LSE Media Policy Project public lecture

Consolidation and consumers

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Introduction

Good evening.
I am delighted to be here tonight. Many thanks to Damian for hosting at such a fantastic venue as the LSE.

I'm afraid I cannot claim to be a fully-fledged alumna of the LSE, although I did study maths here in September 1992 before going on to do a Masters in economics at UCL. That was a fascinating time of crisis and change for macroeconomic policy, with the UK leaving the Exchange Rate Mechanism and embarking on the current era of floating exchange rates and targeting inflation at home.

Now of course, my focus is on the communications market. Tonight I want to talk about the microeconomics behind that sector - not the annals of dusty textbooks, but the powerful present forces that will shape communications and networks at the heart of all our lives.

Communications, like the wider economy, has seen enormous change over the past twenty years. In the early 1990s, mobile phones were the preserve of City bankers. The internet was largely limited to research and education communities. And the fledgling BSkyB was broadcasting a handful of satellite channels to 30-inch dishes.

By the end of that decade, companies and consumers were just beginning to understand the opportunities of the internet, millions of us had mobile phones, and digital TV was beaming out hundreds of channels.

The buzzword then was convergence: internet lines carrying media content, wireless spectrum used for mobile voice and data. The government saw a need for a converged regulator, and Ofcom was born in 2003 to replace five separate regulators.

The cornerstone to our regulation since then has been to open competition by ensuring networks are available to a range of providers. As a result, we can watch House of Cards on Netflix on our laptop, tablet or connected TV. Or catch-up on our favourite BBC shows on iPlayer whenever we choose.

More than a decade on from the creation of Ofcom, the communications market continues to evolve at an astonishing pace. In particular, we are witnessing a wave of corporate consolidation among communication providers in the US and in Europe. These offer greater scale and opportunities for efficiencies. But they also risk disrupting the benefits of competition for consumers.
Having basked for many years under the warm glow of vibrant competition, could we soon feel the chill wind of consolidation?

The market today

To start with, let's consider what consumers are getting from the market today.

Households in the UK spend, on average, £27 a week on their communication services – that's for their phone line, broadband connection, post, radio and TV. Within this average, consumers have a multitude of choices and packages at different price points.

Over the last ten years, consumer prices have grown around 30 per cent. But the comparable price of communications services has gone down, while the quality and quantity of those services has grown. Ten years ago, the average household took a landline and dial-up broadband. Now it gets a landline, mobile, broadband and at least 60 TV channels, plus catch-up services.

How has this been possible? I'd highlight three factors.

First, we've seen a competitive market structure - a healthy number of providers and new entrants to keep everyone on their toes. BT has the lowest broadband share of any incumbent operator among major European countries.

Second, we've seen investment and innovation over a period of quite extraordinary technological change. Just compare the dial-up days of the early 2000s to the ubiquity of the internet today.

Third, regulation - applied in a proportionate way (what I call 'right touch' rather than 'light touch' regulation) - has played an important role.

You may ask why does a fast moving, dynamic sector like this, requires ongoing, specialised regulation at all?

Largely, it's because competitive telecoms are based on connections between different companies' networks, which must run smoothly. Firms need fair access to those networks, and to other resources like wireless spectrum. Creating and maintaining these conditions needs real industry expertise, and ongoing monitoring. Hence the need for specialist regulation.

In regulating, Ofcom's top priority is to ensure that consumers get the best possible deal. This means the best possible services, at the lowest possible prices that allow firms to make a fair return, so they can invest and pay out to their shareholders.

Competition is the indispensable force that drives these results for consumers.

BT - privatised in 1984 - initially faced competition from cable, available in more than 40 per cent of the country. Virgin Media, owner of cable today, has plans to compete in two thirds of the country.

One of Ofcom's first acts - in 2005 - was to require BT to create Openreach - owners of the national fixed line network - as a separate division of the company to give its rivals fair access, and to be seen to do so. This led to competitors like Sky and TalkTalk installing their own equipment and offering their own phone and broadband services at much faster speeds.

In mobile, competition has been strong enough for us to avoid extensive regulation.

For many years, the UK benefited from four or more mobile operators, as well as numerous 'virtual' operators - like Tesco, TalkTalk and Virgin - who use the networks of the big four to compete with them for customers.

