Lessons Learned from Mobile Mergers in Overseas Markets

Speech by Michelle Lim – Chair, Commpete

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Commpete is an alliance for competition in digital communications. Commpete provides a unified voice of 'non-dominant providers' with a clear focus to enable real competition and we work with Government and Industry on regulatory and policy decisions.

At the last CommsDay Summit in October, we launched our election policy which rests on 5 pillars for success for competition reform. These are:

1) To Create right of access to mobile networks for challengers

2) The NBN CEO holds KPI target of 30% Competition

3) A Write down of NBN

4) A Competition Impact Statement accompany all new proposed policy and regulation

And lastly;

5) A Commitment to structural separation principles of NBN

And last week the Standing Committee on Economics recommended the Australian Government require a Competition Impact Statement to accompany all proposed policy and regulation to enhance NBN customer outcomes and to recommit to a separated wholesale-only NBN selling on a non-discriminatory basis.

As an organisation, we look forward to working with Government, regulators and Industry in the year ahead. It will no doubt be a busy one.

I would like to turn to the main topic of my speech today which is to provide insight on mobile mergers in overseas markets and its impact on consumers.

The studies will show why it is not surprising the ACCC will take its time to reach a decision for the TPG/Vodafone Merger.

The ACCC's Statement of Issues raises important competition questions – which need to be answered before any merger decision is made.

- What is the impact on consumers?
- What is the impact on wholesale supply?

- How does that impact competition for fixed and mobile retail broadband nationwide?
- And what are the likely short and long term outcomes?

This is important because mergers are permanent. Therefore, the answers to these questions need very careful consideration.

The ACCC of course will have competition at the heart of any decisions.

Commpete strongly objects to the merger in its current form and supports that merger decisions should not be made in haste – and never simply ushered through.

When the ACCC decision was delayed, there was much surprise throughout the industry. But I believe it's an indication of how we have all become conditioned to think through the eyes of the incumbents. That is, what is best for the incumbents is a *fait accompli*.

The ACCC moving to a Statement of Issues may not be popular with the merging parties. Not popular with the investment bankers, nor the few Providers whose share price rose sharply when the merger was first announced, only to fall dramatically when the ACCC didn't just wave it through.

But Commpete is confident that the ACCC applying strict competition standards will be good for consumers.

There are a significant number of empirical studies which examines the competitive implication of a fourth mobile network operator.

The studies include independent work by academics, through operator sponsored studies and studies undertaken by regulators.

The studies took place over the last two decades and cover 33 OECD countries (Genokos et al), 27 European member states (Csorba) and 240 firms from 119 countries.

These studies provide a cross-sectional analysis of the differences in markets with fourth operators. They also include the ex post assessment of operator entry or exit – in other words, mergers. Each study analyses the effect of increased concentration on prices in retail mobile markets.

The big take out from these studies is that consumer welfare (in terms of price, service and innovation) is positively correlated with the number of telecommunication network operators in the market. Specifically, each study highlights the importance of a fourth MNO in delivering significantly lower prices for consumers.

The five empirical studies published by European regulatory authorities are:

1. The Body of European Regulators of Electronic Communications (BEREC) [[1]]

2. British Regulators Ofcom [[2]]

3. *Belgian Institute for Postal Services and Telecommunications Report [3]*

4. *The RTR Report [4]*

5. *The BWB Report* [5]

These studies showed (in order):

1) There was evidence that retail prices for new customers were higher in the post-merger scenario.

2) That introducing a disruptive fourth player could reduce prices by approximately 17-20% on average. Or approximately 8% for a non-disruptive player.

3) There was a relative increase in Austrian prices for both smartphone users and traditional users after their mergers.

4) Merger simulation models found that the merger resulted in 14-20% increases in inflation adjusted prices.

Other Academic research arrives at conclusions that are generally consistent with these studies.

The academic studies examine concentration of MNO's and the trade-off between higher prices and greater per-operator investment.

Genakos et al. (2017) [6] - a study of 33 OECD countries, found that more concentrated markets resulted in higher prices for the end user. The analysis shows that having four operators in the market results in prices that are 15.9% lower than having only two or three operators.

Csorba and Papai (2015) [7] - study of 27 Member States found that entry increasing the number of operators from 2 to 3 does not decrease price, while increasing the number of operators from 3 to 4 can decrease prices depending on the type of entrant that is local or multinational. Further they found 4 down to 3 mergers were associated with higher risk of long-run price increases and therefore should be assessed carefully.

In many of these overseas markets, the competition regulator ruled that the reduction of MNOs from four to three would have a substantial lessening of effective competition. In all of the cases, the regulator either prohibited the merger or approved the merger under strict conditions.

In recent years, with more data - the European Commission has identified issues with mergers. The recent decisions have either blocked the 4-to-3 mergers or allowed the mergers but with substantial conditions to prevent anti-competitive impacts.

These remedies have generally included increasing competition from MVNO's by wholesale access arrangements such as:

1. a requirement to sell a percentage of network capacity (typically 30%) to MVNO's for fixed charges.
2. upfront agreement with a larger number of MVNOs to provide wholesale access to the merging network;
3. divestment of radio spectrum; and
4. selling of network infrastructure.

