Investigations into the concentration of market power must look beyond the headline for an answer

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The effectiveness of competition is a pressing and growing issue for communications and competition regulators in both developed and developing countries.

Stakeholders and authorities are faced with having to assess **efficiencies** and understand the potential impact of **remedies** – with those remedies aiming to channel some of the efficiency gains back to the wider market and end users. This article focuses on efficiencies.

Efficiencies will be present in all market concentrations. A fundamental understanding of networks and industry drivers is needed in order to investigate the nature of efficiencies in communications markets and services, and to assess the effects of competitive change.

The benefits from efficiencies plus remedies should ideally outweigh the impact of any change in competition, and lead to an overall positive outcome.

Market concentration brings widespread efficiencies

Efficiency gains within the electronic communications industry can be significant, due to the presence of large fixed costs, network effects and uncertainties in terms of the long-term dynamic evolution of the industry.

***Figure 1:** Sources of efficiency [Source: Analysys Mason, 2017]*

Efficiency reason	Recent examples
Scale	Four-to-three consolidation of mobile network operators (MNOs)
Scope	Fixed–mobile convergence, acquisition of content
Asset rationalisation	Network sharing formation and growth

If there are undertakings to reduce prices, then we can be reasonably confident that the efficiency effect will give some benefits back to the market consumers. Without undertakings, the potential for reduced prices depends on the incentives of the concentrating operator(s), the extent of service bundling, and the potential emergence of innovative new products stimulated by the underlying asset effectiveness.

Formation of a joint-venture, co-operation, shared network or co-investment plan for future activities are also challenging to investigate. Efficient sharing has been encouraged at times (for example, infrastructure-sharing regulations), but these forward-looking concentrated ventures have not escaped the attention of competition authorities. This may especially be related to non-price issues – and need close examination in relation to access, wholesale, equivalence of input, preferential contracts or discriminatory effects.

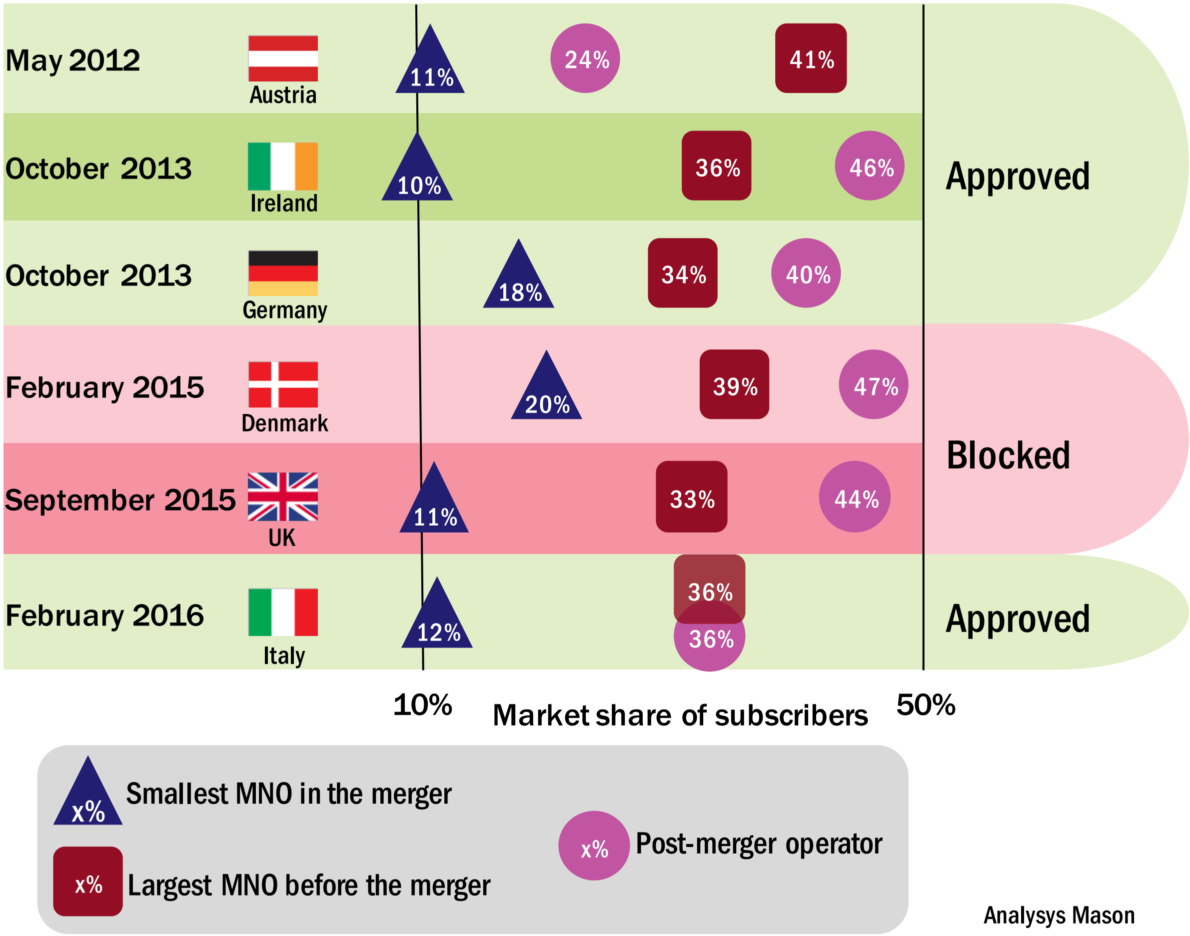
Investigation of efficiencies in market concentration needs to look beyond the headline in different directions to understand the ultimate impact on the market. These directions include the following.

