

What Lies Behind the Incredible Rise and Rise of Bharti Airtel

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A draft CAG report alleges the government helped India's largest telecom company obtain "undue benefits", which we estimate to be around Rs 14,500 crore, by miscalculating revenues and nepotism in spectrum allocation. Airtel also gained Rs 44,000 crore through questionable corporate restructuring

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Sleight of hand, circumvention of administrative norms, understating revenue to be shared with the government, securing efficient electro-magnetic spectrum for telecommunications at discounted prices or even free, sale of assets and restructuring of company holdings for unconscionable profits.

This, according to a draft report of the Comptroller & Auditor General of India – the constitutional body mandated to oversee public finances – summarises the not-so-well-known story behind the incredible rise of Bharti Airtel, India's biggest, and the world's fourth largest, telecommunications group headed by first-generation entrepreneur Sunil Bharti Mittal. The audit covers the period between the 2006-07 and 2009-10 financial years, when the United Progressive Alliance governments headed by Manmohan Singh were in power.

The “culprit” or “benefactor”, depending on one's perspective, is the Department of Telecommunications (DoT) in the Union Ministry of Communications and Information Technology. The CAG report raises questions about whether the corporate conglomerate led by Mittal is where it is at present because of business acumen and its ability to successfully take on competitors. Or whether the amazing ascendancy of the group was a consequence of politicians and bureaucrats not merely designing a favourable policy regime and bending rules but also looking the other way when these regulations were flouted.

Group flagship Bharti Airtel (Revenue: Rs 92,039.5 crore for the year ended March 31, 2015) is one of India's most glamorous corporate entities, operating in 20 countries across Asia and Africa as one of the world's top four mobile telecom service providers in terms of subscribers (nearly 325 million at the end of March).

Basis of CAG's audit

To first answer a question that may seem obvious to some: Why did a government auditor scrutinise the accounts of a private group? The CAG audit was mandated by the April 17, 2014, landmark judgment of the Supreme Court of India that dismissed the plea of private telecom companies that the CAG could not audit their books of account. The apex court

clarified that the “audit” would not be a “statutory” one but an “examination of receipts” to ascertain whether the Union government was getting its due share of revenue by way of licence fee (LF) and spectrum usage charges (SUC).

Now comes the finding that the biggest player in the sector, Bharti Airtel Limited (and its subsidiary Bharti Hexacom) registered “significant abnormal gains” in the period between 2006-07 and 2009-10. At the end of May 2015, the CAG’s Director General of Audit, Post and Telecommunications, drafted a report running into 112 pages (with annexures) – a copy of which is with these writers – claiming that the company systematically under-reported revenues and allegedly earned ‘significant abnormal’ profits through corporate restructuring. The draft report scrupulously records the alleged violations of the law but stops short of quantifying the total loss to the exchequer. However, the gains to Airtel on corporate restructuring alone have been estimated in excess of Rs 44,000 crore. (The Income Tax Department has sent the company a notice alleging tax evasion.)

After the draft report of the CAG is finalised, it will be presented in Parliament and become a public document. At the time of writing, the DoT had not responded to the CAG’s draft report.

It’s all about sharing

Mittal, who is often described as a “telecom czar”, took home Rs 27.17 crore during the last fiscal year, 324 times the median remuneration earned by all his 30,000-plus employees. Fair enough, one could argue. After all, here is an entrepreneur who took his company from a rookie telecom operator with two CMTS (Cellular Mobile Telephone Services) licenses in the first few years of the new millennium to a behemoth holding 23 UASL (Unified Access Service License) licenses and providing telecom services across the length and breadth of India as well as across Asia and Africa in barely a decade.

Bharti Airtel was not alone in obtaining generous concessions from the government between 1999 and 2004 that helped telecom companies that had bid big, but unwisely, in the scandalous tendering for licenses for 21 telecom circles (or geographical areas) during the tenure of Sukh Ram as Union Telecom Minister. Sukh Ram called the shots in Sanchar Bhavan (where the DoT is headquartered) between January 1993 and May 1996 before he was raided by the Central Bureau of Investigation and much later, jailed.

In view of “severe financial constraints” faced by telecom companies, the National Democratic Alliance government of Atal Behari Vajpayee allowed them to move from a fixed (and onerous) license fee regime to a revenue sharing one in August 1999. Six months later, Bharti Airtel acquired a company called JT Mobiles with three CMTS licenses and successfully bid for eight more licenses in 2001.