In the past ten years, significant remedies have been imposed on 4-to-3 mobile telephony mergers in the EU by BEREC (Austria in 2013, Ireland in 2014, Germany in 2015 and Italy in 2016). The two MNO mergers which were withdrawn or blocked during this ten-year period, that is, Denmark in 2015 and the UK in 2016 would also have been 4-to-3 mergers.

For the Hutchison/Orange merger, the remedies offered by the merging party consisted of wholesale access to 30% of total network capacity for up to 16 MVNO's over 10 years. This enabled them to offer mobile communication service to customers in Austria at zero marginal cost.

Similarly, in Ireland, the merger of Telefonica (O2) and Hutchison (3) was cleared by the European Commission. But one of the main conditions was that the merged entity must allow the 2 largest MVNO's to increase their capacity allocation to 15% each. This meant a total of 30% over a 10-year period.

In Germany, with the acquisition of Telefonica and E-Plus, commitments were made to sell to MVNO's up to 30% of the merged entity network capacity for a fixed charge. It also included divesting radio-wave spectrum and extending the existing wholesale agreements.

So, what's happening in Australia?

At the April Commsday last year, Commpete referenced a 2012 report from JP Morgan. This report was used by the Australian Government as an aspirational measure of competition at the time NBN was incepted. It provided a benchmark that with an effective competition policy and a healthy advanced economy, challengers or disruptors should occupy 30% of market share.

In order to assess the competitive effects of a merger between Vodafone and TPG it is necessary to look at what would occur if the merger were not to proceed. In merger analysis this is typically referred to as the merger counterfactual. In this case, the counterfactual should be determined based on what TPG would be likely to do if the merger did not proceed.

The case study of Wabtec/Faiveley Transport is precedent in Europe where one of the merging party is a potential entrant to a market already served by the other merging party.

In summary, the European Commission evaluated the potential entry based on Wabtec's existing capabilities, timeframe and cost to meet the deficiencies. This was to evaluate whether Wabtec could be viewed as a competitor in that industry.

In our view, this could be a useful approach in examining the TPG/VHA merger that should be adopted in determining the counterfactual for the merger analysis. And I'm sure the ACCC will be doing this.

Pricing data from Australia provides anecdotal evidence that we are not immune from the price benefits of an additional fourth operator, nor the price increases resulting from the fourth MNO exiting the market.

History has shown that TPG had been a disruptor in the fixed line broadband market. This slide shows changes in price in the fixed broadband and compare it to the market share of iiNet and TPG. iiNet and TPG were the third and fourth largest fixed broadband operators at that time. We can see as iiNet and TPG gain in size, the annual price reduction decreases.

In this next slide the dotted grey vertical line is marked when TPG announced entry into the mobile market. We can see that data inclusion across Optus, Telstra and Vodafone increase dramatically after this announcement.

While mergers are permanent, there are alternatives. For example, cost synergies are achievable through arrangements such as network sharing. The benefit of network sharing is that either party can exit the arrangement if they wish to pursue a more unique network deployment. We saw an example of this when Telstra launched its NextG network independently from Hutchinson.

MNOs also have options to offer roaming agreements and their willingness to do this is likely to increase with a greater number of MNOs in the market.

I would like to conclude by acknowledging Rod Sims' speech to the CEDA State of the Nation Conference in Canberra in 2014.

> *"Some in business are incredulous that the ACCC would not wave through a merger when investment returns are low so that the merger parties can create, in their terms, a more rational market with sensible, and so higher, pricing.*
>
> *As someone who has spent 15 years advising companies on corporate strategy I know that companies generally expect such orderly pricing with 2-3 players and high entry barriers"*

Rod Sim's then went on to quote David Thodey (ex Telstra CEO) in 2012 stating the obvious when Thodey said:

> *"Now, all the data we've looked at around the world says three operators (in a market) are very rational from a pricing perspective. Once you get to four or five is when you start to get behaviour that can be aberrant in terms of shareholder value."*

Sim's then continued. And I quote

> *"While it may be inconvenient for established players to be challenged by new entrants, consumers are the ones who lose from higher prices and less innovation. Competition is, and is meant to be, at times a disruptive process for the companies involved. Allowing mergers that reduce competition and/or substantially increase barriers to new entry can therefore come at a considerable cost."*

Commpete believes we need to keep real competition at the centre of all thinking, where all design starts.

Competition enables consumers and businesses to have better access, more choice, improved value, strong performance and overall – a better customer experience.

For each and EVERY decision, we need to ensure ALL technology platforms guarantee competition to support a future with 5G where there is equal, timely and open access to consumers through BOTH retail AND wholesale.

We need to ensure future market structures will promote a flourishing wholesale market; will encourage diversity; provide opportunity to disrupt status quo;

and to encourage an Australian telecommunications industry that enables newer companies to enter so – "All of us' – BOTH large AND small – have the opportunity to thrive AND

…above all… it will deliver more to; consumers, to businesses AND Australia's economy.

So, we say: the structure of the market should be to the benefit of the consumer and that means MORE - NOT LESS - competition.

No company should be allowed to have stifling competition at the core of their business strategy.

All the evidence here and overseas shows a better path for consumers and the economy is to have more players - more competition.

Thank you

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