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Telecommunications

Pay First, Call Later

Cellphone companies have discovered that prepaid plans can be a popular -- and profitable -- business

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Scrambling to broaden its customer base, the wireless industry is turning to a long-neglected service offering: prepaid calling plans.

Under these deals, you don't need to go through a credit check or sign a contract to become a subscriber. You simply purchase a cellphone, and then buy a fixed amount of calling time each month.

When your minutes are used up, the phone stops working until you buy more. You can drop the service or switch to another carrier at any time without penalty.

In the past, the industry generally hasn't heavily promoted these offerings, since the usual customers are either credit-challenged or price-conscious -- not a very desirable profile. But now, with 180 million people, or 60% of the U.S. population, signed up for cellphone service, phone companies are running out of creditworthy customers for their traditional plans. To some carriers, prepaid deals look like an attractive niche.

So these companies have introduced new prepaid plans, or entire brands, and in some cases they're tailoring their offerings to suit segments of the market that don't want or can't get a traditional cellular deal. By far, the most attractive demographic is teenagers, who generally are heavy users of cellphones but don't have a credit history.

Carriers are enticing these young customers by loading up their prepaid plans with popular options, such as text messaging and song downloads, that are hard to find on most family plans. For parents, the prepaid plans have a different appeal: the ability to rein in kids' phone costs.

A Distant Second

Still, prepaid plans have a long way to go. Currently, only 8% of cellphone users in the U.S. have prepaid plans, and carriers are loath to change the dominant business model. "Postpaid works for both carriers and customers pretty well," says Roger Entner, an analyst with technology consulting firm Yankee Group in Boston.

With traditional plans, carriers have higher guaranteed returns from customers every month and can punish those who terminate their services early. Monthly revenue per user for postpaid plans is about $60 to $65, while the figure for prepaid plans is about $30 to $35.

Since phone companies know prepaid customers generally aren't going to use as many minutes as postpaid customers, they set the per-minute price for prepaid higher -- and the postpaid price lower. Cellphone users in the U.S. pay eight cents per minute postpaid on average and 10 to 50 cents per minute prepaid, according to Yankee Group.

"With postpaid," Mr. Entner says, "you are depressing [market] penetration a little bit," because not as many people qualify for the plans. But, he says, it balances out because postpaid customers "use their cellphones like water."

Even some big carriers that do offer prepaid plans, such as Verizon Wireless, hedge their bets by charging a flat fee for daily network access. A spokeswoman for Verizon Wireless, which is a joint venture between Verizon Communications Inc. and Vodafone Group PLC, says the company recognizes the potential of the prepaid market and the needs of consumers who want the service, but "we want our customers to be postpaid. ... It's a better business proposition."

But some carriers say a straightforward prepaid model can be profitable -- if you target your audience properly. Virgin Mobile USA of Warren, N.J., has drawn three million subscribers, all prepaid, in the past two and a half years by establishing itself as a trendy lifestyle brand in the youth market. About 70% of its subscribers are under 30 years old. "It's our specialty," says Dan Shulman, chief executive of Virgin Mobile, a joint venture between Sprint Corp.'s Sprint PCS division and Britain's Virgin Group.

The carrier's rates are much higher than those of regular postpaid plans -- 25 cents for the first 10 minutes and 10 cents afterward each day -- but its plan gives young customers access to lots of extras, such as text messaging and downloadable games, screen savers, wallpaper and ringtones. These extras -- which cost $1 to $6 apiece -- have been a big success.

Last year, over 70% of Virgin Mobile's customers used the text-messaging function, compared with 25% industrywide, and over 50% of its customers downloaded ringtones. The carrier's revenue from ringtones represents approximately 8% of the total U.S. ringtone market.

Sprint's merger partner, Nextel Communications Inc. of Reston, Va., is also looking for young customers. Out of 2.9 million new Nextel subscribers last year, 755,000, or 26%, subscribed to Boost, the company's youth-oriented prepaid wireless service. Nextel expects that approximately 33% of its net new subscribers will come from Boost in 2005.

The wireless industry doesn't always treat youth as high-value customers, says Mark Fewell, a Boost executive and one of the founders of the brand in Australia in 2000. But, he says, the industry is coming around as the youth market adopts lucrative data services such as text messaging and downloadable ringtones and wallpaper.

According to In-Stat, a research firm in Scottsdale, Ariz., the youth market will account for over one-quarter of wireless revenue and 28% of subscribers by 2008. And In-Stat predicts this segment will grow faster than the overall market in terms of subscriptions and service revenue.

Churn, Churn, Churn

Another carrier, SmartServ Online Inc. of Plymouth Meeting, Pa., plans to target another underserved consumer group -- immigrants, who need time to establish credit history in order to obtain credit cards and who may be used to prepaid service from international calling cards. SmartServ plans to launch by June a prepaid service, Uphonia, that allows subscribers to call anywhere in the U.S. and throughout the world at one price, possibly 20 cents per minute. Most carriers charge up to $10 per minute for international calling.

Meanwhile, TracFone Wireless, a Miami subsidiary of America Movil SA, the leading wireless provider in Latin America, is going after low-volume phone users of all age groups. Its customer base, all prepaid, grew by 1.4 million last year to 4.4 million, and its revenue grew 44% to about $800 million.

F.J. Pollak, TracFone's chief executive, admits that prepaid is a tough business model. The carrier's monthly revenue per customer is only $14. The key: to be able to manage churn, or the percentage of customers that disconnect every month, and control costs. Mr. Pollak says TracFone has managed to maintain a 4% churn rate, about half of that of some prepaid brands and carriers, by providing simple billing information and low calling rates. A customer can get service at $7.99 a month.

The company also has a patented debit technology that displays the customers' exact airtime balances on their phone screens and audibly alerts them when they are low on minutes.

Mr. Pollak also offers a word of warning to other firms looking to get into the prepaid niche: Be careful how you subsidize your phones. TracFone offered free phones for a while but found that it didn't work for the prepaid model because there is no commitment from customers to stay with them. Now they sell phones from $39.99 to $99.99.

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