Over those last twenty years, there is no doubt that the communications market has delivered significant gains for consumers. But there have been areas of concern.

First, there are hundreds of thousands of people and businesses who have poor or no access to services for reasons of geography or affordability. This is clearly unacceptable when communications are essential to how we live and work. Making services universal is a key priority for Ofcom and we are working closely with the Government and industry to make this happen.

Second, there are signs in recent months of rising prices for landline and broadband customers, without the apparent justification of higher costs or improved service. BT, Sky, TalkTalk and Virgin Media have all raised line rental prices this year.

This might be a temporary blip in the market, and there are still good offers out there for people who shop around.

But customers who worry about the hassle of leaving their current provider, especially older people, can face higher bills. We are concerned about this, and we are watching these developments in the market closely.

Let me turn now to the wave of takeovers and mergers and their implication for consumers.

Risks to competition from consolidation

There are signs that we are entering a period of profound, structural change in communications.

From a world where multiple providers offered distinct services, we are witnessing a shift towards fewer, bigger players offering a 'one stop shop' for television and telecoms.

Companies here and abroad are racing to provide landline, mobile, broadband and TV products in a single package, over converging fixed and wireless networks.

BT now has a fully-fledged TV operation, focused on premium sport.

Vodafone is moving into home broadband and TV.

Sky is launching a mobile service using O2's network.

This can bring convenience and lower prices for consumers, who can get everything they want in one bundle without having to take out different contracts with different providers.

But we are seeing evidence that customers are less likely to switch providers, which could dampen competitive pressure.
In terms of current M&A, BT is looking to acquire EE, potentially adding an established mobile business to its landline and broadband operations, a position it was in when it owned O2.

The Competition and Markets Authority is reviewing that deal and will decide whether to approve it. We have published our evidence, highlighting issues around possible weakened competition in mobile. BT would no longer be a new mobile entrant in its own right, and*may* have an incentive to favour EE over other mobile operators in providing network services.
The mobile companies Three and O2 have plans to merge. This would reduce the number of mobile operators from four to three. It would also remove Three - the competitive new entrant - as a provider in its own right. The combined operator would be the UK's biggest, controlling more than four in ten mobile connections, according to estimates by Analysys Mason.
The Three/O2 deal has been notified to the European Commission and we will be providing evidence on the implications for consumers.

I am not going to get into the specifics of individual cases, though I note EU Competition Commissioner Margrethe Vestager's remarks in New York last week.

The Commissioner pointed to research suggesting that a reduction in the number of players from four-to-three in a national mobile market in the EU can lead to higher prices for consumers, but not more investment per subscriber.

I would, however, observe a clear pattern of mobile consolidation in Europe.

In Austria, Hutchison and Orange merged in 2013.

Last year in the Republic of Ireland, Three acquired Telefonica.

And in the same year Telefonica bought ePlus in Germany.

In each case, regulators imposed remedies to address a loss of competition. Last month, the proposed deal between Telenor and TeliaSonera in Denmark fell through when the European Commission looked set to reject the companies' proposed pro-competition remedies.

Mobile operators argue that they need consolidation to boost revenues and increase efficiency. They make the case that profit margins in the UK are too low, and that they need more scale to invest. They sometimes talk in terms of 'market repair', implying that the UK market has been *too* competitive. The companies also warn that a fragmented European sector makes it harder to compete against major players in the US.
Consolidation can in theory have benefits - improving economies of scale and making it easier to finance investment.

However, Ofcom's experience is that *competition,* not consolidation, drives investment and delivers low prices.
Our analysis of a dozen countries, inside the EU and beyond, shows no relationship between consolidation and investment.

And specifically in the UK, we can see competition between BT, Virgin and a combination of Sky, TalkTalk and City Fibre to drive investment in ultrafast broadband - speeds of 300Mbit/s or higher.

Only when companies *cannot* make an adequate return - because competitive pressure is so intense - might we expect investment to suffer.
The evidence suggests this is not the situation in the UK mobile market, which last year generated £15 billion of revenue.

Even at a time when UK operators are investing billions to roll-out 4G, they are maintaining a healthy average cashflow margin of more than 12 per cent.

We continue to believe that four operators is a competitive number that has delivered good results for consumers and sustainable returns for companies.