The migration to revenue sharing played a major role in Bharti Airtel’s spectacular growth over the years. The CAG claims the company regularly under-reported revenues that the company was required to share with the government as per its licence agreement.

The accounting fudges listed by the CAG come under 23 specific heads and the draft report is as much an indictment of the private corporate group as it is of the DoT that was clearly lax in allowing the company to slip in impermissible deductions while calculating sharable revenue.

Telecom companies share 8% (with effect from July 2013) of their adjusted gross revenues (AGR) with the government and dissimulation with these numbers can do wonders for any company's bottomline. The issue of what constitutes AGR has been contentious since 2003, with telcos arguing that its definition in license agreements is very broad and covers "non-core" revenue. Besides the AGR-based license fee, the government also levies spectrum usage charges of 5% on airwaves bought through auction and a weighted average mechanism is used to calculate the SUC for companies that have bought some spectrum through auctions and got some allotted without auctions.

If non-telecom revenue is included under AGR, companies naturally have to pay more to the government. The Telecom Disputes Settlement and Appellate Tribunal (TDSAT) recently suggested that AGR should include all receipts except capital receipts and revenue from non-core sources such as rent, profit on sale of fixed assets, dividend, interest and miscellaneous income. It further held that even adjustments on account of transactions in foreign exchange must come under AGR although license fees will not be charged twice on the same income.

Accounting fudges

Apart from the general benefits provided to all telecom service providers, Bharti Airtel obtained certain concessions that others did not. This is also the crux of the story behind the incredible rise of the corporate conglomerate headed by Mittal.

The initial success in obtaining spectrum for providing telecom services through questionable means seems to have emboldened players like Bharti Airtel to ask for more of this finite and scarce natural resource against a backdrop of breakneck expansion of cellular phone services, a convoluted policy regime and lax bureaucratic ethics. For Bharti Airtel, obtaining spectrum out of turn and in an allegedly unauthorised manner became par for the course.

The accounting fudges listed by the CAG come under 23 specific heads and the draft report is as much an indictment of the private corporate group as it is of the DoT that was clearly lax in allowing the company to slip in impermissible deductions while calculating sharable revenue. Several questions were raised in Parliament as to whether Bharti Airtel was given preferential treatment in spectrum allocation or not charged a fee. To one such question, Kapil Sibal, the then minister in charge of the DoT (between January 2011 and May 2014) gave blanket statements that everything was done in accordance with prevailing rules, norms and the law.

The CAG differs, and notes that Bharti Airtel:

- Under-reported revenues in the statements of revenue and licence fee and in the company's primary books of accounts (trial balances) and profit and loss (P&L) account, especially on revenues earned from providing pre-paid, post-paid and roaming services, besides forex deals and infrastructure sharing, and also "suppressed" income from investments, interest and miscellaneous sources in calculating AGR while computing LF and SUC.
- Gave its 95% subsidiary Bharti Telemedia Limited Rs 1,487.95 crore as an interest-free, unsecured loan in 2009-10, thereby violating the "arm's length" relation between a holding company and its subsidiaries, decreased its own revenues by the amount of interest payable and ultimately, the LF and SUC payable to the DoT.

- Ignored revenue accounted under global operations and under its infrastructure provider (IP-1) licence for computation of revenue share.
- Did not consider income from profit on sale of fixed assets in AGR.
- Deducted written-off, bad debts worth Rs 91 crore from gross revenue and claimed deductions for providing PSTN (Public Switched Telephone Network) services against leased line charges in 2006-07.
- Ignored revenue from sale/lease of bandwidth charges in AGR for computation of LF and SUC.

Bharti Airtel's most interesting accounting manoeuvre came in the form of successive transfers of infrastructure assets to its subsidiaries at zero value. The CAG has claimed that the company and its subsidiary, Bharti Hexacom may well have secured financial benefits to the tune of Rs 10,978.77 crore through investment revaluation and Rs 33,617.55 crore through changes in the market value of shares received.

Full spectrum dominance

The not-so-well-known aspect of the spectrum allocation scam is that Bharti Airtel continuously secured more spectrum than was due to it. The non-implementation of the recommendation of the Telecom Regulatory Authority of India (TRAI) to auction broadband wireless access (BWA) spectrum in the 3.3 GigaHertz band resulted in a loss of Rs 3,009 crore to the exchequer and a corresponding gain to Bharti Airtel, claims the CAG. While stating that the total value of the spectrum granted gratis or out of turn has not been worked out, even the tentative estimates made in the CAG's draft report are substantial.

