

Final report for ECTA - Summary

Europe's digital deficit: revitalising the market in electronic communications

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I Executive summary

I.i Context

Competition has been one of the main forces behind choice, value and innovation in telecoms markets. It has led the way in the development of new services, in reducing prices, and in stimulating demand.

The creation and widespread use of high-speed networks and services are important goals for the European Digital Agenda. The role of effective competition in driving service quality, availability and take-up remains equally valid with the transition to fibre-based fixed networks and high-speed mobile networks.

There is a widespread assumption that competition is effective today, and in some service markets (notably consumer broadband) undoubtedly significant progress has been made. However, competition is often less developed than may be desirable.

Many countries show high, and stable or even increasing market shares for the incumbent. For example, in the fixed calls market, incumbents still retain 60-70% of the retail market by value, whilst broadband retail market shares remain unbalanced as seen for six EU member states in Figure I.1 below.

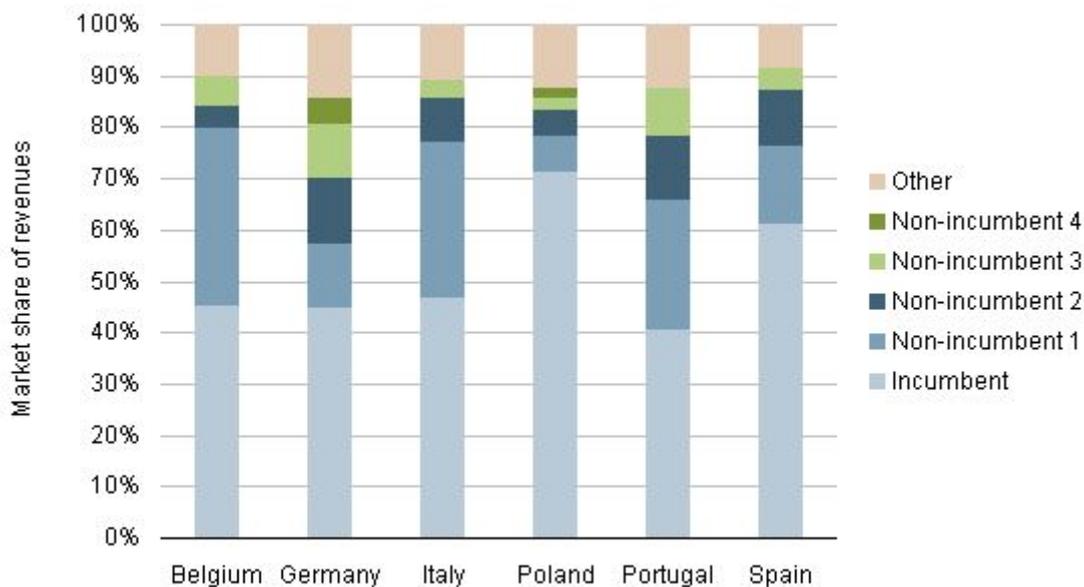


Figure I.1: Market shares in the retail broadband market in six EU countries [Source: Analysys Mason Research]

Major competitors remain significantly less financially secure than incumbents with EBIT margins significantly lower (as seen in Figure I.2) and capex equal or higher as a proportion of revenues. Incumbent EBIT margins have been maintained even whilst they are making investments in FTTx networks.

