

CHAPTER 1 INTRODUCTION

1.1 Introduction

Telecommunications is one of the most dynamic sectors in information and communication technology industry. The increase in subscription of mobile telecommunications after 1985 was the result of advanced IT development and digitalization¹. In recent years, technology for radio communication has been progressed very rapidly to improve communications irrespective of the proximity that one is currently in. Moreover, the convenience and affordability of this service have transformed it to be widely accepted. The use of mobile telecommunications has been so common in all 'social contexts' that users are reminded to turn it off at some public events or performances.

While technological progress has changed the landscape of the whole industry, competitiveness has pushed reforms more rigorously. Market structure has evolved from a public monopoly to the current competitive environment. The momentum of trade liberalization and privatization has resulted in reduction of rules and regulations, deregulation and even re-regulation. While privatization remained the critical turning point of this industry, it introduced competition that has brought with it a stream of mergers, acquisitions, alliances and restructuring activities. It has also led to trends and movements to lower operating cost, for higher profit generated from economies of scale. Now, the main focus of the industry is to settle the details of consolidation and merging activities among the merged entities.

¹ Digitalization represents the evolution of communication, media and electronic devices from analog to digital formats and protocols, by Burnham(2002)

The competition ahead is going to be very stiff. We see operators engaging in aggressive promotional efforts to capture new subscribers, and at the same time, trying to retain existing ones. When short-term saturation sets in, the new growth in the industry is expected to be sluggish. Operators look at the alternative measures to recruit new subscribers. Operators have realized that by merely acquiring new potential customers and inducing consumers to shift from other service providers to their network, when the operator's own premier subscribers are churning out, the net effect might be a loss in the subscriber base. Moreover, if we examine the competitiveness, survival and profitability of a mobile service provider, we are bound to analyze its subscriber base. A fluctuating and unpredictable subscriber base makes operational and strategic planning very difficult.

When the market is competitive, operators who strive for survival in this telecommunications evolution should take a proactive approach to minimize churning. Reducing churn is parallel with an increase in the retention of subscribers. By understanding why customers churn, the company can reduce the churn rate by offering customers incentives to stay. The company can then focus on their weaknesses to implement measures that fulfill customers' demands. Thus, churning is important in determining a firm's performance.

1.2 Churning in the Mobile Telecommunications Industry

Subscriber churning refers to the movement of subscribers from one provider to another, in search of better rates, services or benefits from signing up with a new carrier. (Wei and Chui, 2002) It is important to distinguish between service provider initiated churning and customer initiated churning. Service provider initiated

churning is mainly due to payment default in the event of nonpayment. However, this is not the main focus of this paper as the involuntarily churning is very much beyond the scope of our study. In this paper, we concentrate on the latter which is the customer initiated churning, where a customer initiates the termination of the service contract. This will happen when subscribers are not satisfied with their existing providers or they derive a net gain or benefit from switching to new service providers. There is a possibility that subscribers will churn if operators invent newer, better or cheaper plans that provide value-added service to their consumers.

1.2.1 The effects of Churning on the Subscribers

Subscribers experience switching costs when churning occurs. The decision of churning service providers may be due to one simple reason or a complex one with many contributing factors. Once decided, users have to terminate their services with the existing operator and register with the new service provider. As such, consumers have to understand the new service provider's policies, sales or promotion campaign, and even the billing system. In mobile communications, the charged rate is set according to the mileage of a call. This characteristic amplifies the searching costs as consumers have to gather price information of each call from each mobile phone service provider over a wide range of plans. This obviously consumes time and resources. A subscriber who is ready for churning, has to start a new relationship with the new service provider; despite the efforts and trouble involved in churning the service provider. Thus, is it easy to make a churning decision?

1.2.2 The effects of Churning on the Operators

Operators perceive churning as the migration of consumers from one provider to another that results in lower operating profit. Subscriber loss results in current and discounted future revenue lost. Moreover, it brings in higher acquisition and operating costs. If firms are unable to lock in their new subscribers for some time sufficient to recover the initial high acquisition cost, the firms are not going to gain long-term profitability. Furthermore, the survival of the firms in this competitive market environment can be very difficult. For instance, to offset an average churn rate of 2 to 3 percent per month, the operators have to bring in more than 2 percent of new business to maintain the company's performance at the same place. Thus, the ability to manage a low churn rate and high retention ratio is crucial to a firm's profitability.

Mobile operators aim at capturing a bigger market share, have been making various efforts to develop brand awareness through publicity. Advertisement campaigns are part of their tools in reaching out to the potential and existing subscribers. In order to lock in the existing customers, service providers have to cultivate brand loyalty and create an artificial switching cost that is being perceived massive by their subscribers. On the other hand, to combat the competitor retention strategies, service providers offer incentives to consumers for switching into their network. Incentives include lower access fee, lower rates, and waiver of registration or connection fee. Others even offer an introductory price that is about 20% to 30% below the market rate, or even a cash rebate to attract new subscribers. The expectation is that these early investment will bring in long-term stream of profits from loyal customers that offset the initial acquisition costs. All these efforts and measures in advertising, product

differentiation and special offers have inevitably hike up the cost and lower the operating profit.

Churning is a factor that affects both users and providers. As things are different now, we need to reexamine the perceived notions of capturing a bigger subscriber base or market share to obtain higher revenue or profit. But instead the service providers should look at ways to lower operating cost because it is extremely important to understand the factors that influence a customer's decision in considering switching or churning from one service provider to another.

1.3 Objective of The Research Paper

There are very few empirical studies on churning in the telecommunications industry. Even though churning statistics are routinely reported by industry analysts, we found that no attempt has been made to study the determinants of churning rigorously. Instead, existing empirical studies mainly focus on marketing structures, regulations and its social contexts. The objective of this paper is to examine the factors that determine churning in the mobile telecommunications industry.

1.4 Significance of The Research Paper

This paper addresses the gap in empirical literature on determinants of churning in this industry. It is hoped that this study will shed some light on understanding the variables that influence users' churning behavior in the Malaysian mobile telecommunications industry.

1.5 Outline of the Paper

The rest of the paper is organized as follows: Chapter 2 reviews the literature. Chapter 3 provides a brief overview of the development of mobile telecommunications in Malaysia. Chapter 4 describes the models and the data used for analysis. Chapter 5 presents the empirical results of our findings. And chapter 6, concludes.