Session 8: Market definition and Significant Market Power (SMP) designation in a broadband world

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The issue (1/3)

• Ex ante regulation has been common
• Based on the assumption that some infrastructure is a natural monopoly
• Traditionally it was easy to know who to regulate
• The best pro-competitive measure was typically an interconnection obligation at wholesale prices
The issue (2/3)

• The success of deregulation has made the situation more complicated
• The links between services and network technologies are no longer clear
• Different types of networks can now compete with each other
• Bundled offers (triple play) are common
• Flat rate is common
• Need to invest in network infrastructure
• Infrastructure may become a commodity
The issue (3/3)

• Defining markets, and who has market power, is harder
• Market power might be abused in areas that were not traditionally regulated
• Markets change rapidly, which may make regulations obsolete
• There may be a need to focus:
  – More on promoting investment in infrastructure
  – Less on promoting access to existing infrastructure
Market definition in a broadband world (1/3)

• Regulatory intervention is justified only in case of market failure:
  – Barriers to entry
  – Exploitation of significant market power (SMP)

• Establishing SMP requires defining a “market”

• In regulation, this is done ex ante, in competition law cases ex post
Market definition in a broadband world (2/3)

• Markets are defined in terms of products and services that are:
  – Demand side substitutable
  – Supply side substitutable

• A market is typically defined for a given geographical area
Market definition in a broadband world (3/3)

• The hypothetical monopolist test:
  – Can a company increase prices and maintain volume?
  – If yes, that is the “market”
  – If no (because customers move to alternatives), then include the alternatives in the “market”

• In telecommunications, it is important to distinguish between retail and wholesale markets
The role of services

• Broadband is multi-service
• But bandwidth might restrict service availability
  – This might result in several “markets”
    • Low vs high bandwidth
    • Symmetrical vs asymmetrical
• Thus market definition depends on services
  – Their substitutability might change rapidly
The role of customer flexibility

- Some customers have rigid requirements: they are “captive”
- Others are flexible: they are “marginal”
  - For example, some customers don’t need high upload speeds and so can use xDSL
- Market definition must focus on marginal customers
  - But watch out for price discrimination: charging different types of customers differently
    - Multiple complicated pricing plans
Chain of substitution

Fiber  VDSL  ADSL

Marginal Fiber customers

All three technologies are part of the same market
The chain depends on the services
Geography

- Different market if geographic restrictions
- Same market if geographic overlap and uniform pricing
- Different policies can be applied to different geographies:
  - For example, dense urban areas versus rural areas
One-way substitution

• Customers may be willing to move from ADSL to fiber, but not the other way
  – If so, there are different markets
  – But there may not be SMP because of competition from the other market
Vertical relations

• Availability of services may be restricted not by technology, but by commercial agreements:
  – Exclusive deals with copyright owners
  – Exclusive deals with specialized providers (e.g. for payment systems)

• Such situations can result in separate markets, since there is no substitutability
Bundling

• Bundled offers (e.g. triple play) are common. Is the relevant market:
  – The bundled offer?
  – The individual services?
  – Both?

• Bundling may limit consumer substitutability

• As usual, one has to analyze the “marginal consumer”
  – In Hungary, a consumer survey was used
Wholesale markets

• Regulatory intervention at retail level can be minimized by:
  – Wholesale access obligations
  – Including for key wholesale services

• Limit control over essential infrastructure

• But provide incentives for investment in additional infrastructure

• Layered approach (unproven)
  – Facilities
  – Services
  – Applications
An example

• Are fixed and mobile broadband in the same market?
  – Leaders: fiber is widely available; separate markets moving towards one
  – Developed: ADSL/cable are widely available; separate markets
  – Developing: fixed is not widely available; same market
Significant Market Power (SMP)

• Power to
  – Set high prices
  – Provide low quality
  – Not innovate
  – Lock out competition

• Some regulators look only at market share

• Others also consider
  – Control of essential facilities
  – Economies of scale
  – Barriers to entry
Convergence

• Can be expected to reduce SMP
• But lack of investment in infrastructure can reduce competition
• Presence of competing infrastructures can stimulate competition
  – Cable
  – ADSL
Vertical arrangement and bundling

- Over the top (OTT) services can
  - Reduce SMP
  - Increase SMP

- This depends on the vertical arrangements
  - Profits from exclusive deals may flow upstream, not remain with the network
  - So regulatory intervention at the network level may not be effective

- There may be similar issues if bundles cannot be replicated easily
  - For example bundling television content
Traditional regulation

- Regulate retail prices
- Mandate access to infrastructure
- Regulate wholesale prices
- Enforce interoperability
- Impose transparency
- Impose non-discrimination
- Impose accounting separation

The objective is to favor competition
Implications of convergence

• Important to promote investment
  – How to do this is not obvious, since price controls may discourage investment

• Non-regulated services may play an important role
  – TV content
  – VoIP

• Vertical agreements and bundling may
  – Increase efficiency
  – Reduce competition
Conclusions

• One size does not fit all

• Consider competition-law like regulation
  – This may require changes in the mandate of the regulatory agency

• Coordinate with the competition law authority
For more information