall economic rationale.

Clearly, the level and mix of cost savings will differ from deal to deal, reflecting the deal characteristics and each operator’s unique positioning, assets, and coverage. However, typically the radio access network represents the majority of a telco operator’s capex.

In pursuing and realising such savings, the challenge for established networks is that much of the capex is already sunk, and recovering the migration costs through opex savings alone may result in a very long payback. However, experience in the industry illustrates that capex is always ongoing with upgrades, changing architectures, and now even obsolescence. Each ensures that savings from tower sharing can be achieved throughout the investment cycle.

Furthermore, as we have already pointed out, a successful tower sharing deal delivers other benefits, quite aside from lower costs. First, by recognising that coverage is no longer the differentiator, it enables the operators involved to focus on the attributes that really do make a difference in the eyes of today’s customers, such as the brand, service portfolio, pricing, and responsiveness to customers’ needs. And second, tower sharing helps operators respond to the environmental pressure for a more efficient use of infrastructure and lower carbon emissions.

3G effect

Tower sharing has been emerging as an attractive option for many operators, and both the advent of 3G technology and the resulting requirement for heavy investment in new network infrastructure have brought this into focus. For established operators, the capacity costs to support the recent surge in demand for data services are causing operators to study their ongoing cost profile and examine whether tower sharing might be a valuable tool in their efforts to remain competitive at the retail level, as well as to deliver wider environmental benefits.

Regulatory perspective

Telecommunications operators who wholly own tower sites incur growing capital expenditure and high operating costs. This is pushing operators to restructure their tower business into the sharing of infrastructure.

The new Government Regulation No. 36 of 2010 issued on 25 May 2010 concerning the Negative List of Investment (DNI) confirms that the telecommunication tower business is reserved for domestic investment only. This restriction is in line with the Minister of Communication and Information Regulation No. 02/Per/M.Kominfor/3/2008 concerning the Guidelines for the Use of Telecommunication Towers which stipulates that towers can only be used by Indonesian business enterprises or Indonesian citizens.
Financial reporting consideration

Tower sharing has implications for both capital and operational costs, as well as for the control and ownership of the asset base. Inevitably, this raises complex issues concerning asset records and accounting, including, for example, the write-off or accelerated depreciation of existing fixed assets. These issues may be substantial enough to shape the structure and operation of the arrangements.

The sharing arrangements come in many forms. However, the key characteristics of a typical arrangement include:

• the right to use a specified tower;
• a specified term of use (often the majority of the useful life of the relevant assets);
• legal title not being transferred;
• a number of associated service agreements including Operations and Maintenance (O&M).

There is no specific guidance on accounting for tower sharing under Indonesian accounting standards. The accounting treatment is determined by the arrangement's commercial substance. This requires a careful review of each set of specific facts and circumstances.

Generally, the review starts with an analysis on whether the agreement constitutes a leasing arrangement in accordance with Interpretation of the Statement of Financial Accounting Standards (ISAK) No. 8 “Determining whether an Arrangement contains a Lease”. Determining whether an arrangement is, or contains, a lease shall be based on the substance of the arrangement and requires an assessment of whether:

(a) fulfilment of the arrangement is dependent on the use of a specific asset or assets (the asset);
(b) the arrangement conveys a right to use the asset.

Once it has been determined, in accordance with ISAK No. 8, that tower sharing constitutes a lease, then the arrangement is accounted for in accordance with Statement of Financial Accounting Standards (PSAK) No. 30 (Revised 2007) “Lease”. Under PSAK 30 (Revised 2007), a lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership; otherwise, it is classified as an operating lease.

In our experience, tower sharing normally constitutes a lease because the fulfilment of the arrangement depends on the use of the tower space and the arrangement conveys the right to use the asset. However, lease classification should be based on an overall assessment of whether, substantially, all the risk and rewards of ownership of the leased asset have been transferred from the lessor to the lessee. This will include consideration of the indicators listed in PSAK 30 (Revised 2007) and other relevant aspects of the arrangement.
Taxation on Towers

For tax purposes, tower sharing arrangements need to be considered operating leases because the lessors are not financing companies approved by the Ministry of Finance.

Previously, tower and/or telecommunication operators treated income received or earned from tower rental/leasing as subject to Article 4(2) final tax at 10% of the gross amount of invoices (excluding 10% VAT). Accordingly, this tower rental income was reported as income subject to final tax in their annual corporate income tax returns.

Last year, however, the Director General of Tax (DGT) issued confirmation letters to tower and telecommunication operators confirming that tower rental is subject to a non-final tax regime (Article 23 WHT) at 2%. Accordingly, a few tower and telecommunication operators decided to recalculate their annual corporate income tax obligations from the final tax regime originally applied for a normal corporate income tax basis (i.e. the non-final tax regime). Consequently, tower and telecommunication operators may:

• Request their customers to overbook Article 4(2) final tax which has been withheld by the customers to Article 23 income tax
• File their revised annual corporate income tax returns and settle any tax underpayment based on the revised version

Tower operators must also charge 10% VAT on tower rental fees (the gross amount of invoices).
PwC Indonesia can provide wide ranging support to operators across the tower sharing process

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1. What is the benefit of sharing?
2. Who is the optimal partner?
3. How will I negotiate?
4. Will the charging be regulated?
5. Will the pricing mechanism create the right incentives?
6. How will accounts be affected?
7. Will there be redundancies?
8. Will my quality of service be affected?
Putting our values into action

Excellence
Delivering what we promise and adding value beyond what is expected.
We achieve excellence through innovation, learning and agility.

Teamwork
The best solutions come from working together with colleagues and clients.
Effective teamwork requires relationships, respect and sharing.

Leadership
Leading with clients, leading with people and thought leadership.
Leadership demands courage, vision and integrity.

This summary is not intended as professional advice. It is suggested to always consult with your usual PwC contact.