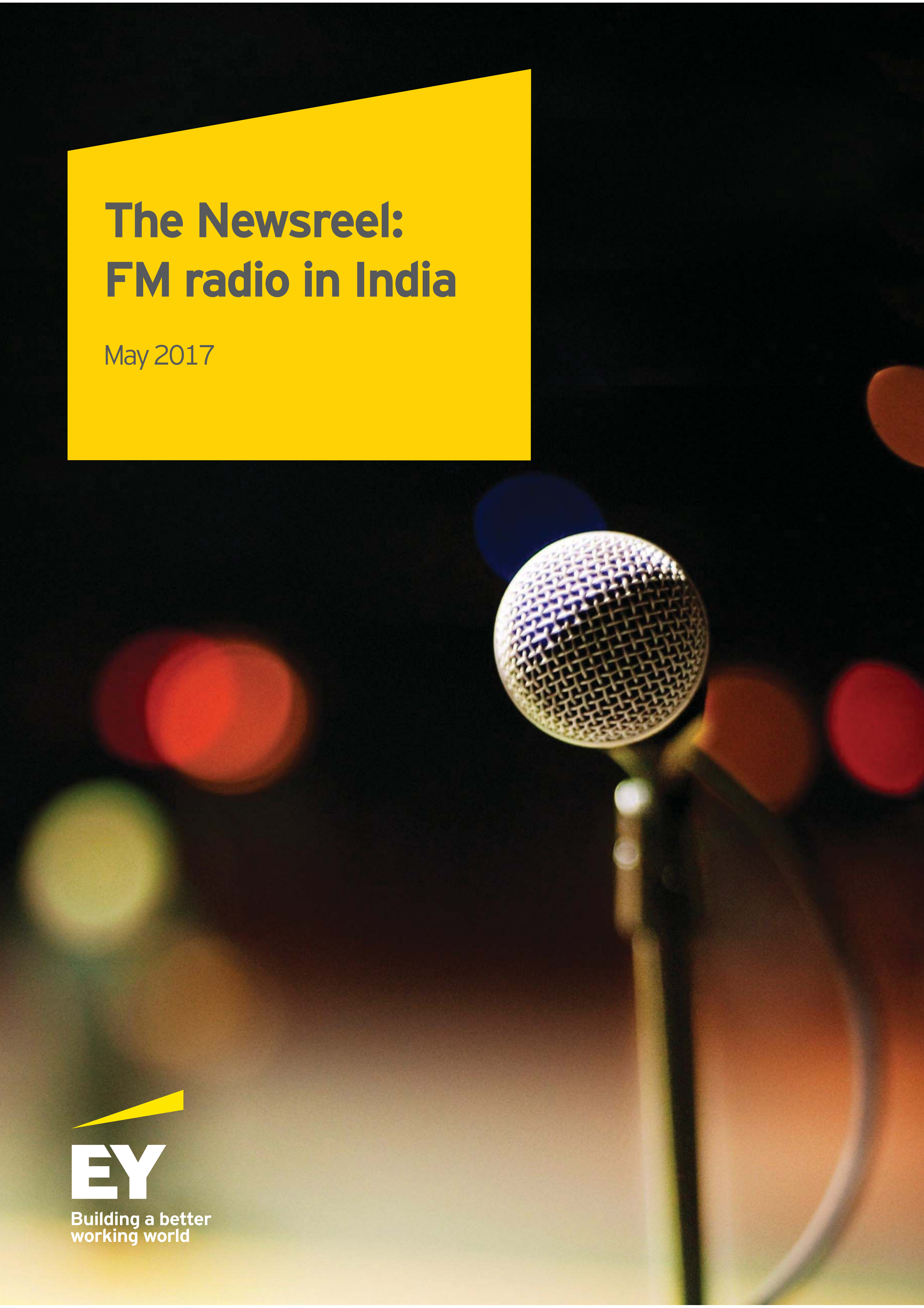
The Newsreel: FM radio in India

May 2017



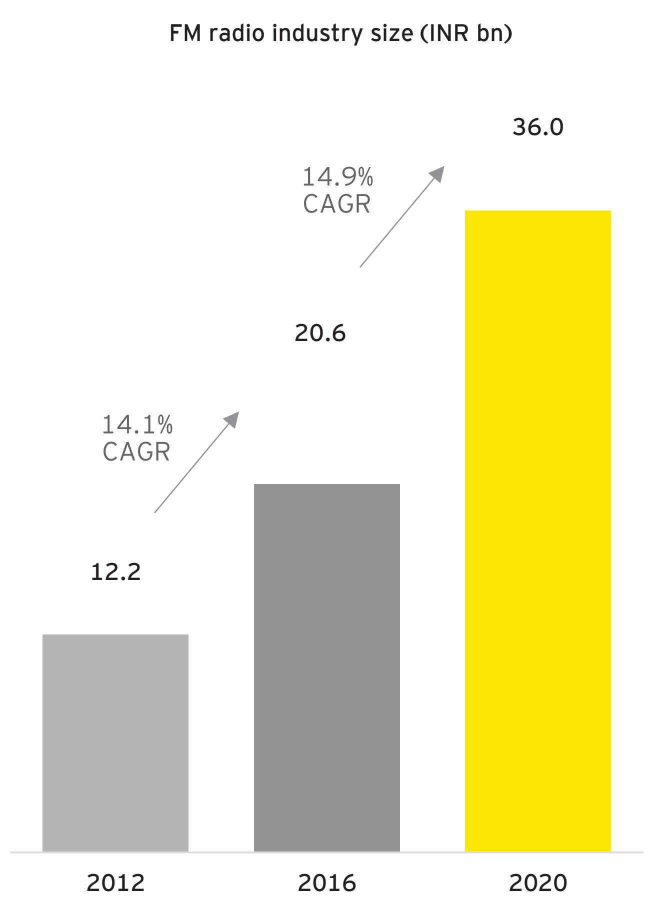
Building a better working world

The story so far

The INR21bn FM radio industry continues to hold a unique niche in the Indian media landscape. It is an effective reminder medium that can be localized at a city-level, provides free experiences for audiences and can easily reach all consumer strata.

While the industry experienced an INR0.4bn–INR0.5bn dent in 2016 following demonetization, with on-ground activations hit particularly hard, the sector is expected to bounce back by Q2 2017[1]. Buoyed by the continued operationalization of new Phase-III stations, the industry is projected to grow ~15% annually till 2020 — faster than other traditional mediums such as TV and print[2].

Radio has finally been unshackled, and can now fulfil more of its potential. The need of the hour on the revenue side is maximization of sales efforts through ad sales analytics, account planning, customer segmentation and automation, as well as better sales reporting. In order to bring forward break-even, radio companies need to look at costs aggressively and dispassionately, covering networking, automation, robotics and improved expense controls. As the industry enters its next phase of growth, we explore several key trends in this space.