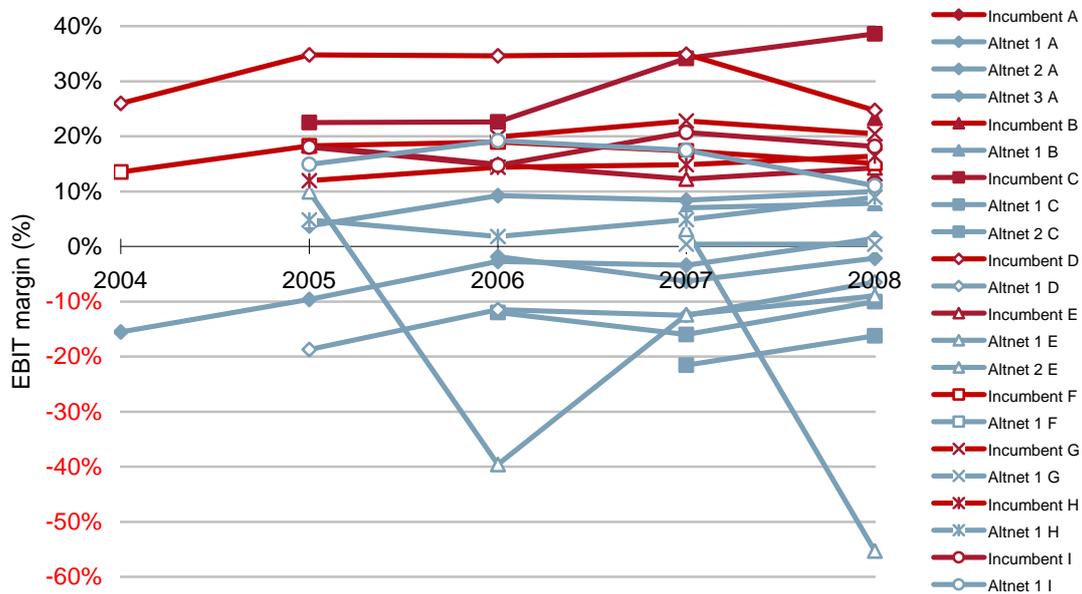


Figure I.2: Benchmark of Incumbent and competitive operator EBIT margins [Source: Operator data, Annual reports, Telegeography]

Many European consumers and businesses have a limited choice of suppliers and are paying more than they should or are receiving sub-standard speeds or services. We calculate the additional consumer surplus (from lower prices, and where relevant higher volumes) that could be generated from improved competition as EUR25 billion per annum.

Whilst ARPU for broadband Internet services are slowly varying and do not appear to be strongly influenced by the level of competition, we estimate that competition has materially improved the speeds available to most EU citizens such that they can afford to purchase 8Mbit/s or more, compared with around 2Mbit/s which has been the outcome in less competitive countries. Consumers have therefore been able to benefit from more advanced retail services and bundles. The effect of unbundling on speeds available for a standard price of around GBP20 per month in the UK can be seen in the figure below, showing strong declines in the price of 8Mbit/s broadband which correlate with the arrival of large-scale unbundling. We find similar patterns in other countries.