- **Short-term market changes** can have clear indicators for the intensity and nature of competition, but longer-term effects are less obvious and play out against the backdrop of a dynamic communications industry involving voice, Internet, TV and content services and infrastructure.
- **Upward pricing pressure (UPP) tests** are a key basis on which to show the short-term price effect of reduction in competition. However, the purpose to which the operator may put its new-found price advantage depends on whether it is more of a price maker or price taker in the market, and the nature of competition in the market (for example, whether the market features Bertrand, Cournot or Stackelberg forms of oligopolistic competition) – because the competitive reactions work differently in each case.
- **Efficiency gains from co-investment** are harder to investigate because competitors are investing together. It could be that separate investors might 'unnecessarily' duplicate assets; but it should not be forgotten that duplication itself can bring benefits to consumers through competition to utilise capacity, but may also depress investor returns.
- **Identifying improved networks** that would not have been built – using investment and roll-out plans (although plans are not actions, so need to be tested robustly).

The change in competition can lead to various potential harms, through the horizontal, vertical, coordination, and collective/co-operative negative effects of the concentration. Making the case for positive changes in long-term competition post-concentration is challenging. It requires a deep understanding – or projection – of competition and dynamic effects over the long life of telecoms assets. This case should not double count already-covered efficiency benefits.

The scale dimension of recent EU mobile mergers

Figure 2: Recent MNO mergers in the EU, by country [Source: Analysys Mason, 2017]



The early approved mergers in Ireland and Germany created the largest players in their markets, absorbing small players below 20% market share (see Figure 2). Similar attempts 2 years later to create the largest players in Denmark and the UK were blocked, even though the smallest operators before the merger also had 20% market share of subscribers or less. On the same measure, the Italian merger appears more modest, creating an operator to just match the largest in the market. However, it can also be argued that equal-sized operators have little incentive to fight intensely over each-others' customers, so even though efficiency will improve with scale, competition will be reduced.

This timeline points to the importance of the structural remedies offered in the most recently approved (and also rejected) mergers: the creation of a new mobile operator aims to rebuild the intensity of competition in the market. MVNO facilitation, reworking network sharing agreements and behavioural rules were not seen as sufficient because they still relied on the same infrastructure owned by the post-merger company. A new separate network operator was the intended structural remedy to merger concentration.

What is needed next

A deeper understanding and demonstration of the underlying network, financial and economic issues can help design remedies that are more targeted but still effective. A stronger justification for forward-looking co-operation between players to co-invest or run a joint-venture is needed to improve the case for the long-term competition benefits of the activity.

The assessment of efficiencies, and the implications for benefits to end users, both before and after the formation of more-concentrated market structures will become a regular feature of communications market governance in the next decade. The solution to successful merger, joint-venture, acquisition and co-investment will require a unique mix of expertise: regulation and governance; network knowledge; business and capacity strategies; investment decision-making and economic practice. Analysys Mason is ideally placed to provide this.

For more details of how Analysys Mason can advise merging operators, interested parties and competition authorities on the details of competitive efficiencies and market effects, contact Ian Streule.