Initially, a cumulative maximum of 4.4 (MegaHertz) MHz was allowed to service providers in the 22 circles of the country in the 890-902.5 MHz and the 935-947.5 MHz bands. Bharti Airtel and/or its predecessor companies obtained an additional 1.8 MHz in the 900 MHz band between December 1996 and August 2000 worth Rs 463.56 crore in seven service areas.

In January 2002, the DoT decided to consider allocation of additional spectrum of 1.8 MHz (paired) in the 1,800 MHz band to operators with 400,000 customers but released the spectrum only after 500,000 subscribers were reached. This would need a payment of one per cent of the AGR for spectrum beyond 6.2 MHz and up to 10 MHz.

Bharti, not only managed to elude the 1,800 MHz clause and get 1.8 MHz spectrum in the premium 900 MHz band in Delhi but also secured additional spectrum in the 900 MHz band beyond 6.2 MHz in three other service areas as well in what is described as a "flagrant violation".

A different spectrum scam

The DoT consistently ignored recommendations that were made by the TRAI between September 2006 and July 2008 to auction BWA (broadband wireless access) spectrum in the 3.3 GHz band as well (after accepting the suggestion "in principle") and allocated spectrum in the 3.3 GHz band year after year over the past six years free of cost. Apart from regular allocations, Bharti Airtel secured 2×6 MHz spectrum in 165 cities and 2×1.75 MHz in three cities in the 3.3 GHz band across the country, through administrative allocation (April 2005 to July 2009), for one year but extended annually. Forty-three cities were in the eight service

areas where Bharti Airtel had 20 MHz spectrum in the 2.3 GHz band and continued with both 2.3 GHz and 3.3 GHz spectrum getting undue advantage over its competitors.

Not auctioning the BWA spectrum in the 3.3 GHz band caused a loss of Rs 3,009 crore to the exchequer (price for 20 MHz BWA spectrum in the 2.3 GHz band in the 2010 auction) through evasion of the stipulated one-time charge for $2 \times 6 \text{ Mhz} / 2 \times 1.75 \text{ Mhz}$ of BWA spectrum in 3.3 GHz band in eight service areas, the CAG has estimated.

Further, 125 of the 168 cities fell under the 14 service areas where Bharti did not win the BWA spectrum in the 2010 auction but could continue to offer services just the same. The public sector Bharat Sanchar Nigam Limited was among others at the receiving end. The DoT continued to violate the TRAI's recommendation even after BWA spectrum was auctioned between March and June 2010.

What was worse, extending the validity of $2 \times 6 \text{ MHz}$ spectrum in the 3.3 GHz band in 125 cities in 14 service areas where Bharti did not win BWA spectrum, allegedly caused a loss of Rs 2,772.52 crore to the exchequer and a corresponding gain to Bharti, the CAG has claimed.

The TRAI had opposed giving some operators both city level and circle level spectrum to ensure a level playing field and wanted operators in the 3.3-3.4 GHz band to choose between circle or city-based service areas for BWA services on acceptance of a fresh set of conditions relating to rollout and annual spectrum charges, payment of an upfront one-time spectrum acquisition fee.

In 2008, even the DoT had assessed that $49 \text{ MHz} + 49 \text{ MHz}$ spectrum had been allotted in the 3.3-3.4 MHz band but after migration to the circle level, some areas would have auctionable spectrum left for new entrants. Yet it chose not to give service providers with assigned spectrum in the 3.3 GHz band the option to migrate to circle level operation and went ahead with auction of 2.3 MHz issuing the guidelines in this regard only in August 2008.

TRAI bypassed

While answering a question in the Rajya Sabha on May 3, 2013, on allocation of excess spectrum, former telecom minister Sibal had said:

“The allotment of additional spectrum beyond 6.2 MHz was considered in [the] 1,800 MHz band. However... in [the] 900 MHz band to three service providers, some small amount of coordinated spectrum varying from 1.6 MHz to 3.6 MHz was available in some of the service areas. Hence, instead of keeping small chunks of spectrum unutilized, the same was allotted to some operators as additional spectrum, bearing in mind the fact that it was not sufficient to meet even the initial spectrum allotment of 4.4 MHz required for initial network planning rollout and further growth to any prospective new operator. Therefore, the available spectrum in [the] 900 MHz band was allotted beyond 6.2 MHz to those operators who fulfilled the conditions of subscriber base criteria as per the orders in force at that time”.