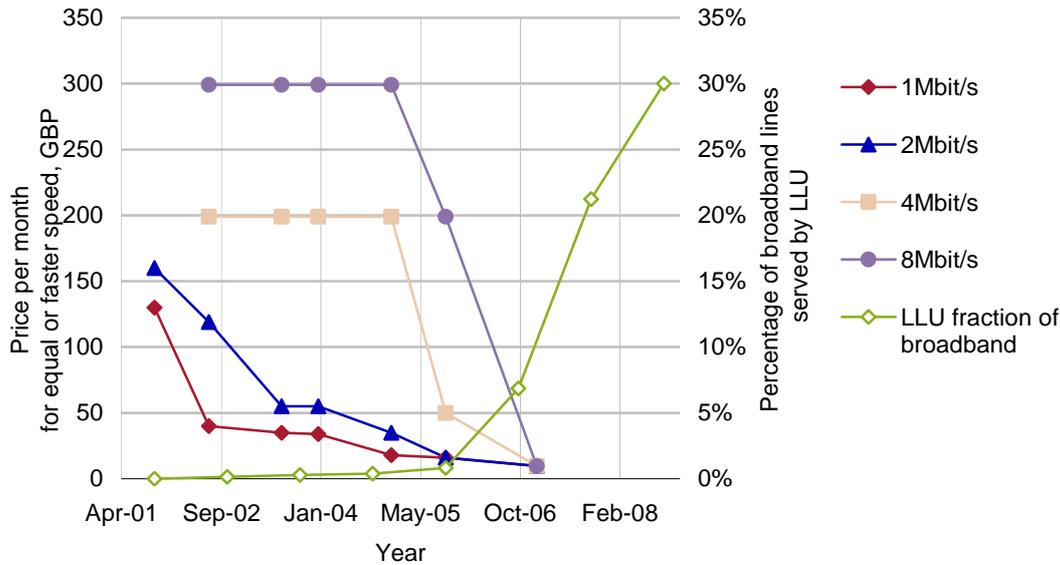


Figure I.3: Lowest market price for a specified speed broadband product over time in the UK [Source: Analysys Mason Research Broadband pricing study]

We have found a similar pattern of relatively high charges and/or speed restrictions for services provided over ‘next generation’ networks in countries in which effective wholesale access has not yet been created.

In Belgium, where VDSL has been deployed, ‘next generation’ speeds are not offered by the incumbent and an 18MBit/s triple play offer costs €70 per month compared with €20 for a similar offer in France provided over ADSL. We estimate that effective next generation wholesale offers could bring high speeds at lower prices to Belgian consumers and businesses and double the rate of high end broadband adoption in Germany.

Regulation is not yet sufficiently protecting the interests of consumers:

- Significant market power (SMP) remedies are lagging the market realities (e.g. as regards double- and triple-play products).
- Ex-post competition law cases have proved slow and rather ineffective in preventing abuse of dominance in the electronic communications sector. When combined with the enduring nature of remaining bottlenecks, and the persistently high market share of incumbents, the shortcomings of ex post enforcement in this context will limit the scope of national regulatory authorities (NRAs) to withdraw from ex-ante regulation of access to key facilities and services.

Evidence from a survey of competitive operators and analysis of available data particularly highlights discriminatory conduct by dominant firms which takes a number of forms, including:

- refusal to supply fit for purpose access to essential bottleneck facilities and services
- margin squeeze
- non-price discrimination including delay, inferior product quality and information asymmetries.

Examples documented in the main body of the report include:

- Refusal to supply FTTx-based access on reasonable terms¹ in Germany and Belgium, with similar issues likely to arise due to extension of fibre networks in other countries. Refusal to supply IP-based voice access in Germany.
- The lack in most countries of an IPTV-capable bitstream product, which prevents alternative operators from offering triple play services where unbundling is unviable (for example with the transition to FTTx networks or in less dense areas); refusal to sign contracts on the basis of the RIO in Poland; the lack of wholesale Ethernet access services or business-grade broadband access for businesses in many EU countries.
- Potential or proven margin squeeze relating to: broadband services or bundles in Poland, Italy and Portugal; fixed calls in Germany, Italy and Belgium; and mobile services in Belgium and Italy. The existence of aggressive and long-lived discounting regimes in Spain and Austria which may have similar effects.
- In many countries, non-price issues including: additional delays in activation for wholesale customers, poor ordering systems, rejection of valid orders, failure to comply with SLA.

There are fears that the competitive situation will significantly worsen if measures are not taken to prevent such discriminatory conduct in the delivery of next-generation services, where current evidence in a number of countries is not encouraging.

If action is however taken (by NRAs, competition authorities, and the Commission) to address discriminatory conduct, consumers would reap significant benefits. In particular, the take-up of high-speed, next-generation services could be materially increased.

I.ii Possible actions

Strong competition needs to remain a priority to complete the last 20 years' work towards a liberalised electronic communications market. For example, any amount of investment in next-generation access (NGA), however desirable, will not benefit typical subscribers if it results in monopoly or oligopoly, because high-speed services will be priced well above the typical average spend.

¹ Regarding for example date of availability, Multicast/IPTV capability, price.