Overseas, there is emerging evidence that consumers may be paying the price of mergers.

According to the Austrian regulator, mobile prices have risen by 28 per cent since the 2013 deal reduced the number of networks to three.

Light users of mobile - typically that means older people, children and teenagers - have been hit hardest, seeing prices rise by 36 per cent.

The crucial test for a regulator like Ofcom is whether prospective mergers promote or harm the interest of consumers.

Again, Commissioner Vestager summed up the position when she commented on the withdrawal of the Danish merger:

"EU merger control has to make sure that company tie-ups do not lead to reduced innovation, higher prices or reduced choice for consumers, and do not restrict competition in the internal market."

I am concerned that the UK could end up with more concentrated markets that lead to higher prices and reduced choice for consumers, without the promised boost to investment and innovation.

This is an urgent question. Once competition slips away, it is hard to re-establish especially in telecoms where barriers to entry for new firms are high.

If that is the risk, how should regulators respond?

How should regulators respond?

Regulators need first to be clear about the evidence for how consolidation is affecting consumers.

If there is evidence of consumer harm, then the first step is to ensure the right kind of merger remedies. Sometimes that means permanent, structural changes so that competition can continue to flourish. Giving up spectrum to a new market entrant would be one example. Those kinds of conditions have lasting effects, and don't need ongoing regulation.

But structural remedies do require a new entrant to build a completely new network, and, even with access to spectrum, that will be challenging. So recent deals have gone through with a different kind of remedy, where companies must provide access to their network for 'virtual' mobile operators.

These so-called access remedies can make perfect sense at the time, but they may need to evolve as the market changes.

For instance, granting more access to virtual operators could be less effective in a future where mobile operators maintain exclusive access to new 5th Generation networks.

More fundamentally, the European Commission and European telecoms regulators have raised concerns that the specialist European framework governing the communications sector may not be sufficiently flexible to allow for the regulation of markets where there is a limited or shrinking number of players - namely an emerging oligopoly.

This specialist framework allows regulators to intervene *ex ante* - in other words, to take action to address damaging market features that could harm consumers, before that harm materialises. It therefore offers greater flexibility than merger remedies alone.
The problem is that the framework sets too high a bar for regulating cases where no one company has market power but the market is still highly concentrated, and consumers can be made worse off as a result.

To address any concerns, the framework requires us to show that the market structure is likely to result in a degree of coordination between operators. This may require demonstrating tacit collusion, which by definition is hard to prove.

The European body of telecoms regulators, of which Ofcom is a member, published a paper in June this year raising this issue.

It talked of the difficulty of ensuring "the development of effective and sustainable competition" in the presence of what it termed "tight oligopolies", namely highly concentrated markets.

The European Commission has now committed to consider the issue as part of the review of the telecoms framework.

This initiative is to be welcomed. I hope it does lead to a revision in the framework so that regulators have the full range of tools to respond to a changing market.

This is not about regulators seeking new powers for the sake of it, or regulatory creep. Rather it is a recognition that the statutory framework needs to evolve to deal with emerging challenges in a rapidly evolving sector.

Any new powers would need to be applied proportionately, and with care. Checks and balances should be built into the system to ensure that happens.

With a change in the framework we could do more to facilitate the entry of new operators, keep low price deals on the market for longer or require companies to give up spectrum.

Whatever happens to the European framework, Ofcom will be keeping a close eye on the impact of UK consolidation on consumers.

Tracking prices to make sure they continue to offer a good deal for consumers.

Monitoring operators' financial positions, including profits and market shares for signs that competition is weakening.

Reporting on customers' satisfaction levels, quality of service, and the level of switching between providers.

If we do find a problem, there is action we can take using our existing powers.

Making switching between providers easier for consumers.

Publishing more price information so consumers can compare deals.

Regulating those sections of the market where a single operator is found to be dominant.

I want to end by emphasising that this is a key moment for the communications market. The scale of change in the next twelve months and beyond could dwarf what we have seen over the last ten

years. If the current merger wave continues, there are risks to consumers and businesses who have enjoyed one of the most competitive markets of recent years.

The challenge for Ofcom is to ensure that the market continues to deliver for UK consumers, while allowing companies the space and opportunity to thrive and deliver decent returns. This will be easier if we have the full set of tools to do the job.

Thank you very much.

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