What Sibal did not clarify was why the DoT had not obtained TRAI approval and declared this policy transparently for the knowledge of all operators. Spectrum in the 900 MHz band is very efficient and can cater to twice the number of subscribers compared to spectrum in many other bands. Hence, it became easier for telcos with 900 MHz spectrum to attain the number of subscribers required for getting additional spectrum.

Yet, the government auditor said the DoT continued violating the TRAI's recommendation and also ignored the recommendation of a technical committee (made on November 21, 2001) that the allotted 6.2 MHz+6.2 MHz spectrum was sufficient for a subscriber base of about 900,000 per operator in "high penetration" areas like Delhi and Mumbai for another 24-30 months.

There was generosity with 900 MHz band spectrum too; spectrum that is scarce and efficient in comparison to that in the 1,800 MHz band. The DoT allocated spectrum valued at Rs 244.11 crore to Bharti Airtel in four service areas (Andhra Pradesh, Delhi, Karnataka and Punjab) for free. Again, violating its own norms, the DoT allocated additional spectrum of 2 MHz beyond 8.0 MHz + 8.0 MHz up to 10 MHz to Bharti Airtel in the Delhi metro service area in July 2003 and did not charge even a one-time entry fee. This set a precedent of sorts for other operators who sought additional spectrum. The largesse for Bharti was permitted over and above the generous concessions given to all Cellular Mobile Service Providers (CMSPs) between 1999 and 2004 that included a relief of Rs 4,565 crore in terms of the net present value for migrating from the fixed entry fee system to the revenue sharing regime in 1999.

Fast-forward to 2012. Despite the Supreme Court's February 2012 order to auction spectrum after wide publicity, the CAG alleges that spectrum allocation is still being administratively regulated without any auction, without incurring additional costs and with the DoT also not enforcing roll-out obligations on the telcos.

With assets like these

Through a maze of transfers, not unknown in the corporate way of doing things in India, Bharti Airtel engaged in infrastructure asset sales to its subsidiaries at zero value resulting in non-payment of LF and SUC, while giving itself enormous financial advantages. As is wont in such operations, transfer gains by Bharti Airtel and its subsidiaries, Bharti Infratel and Bharti Infratel Ventures derived directly or indirectly from such machinations went unrecorded (see table below).

Post asset transfer, Bharti Airtel revalued its investments, revising the value directly in the balance sheet with a corresponding addition of an equal amount to reserves, deriving net gains of Rs 2,478.52 crore, according to the Income-Tax department. Over two rounds of bonus shares were given: Bharti Infratel allotted 49.99 crore fully-paid bonus shares at the ratio of 1:9999 bearing a face value of Rs 499.95 crore to increase the shareholding of Bharti Airtel from a meagre 50,000 shares to 50 crore shares and the face value from Rs 5 lakh to Rs 500 crore on August 21, 2008.

Bharti Infratel Limited was incorporated as a subsidiary of Bharti Airtel on November 30, 2006 to set up, operate and maintain wireless communication towers, provide network development services and to engage in video, voice, data and internet transmission business in and out of India among other things. Bharti Airtel transferred its telecom infrastructure worth Rs 5,739.6 crore to Bharti Infratel at zero value and showed it as a loss on transfer of telecom infrastructure in the P&L account for 2007-08. It withdrew an equal amount from the reserve for business restructuring, adjusting it against loss, said this was sanctioned by the Delhi High Court and that there was no impact on the P&L account. Bharti Airtel's annual report for 2007-08 talked of the scheme of arrangement between Bharti Airtel and Bharti

Infratel for transferring telecom infrastructure assets being approved by the high court on November 26, 2007 with effect from January 31, 2008.

Four years later, on August 23, 2012, Infratel allotted 100 crore equity shares with face value of Rs 1,000 crore as fully paid bonus shares to Bharti Airtel, resulting in the company's total number of shares trebling from 50 crore to 150 crore. The advantage to Bharti Airtel after transferring the infrastructure assets was quantified by the CAG at Rs 27,259.30 crore. Besides, there was an additional dividend of Rs Rs 1,485 crore from Bharti Infratel during 2012-13 and 2013-14.

The Bharti Infratel IPO (initial public offer) of shares led to the holding of Bharti Airtel in Bharti Infratel falling from 86.09% to 79.42%. The equity shares were allotted on December 22, 2012 and the carrying amounts of controlling and non-controlling interest were adjusted to reflect the changes in their relative interest in Bharti Infratel. Consequently, a dilution gain of Rs 1,664.9 crore was recognised directly as equity attributable to the shareholders of the parent, Bharti Airtel.

