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For Cellphone Makers, Signs of Pain in Spain

For cellphone makers betting on booming global growth, the Spanish market has emerged as a key test case. Early signs aren't good: new data suggest that efforts by wireless carriers there to reduce spending on device subsidies are hurting cellphone sales.

Earlier this month, we reported that the global telecom industry has its eye on Spain, where two leading wireless carriers in recent months abruptly stopped offering cellphones to new customers at a discount. The moves were seen as the most aggressive among efforts by carriers around the world to rein in how much they're spending subsidizing phone purchases by consumers—an increasing drain on phone-company profits as consumers flock to expensive smartphones.

The first data points coming out of Spain suggest that, in fact, the smartphone market is growing less quickly than expected now that subsidies are going away. After getting feedback from phone manufacturers on the impact of the subsidy cuts, market-research firm International Data Corp. is reducing its estimates for sales in Spain, analyst Francisco Jeronimo said.

The Spanish market has already been buffeted by Europe's economic crisis. The subsidy cuts are adding to the pain for phone makers, Mr. Jeronimo said. IDC is revising its forecast for the growth of smartphone sales in Spain in the second quarter to just 7%, down from a forecast of 21% growth just a few months ago, he said. The overall market, meanwhile, is expected to contract more quickly than previously expected: IDC now expects the total number of cellphones sold in Spain to shrink by 21% in the second quarter from a year ago, compared to a previously estimated 15% decline.

The efforts by wireless carriers to reduce their spending on subsidies has given hope to their investors, made investors in phone manufacturers nervous, and raised the specter of higher prices for consumers. Until recently, a new customer at Spain's leading wireless carriers, Vodafone Group PLC and Telefonica SA, could get the latest iPhone for $250 with a two-year contract. Now, a new customer has no choice but to buy the device at full price, around $800.

In the U.S., carriers have said that they're watching Spain closely, and they've also come under sharp criticism from investors for how much they spend on subsidies. For now, they've tried to reduce their subsidy spending with more modest steps—for example, increasing the fees that customers have to pay when upgrading to new phones to reduce the frequency with which they pay subsidies. Going further could be tough, since U.S. customers are very much used to being able to get a new phone at a discount every year or two.

But Vodafone, one of the world's biggest wireless operators, says it may take its experiment in Spain elsewhere.

"It's a healthy thing, and we are trying not just in Spain to go there," Vodafone CEO Vittorio Colao said on the company's earnings call yesterday, in response to a question about the new subsidy model in Spain.

In the first three months of the year, the overall Spanish cellphone market shrank 8%, IDC says. That was probably due for the most part to the country's economic troubles, since the new subsidy policies didn't start to kick in until the end of the quarter.

But drilling down into the first-quarter data shows that as phone sales are buffeted by economic conditions and changes to carriers' subsidy models, it's the lagging phone manufacturers, rather than market leaders Apple and Samsung, that could be hurt the most.

Even as the total market declined, Apple's sales in Spain grew 6.5% in the first quarter compared to a year before, while Samsung's increased 41%, IDC said. Meanwhile, Nokia and RIM sales each declined more than 40%.

"Consumers are a lot more picky when they choose their devices, because now they have to pay for their devices," Mr. Jeronimo said of the Spanish market. "They need to be a lot more careful if they need to invest a bit more."