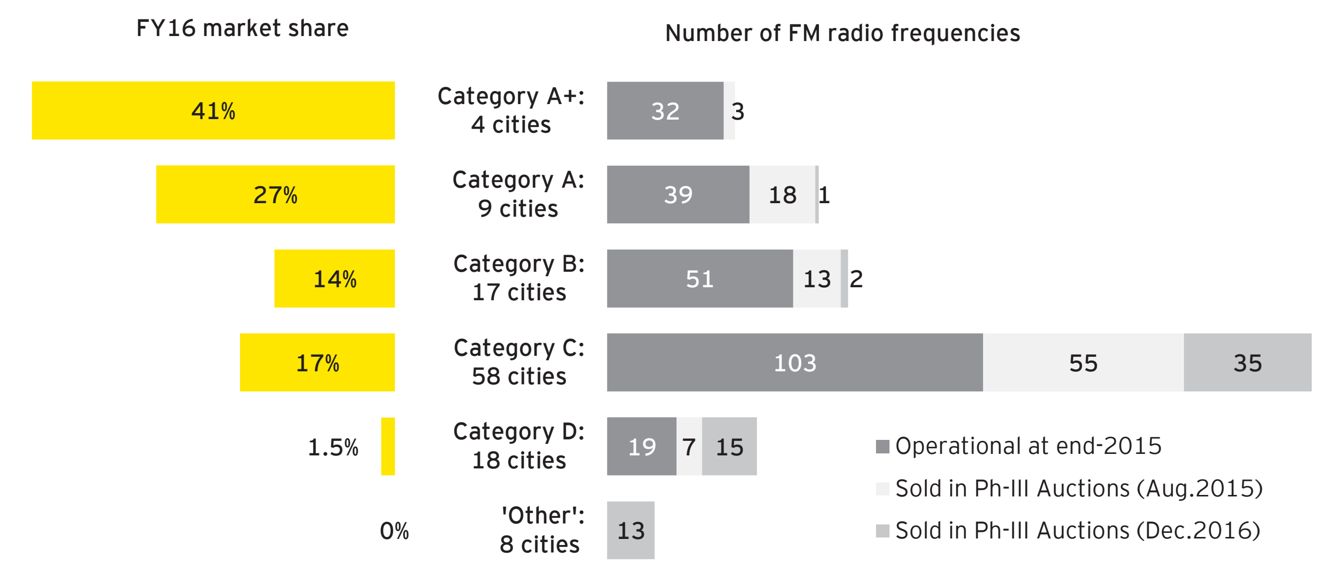


Source: EY Analysis

1 "Demonetisation: FM radio firms seen taking a hit", Livemint, Dec.2016; "Pitch Madison Advertising Report", Pitch Madison, Feb.2017
2 EY industry discussions and analysis

1. The Phase-III auctions flattened the radio landscape, but future reserve prices will need rationalization

India's radio market today is top-heavy, and the country's A+ and A category cities* comprised over two-thirds of total industry revenues in FY16 [3]. However, the FM landscape is flattening, with 140 frequencies in B, C, D and "Other" category markets sold in the industry's Phase-III auctions [4]. With nearly a hundred of these stations yet to be operationalized at the end of March 2017– including in 28 virgin markets such as Dehradun, Hubli-Dharwad and Salem – the medium's reach is set to deepen significantly [3].



Source: Ministry of Information & Broadcasting; EY analysis

** The Ministry of Information & Broadcasting has used population levels to categorize cities A–D, with "Other" including smaller cities in the border areas of Jammu & Kashmir and North Eastern states*

However, to continue radio's expansion into smaller towns, reserve prices will need to be rationalized in future auctions. Reserve prices for a fresh radio city have traditionally been set as the highest bid received in the prior auction for the same city category and region. But as this categorization is based on population – without factoring in paying capacity – the market potential of similar category cities can differ. Moreover, amplification of bid prices because of scarcity of frequencies can result in cities with similar revenue potential receiving different bids. It is also time to re-evaluate the possibility of reduction of inter-frequency separation so as to increase the number of frequencies available in larger A+ and A markets. However, doing that now could be seen as unfair to existing bidders, and would require a mechanism to equalize license fees.

The effect of the current price-setting mechanism was seen in the second batch of the Phase-III auctions. High reserve prices elicited muted interest from operators, and 200 frequencies went unsold, including in B category cities such as Vijayawada and Asansol and C category cities such as Trichy and Mangalore [4]. Meanwhile, one frequency in Muzaffarpur was sold for INR43.5mn, while three stations in the same city were sold for INR1.5mn apiece in the first batch [4]. To prevent such scenarios, the Telecom Regulatory Authority of India recently proposed a mechanism to set reserve prices by taking into account variables such as GSDP per capita and local stations' revenue, while de-linking reserve prices from prior auction bids [5]. Going forward, such a framework could re-kindle operator interest and help spread radio across the country.

3 EY industry discussions and analysis

4 "FM Phase-III Auction Results", Ministry of Information & Broadcasting, 2015/16

5 "Recommendations on Reserve Prices for auction of FM Radio channels in New Cities", TRAI, Mar.2015

2. Content differentiation is on the rise – particularly in the largest cities

The Phase-III auctions are having a unique effect on content in category A+ and A cities. Once all frequencies are operationalized, each of the 13 markets in these categories will have at least 6 stations – up from just 5 such cities before the auctions [6]. To carve out a niche in a crowded market and create separate brands for second stations in the same city, networks are making a concerted effort to differentiate offerings. This is occurring across both genres as well as languages:

- Radio Mirchi launched a romance-themed second brand Mirchi Love to complement its existing contemporary hits radio stations.
- Retro-themed second brands were launched by Radio Fever (Radio Nasha, centered on music from the 1970s-90s) and Red FM (Redtro, centered on content from the 1990s).
- Big FM re-launched its Delhi station, ensuring its positioning was more "mood and tempo-led" and more in-line with "on-the-fly" consumption, relative to its Mumbai counterpart [7].
- Radio One converted its Bangalore station to an international format [8].