The other company involved in this game, Indus Towers Limited, was promoted in November 2007 as a joint venture between the Bharti group (including Bharti Infratel), Vodafone India and Aditya Birla Telecom, to render passive infrastructure services to telecom service providers. Another arrangement between Bharti Infratel and Bharti Infratel Ventures Limited or BIVL (incorporated as a wholly owned subsidiary of Bharti Infratel) with due court approval, saw the transfer of telecom infrastructure assets from the former to BIVL with effect from May 5, 2011. On May 31 that year, BIVL secured the court's sanction to merge with Indus Towers on April 18, 2013 to transfer of all assets and liabilities of its subsidiary to Indus Towers Limited and wind up the subsidiary. The scheme was effective from June 11, 2013.

Go merge and multiply

The CAG says that consequent to the BIVL-Indus Towers demerger, the Bharti group exchanged control of BIVL for an additional interest in Indus Towers and thus managed to:

- Derecognise the assets and liabilities of BIVL from its consolidated statement of financial position (net gain: Rs 4,363.10 crore);
- Recognise additional investment in Indus worth Rs 525.81 crore that was the group's share of the aggregate (a) fair value of the net assets contributed by the joint ventures and (b) book value of net assets of BIVL contributed by the group; and
- Recognise resultant gain of Rs 895 crore as exceptional income.

There was yet more self-enrichment. By August 2012, Bharti Airtel held 150 crore shares in Bharti Infratel, of which it sold 8.5 crore shares on August 11, 2014 for Rs 2,142 crore at Rs 252 per share. Bharti Infratel made an IPO of 18.89 crore shares at Rs 220 per share in December 2012 at a total value of Rs 4,155.80 crore with the shares listed on the Bombay Stock Exchange on December 28, 2012. Additionally, Bharti Infratel received Rs 625 crore as dividend from Indus Towers Ltd during 2012-13 and 2013-14.

The I-T department objected to the demerger of these assets alleging tax avoidance. "They could have transferred the assets directly to Indus Towers instead of forming new companies", an unnamed official was quoted as saying in the *Economic Times* (January 29,

2014). Essentially, Bharti Airtel transferred assets worth Rs 5,739 crore to BIL for free and claimed tax exemption as the transaction was termed as a loss to Bharti Airtel. Subsequently, these assets were valued by it at Rs 8,218 crore in its balance sheet. The final effect of the transaction was an increase the value of the assets by Rs 2,479 crore.

This is apparently nothing but income and thus taxable. The I-T department issued an assessment order for 2008-09 in which it was claimed that the manner in which the company calculated its taxable income was not only “erroneous but also... prejudicial to the interest of the revenue”. The notice of the I-T department says that Bharti “misrepresented” facts before the Delhi High Court to obtain approval for demerger and subsequent merger with Indus Towers. “The assessee company has not disclosed the full and true intention in the scheme of arrangement approved by the high court,” the notice alleged..

Reaping ‘significant abnormal gains’

The draft report of the CAG concluded: “Bharti Airtel Ltd reaped significant abnormal gains through successive transfers of infrastructure assets, deviated from accounting standards and India’s generally accepted accounting principles, avoided to book the sale of assets, their associated income and gains in the profit and loss account, thereby understating the gross revenue, which in turn resulted in corresponding non-payment of license fee and spectrum usage charges.”

Significantly, Bharti Airtel’s statutory auditor did not qualify his opinion but admitted that the country’s generally accepted accounting principles would not permit such utilisation of reserves for business restructuring and would lower the company’s profit after taxes for the year by Rs 5,739.60 crore.

The observations in the draft report of the CAG were sent to the DoT in parts between February 2015 and April 2015 but no response had so far been received.

Detailed questionnaires were emailed on July 22 (and hard copies sent by Speed Post) to Rakesh Garg, Telecom Secretary, to Sunil Mittal as well as the two senior-most executives in charge of corporate communications in the Bharti group. The head, corporate communications, spoke to one of the writers and said a response would come in due course. He also provided background information in the form of replies to questions raised in Parliament and judicial orders.

Bharti Airtel is one of corporate India’s outstanding successes. There is no disputing that. Yet there is reason to read between the lines and scrutinise the fine print and question if this magnificent growth is built on the foundations of accounting artifice and government indulgence.

One can literally hear the call drop.