Unbundling the copper loop has already led to massive benefits for EU citizens; it would be folly to ignore this strong success when building the next-generation network (NGN). Regulators and governments should therefore prefer NGA architectures and business models that can support retail service competition, ideally allowing unbundling.

We believe that in many circumstances high-speed wholesale access products (including bitstream) would also give strong benefits to consumers, either through lower prices, improved speeds, specialised entertainment or business services, or other features of the offer (e.g. contract duration). They will also increase high-speed broadband service take-up as a result.

NGA deployment models proposing 'risk sharing' need to be understood in light of the fact that even the more successful entrants have a smaller existing customer base than the incumbent and relatively poor cashflow; this may be as a result of anticompetitive behaviour by incumbents (noting that the courts have found competition law abuses by many incumbents). Most incumbents, on the other hand, have strong cashflow and a large customer base that could be transferred directly to a new network. Pricing or investment models that require large up-front investments or reward high volumes therefore risk creating barriers to entry and may result in foreclosure, undermining any potential benefits from competition.

The Commission has an opportunity to emphasise many of these points in its upcoming recommendation on NGA.

It should not be possible for a party subject to SMP remedies or general conditions to evade them simply by changing the technology over which they provide services. This may require care from NRAs in drafting market definitions or remedies during periods of technological change and additional Commission scrutiny in the Article 7 process.

The Commission and national regulators should set targets and monitor progress towards achieving competitive retail markets and closely monitor the use of key wholesale inputs which support competition under the European Digital Agenda.

Enforcement of SMP remedies under the existing ex-ante Framework needs to be strengthened.

- Non-discrimination, if properly enforced, is a powerful remedy especially if the concept of 'equivalence' (using the same inputs, at the same price and non-price conditions, and using the same systems and processes) is followed. Indeed, it offers the opportunity to ensure that networks remain open to competition as they are upgraded rather than on a case by case basis and with some delays, as well as providing guarantees on service levels. Nevertheless despite existing non-discrimination remedies there is endemic discrimination in many countries, showing how difficult it is to enforce. BEREC or Commission guidance on the use of non-discrimination might be useful.
- Functional separation, at least if effectively implemented so as to create the right structures, products, and incentives, can provide a useful means to enforce non-discrimination through creating positive incentive mechanisms and to break free of the slow and continuous battle

over availability and non-price conditions for wholesale products. There may however be a risk that less optimal functional separation measures might create additional delays, inefficiencies and costs, and could reduce regulatory certainty. There is a role for the Article 7 process in ensuring that any functional separation is well designed and meshes well with the other parts of the regulatory framework. Guidance could also be useful.

Persistent gaps between the profitability of even large scale entrants and the profitability of incumbents may warrant closer examination of access prices to ensure they are not excessive. The prices of regulated services, and their supporting cost models and accounting data, need to be coherent and transparent to market players and closely examined by NRAs. If necessary, action should be taken by BEREC or the Commission.

The Commission and national competition authorities should assess whether the competitive issues identified in this report such as denial of access to key inputs in relation to next generation networks, or margin squeeze (in broadband or triple play, fixed and mobile calls markets) may warrant ex post enforcement action or a wider review.

The Commission has an explicit role in cross-border trade in the internal market and should take greater interest in the provision of pan-European communications services to multinational businesses (large and small). A recommendation on this and related issues (regarding bitstream and point-to-point Ethernet links) might be useful; one possible outcome would be to recognise different market segments or the need for different remedies through the market analysis process.

Whilst the mobile market shows fewer difficulties than fixed, it does still have a number of worrying characteristics, including persistently imbalanced market shares in many EU member states. The dynamics of mobile competition and barriers to competition in the mobile sector could usefully be examined by the Commission.

The evolution of the retail market towards service bundles needs to be reflected by NRAs and may soon require the Commission to modify the definition of the retail markets that are examined in the context of Market 5 to take account of double- and triple-play developments. Competition will fail unless there is a suitable wholesale product for providing double- and triple-play products.

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