3. Radio is now able to offer relevant ad bouquets to brands

India's radio industry today is fairly consolidated, due to cost economies of scale and higher entry barriers relative to mediums such as print or digital. As a result, ~90% of revenues and ~80% of frequencies were held by the top 10 networks in FY16 [9]. This consolidation, coupled with the expansion of radio to over 400 stations in 114 towns, means that a single network can now offer an advertiser significant reach and create a viable alternative to TV or print. Large national networks (e.g. Radio Mirchi, Red FM, Big FM, My FM, Radio City and Fever FM) and strong regional players in the South (e.g. Hello FM, Radio Mango and Club FM) are increasingly able to offer brands wide-ranging bouquets targeting listeners in metros, tier II/III cities or specific regional clusters. We believe this will have a positive effect on the radio segment's share of ad revenues in the medium term.

6 "FM Phase-III Auction Results", Ministry of Information & Broadcasting, 2015/16

7 "People may duplicate our formats but we don't duplicate our formats", Exchange4Media, Sep.2016

8 "Radio One goes international in Bangalore", Bestmediainfo, Jan.2016

9 EY industry discussions and analysis

4. Networks are complementing on-air offerings with multi-media campaigns and events

With customers consuming more media non-linearly, advertisers have begun focusing on integrated multi-media solutions to reinforce messaging and raise brand visibility across platforms. Most major radio networks have an in-built advantage here, as they are able to leverage the print, TV or digital arms of their parent media groups. For instance, Radio Mirchi (Times Group) carried a Hero Cycles campaign during the odd-even rationing plan in Delhi across its print properties [10]. Meanwhile on the digital front, Radio City (Jagran Prakshan Ltd.) launched an interactive mobile app for its program Love Guru [11].

Advertisers have also been attracted to the physical touchpoints offered by experiential solutions and events. To meet this demand, radio networks have launched various properties in recent years:

- Indigo FM (Jupiter Capital Ltd.) launched the international-themed "Indigo & Blues" jazz festival.
- Big FM (RBNL/Zee Media Corp.) created the arm-wrestling property "BIG Panjaa League."
- Fever FM (HT Media) launched the "Entertainment Ka Baap Awards" celebrating radio.
- My FM (DB Corp.) created the "Jiyo DilSe Awards" for recognizing individuals who are bettering society.
- Radio City created the televised "Freedom Awards" for independent music.

Events are showing strong growth potential, with major operators recording higher revenue growth for this category relative to on-air advertising [12]. The appeal of on-ground visibility for brands means events and activations will continue to form an important revenue stream for the radio industry, and can grow to contribute up to 20%-30% of revenues for national networks [13].

5. The industry needs effective account management and reporting to realize its next phase of growth

Radio has traditionally been the focus for large corporate advertisers, who aim to buy coverage across the country. As a result, national corporates account for up to 75% of revenues for some major networks today [14]. But this mix is changing. First, as consumption increases in smaller towns, local businesses are maturing in tandem and foraying into radio advertising for the first time. Second, as more frequencies become operational within a state and city, the value of selling a single geography to local advertisers rises. Finally, with marketers emphasizing ROI more than ever, the efficacy of localized messages over national communication is also driving the popularity of local campaigns. For these reasons, the share of national corporates to the revenue pie is falling. Radio City, for instance, has increased its share of revenue from local advertisers to ~50% today, up from ~25% when it was launched [15].

10 "Radio firms look beyond jingles for ad revenue", Livemint, Jun.2016

11 "FM Radio is now a viable business", Business Today, Aug.2016

12 "Analyst/Investor Conference Call", ENIL Financial Results, Nov.2016

13 EY industry discussions and analysis

14 "People may duplicate our formats but we don't duplicate our formats", Exchange4Media, Sep.2016

15 "Clients are looking for experiential solutions beyond radio or print", Exchange4Media, Sep.2016

With radio reaching more towns and local clients, a strong feet-on-the-street presence becomes crucial for reach and perception. These local sales representatives can also help teach new clients how to create effective plans. This is important, as the high churn rate of local advertisers in prior years has partly been due to operators failing to invest this time working with clients, and instead accepting any level of business they give [16].

In order to scale effectively, account management also needs to be supported with robust systems. In terms of organization, clear value propositions can be developed by segregating accounts into geographies or categories (e.g. focus accounts, industry verticals and SMEs). In terms of technology, this can mean recording client information in an opportunity management system to streamline pitch processes, inputting sales in a centralized MIS to track KPIs, or arming representatives with mobile dashboards to enable decision-making. To boost productivity in this fashion, Big FM for instance deployed the tool CRM Next, which allows the network to measure client relationships and sales inputs [17].

6. Radio networks have become more cost conscious

The radio business is characterized by low variable costs but high fixed costs and one-time fees. Existing stations can incur significant migration fees, with Phase-III migration fees for B and C category cities such as Coimbatore, Patna and Chandigarh exceeding INR150mn [18]. Meanwhile, aside from auction fees, new stations can require an initial capital investment of INR30mn–INR50mn in B and C category cities (if stations are not networked) [19]. But once stations recoup these investments and break even, 65%–80% of additional revenues accrue to the bottom line [19,20]. As this breakeven proved elusive or occurred too late for many stations under Phase-II, the industry has become increasingly cost-conscious. This was reflected in the Phase-III auctions, in which nearly 240 frequencies went unsold in the first and second batches as networks became more judicious in entering markets.

Profitability is also expected to improve under the 15-year Phase-III regime due to the networking of channels. Networking is now permitted across a broadcaster's entire network, not just in C and D category cities as under Phase-II. This allows networked stations to share infrastructure with larger stations, and if content is reused, much of the INR10mn–INR15mn studio cost can be saved[19]. These networked channels are also able to realize sizeable operating efficiencies via lower overheads, payroll, marketing expenses etc. To leverage these cost savings, radio networks are employing a hub-and-spoke model, wherein smaller cities in a state or region are networked to the operator's major market. As networks continue to expand, there is significant scope for shared services to help manage this scale-up and streamline processes involving RO entry, billing systems and digitized content management. Robotics process automation can also bring in significant savings, in addition to increasing accuracy and reducing time.

16 "Biggest job for radio companies in the coming years is to be evangelists", Business Today, Feb.2017

17 "People may duplicate our formats but we don't duplicate our formats", Exchange4Media, Sep.2016

18 "City-wise NOTMF for migration from Ph-II to Ph-III", Ministry of Information & Broadcasting, Sep.2015

19 EY industry discussions and analysis

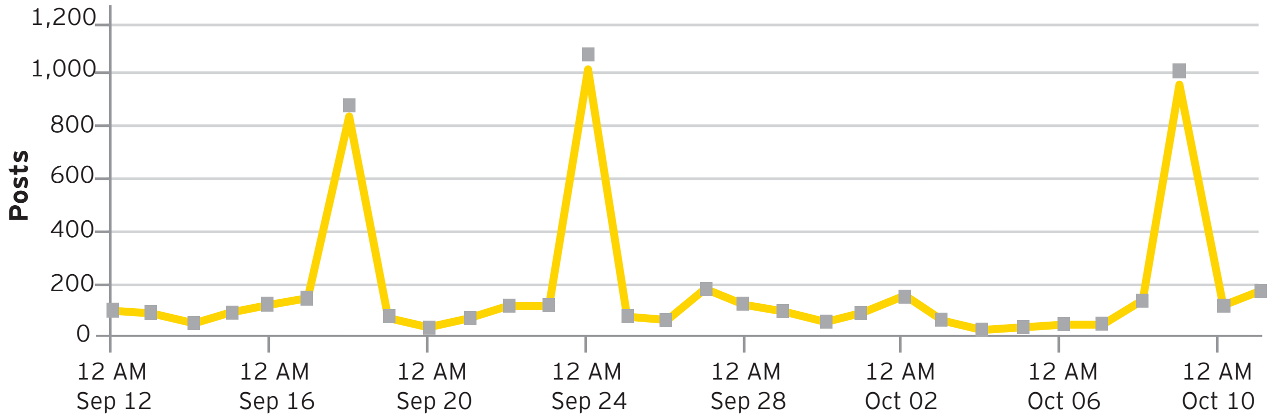
20 "IPO Watch", Economic Times, Mar.2017

7. Social listening is emerging as an alternative form of measurement

Given the industry's expansion into smaller towns and alternative genres, accurate radio measurement is imperative for networks looking to showcase their reach to advertisers. However, measurement of Indian radio listenership remains limited, with Radio Audience Measurement (RAM) currently sampling 480–600 individuals apiece in four cities (Mumbai, Delhi, Bengaluru and Kolkata) [21]. To create a more robust system, industry stakeholders have recommended widening the net to 15–20 cities and replacing the current diary-based methodology with a form of electronic measurement not reliant on recall [22].

As the industry waits on an updated ratings system, many networks have turned to social media as an alternative form of measurement. Social listening can take various forms and has the capacity to measure ratings via the volume of online posts, key conversations taking place via word clouds, sentiment analysis via classification of replies, identification of high-profile influencers and demographic profiling of listeners.

Social volume analysis of a Mumbai-based radio network



Source: Radian 6 Analysis

Such analysis can be done at a granular city-level, allowing networks to discern differences between their own stations, competitors and local consumer preferences. The resulting insights can then be used to modify content strategies, customize launch marketing and focus on the most effective engagement channels.

21 Radio Audience Measurement portal (TAM India)

22 "FM operators want larger sample size, more accurate data collection", Exchange4Media, Apr.2016

Harrish Bhatia- CEO, My FM

What are your key learning from the Phase-III A and B auctions of private FM channels?

a. The Phase-III auctions showed us that the Government is willing to take radio seriously and is working toward expanding the reach of radio to the length and breadth of the country. This is a very good sign for the industry as a whole.

b. We need innovations to succeed in markets where the overhead costs, i.e., costs incurred without even starting a station, such as OTEF, license fees, etc. are already substantial whereas the market potential is less. We are working on several fronts in this regard and will implement them soon.

c. For batch II of Phase-III, the reserve prices of most of the new cities were high and therefore the response was lukewarm. The Government should seriously work on rationalizing these points.

d. Deferred payment: As per current policy, successful FM bidders have to pay 100% of their bid amounts upfront, within three weeks of the end of the auctions. It takes up to 12 months for stations to become operational. We therefore urge that the Government announce a deferred payment plan like in the case of telecom auctions. The first payment should be just 25% of the bid value, payable when BECIL delivers the operational facility. There should then be a three-year moratorium on payments. The remaining 75% payment can then be collected over the next few years.

e. Music royalty: A significant cost of a radio station is music royalty. If the music copyright issue is resolved, it would lead to better cost management.

Where do you see the radio industry in three years in terms of:

a. Topline growth: We expect the industry to grow at a CAGR of 15% year-on-year for the coming few years.

b. Share of ad spend: Currently, radio is about 4% of the total advertising pie. We expect that radio as a whole will grow at a faster rate than the rest of the traditional media and thus the share of ad spend will increase as well.

c. Complementing print/TV campaign: Radio is a retailer's medium; it is the only media that is consumed when the store is open. Further, studies have shown that when a campaign on print/TV is coupled with radio, the brand metrics improve significantly. We do not expect radio to become an alternative to print or TV but rather complement them.

What will be the key success factors for the next three years in terms of:

a. Sales/account management: With the advent of new radio stations in the cities, retaining clients as well as introducing radio to new clients will be key.

b. Alternate revenue: Radio works on a shoestring margin, and alternate sources of revenue can certainly alleviate these pressures, be it through on-ground activities or even collaboration with other entities.

c. Localized content: In Radio, the primary expectation is that of music, so that still dominates the content arena. Our primary target audience is a mature listener who wants meaningful content from radio, and therefore allowing of news on radio will further strengthen the relevance of the medium and also the consumption.

Our M&E practice

EY India has a dedicated M&E practice of more than 300 professionals across 15 key segments of the industry. We provide services to many of the country's leading M&E companies as well as to global media giants operating in the country.

We have developed a wide range of services, such as entry strategy, private equity placement, due diligence, IT security review, organization structure, performance improvement and tax structuring. This has enabled us to establish a strong presence in each segment of the industry.

As your advisors, we can help respond quickly and effectively to the challenges the entertainment industry faces today.

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