

The Geographic Dimension to Market Definition in Telecommunications

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Introduction

- Competition is developing in a number of telecommunications markets
- But the increase in competition is not evenly spread across the country
- Existing regulation is based on definition of national market for most services
- Uneven spread of competition challenges these market definitions
- Purpose of this presentation is to describe Ofcom's thinking on this issue
- Presentation is generic – about the issue of geographic markets rather than about a particular market

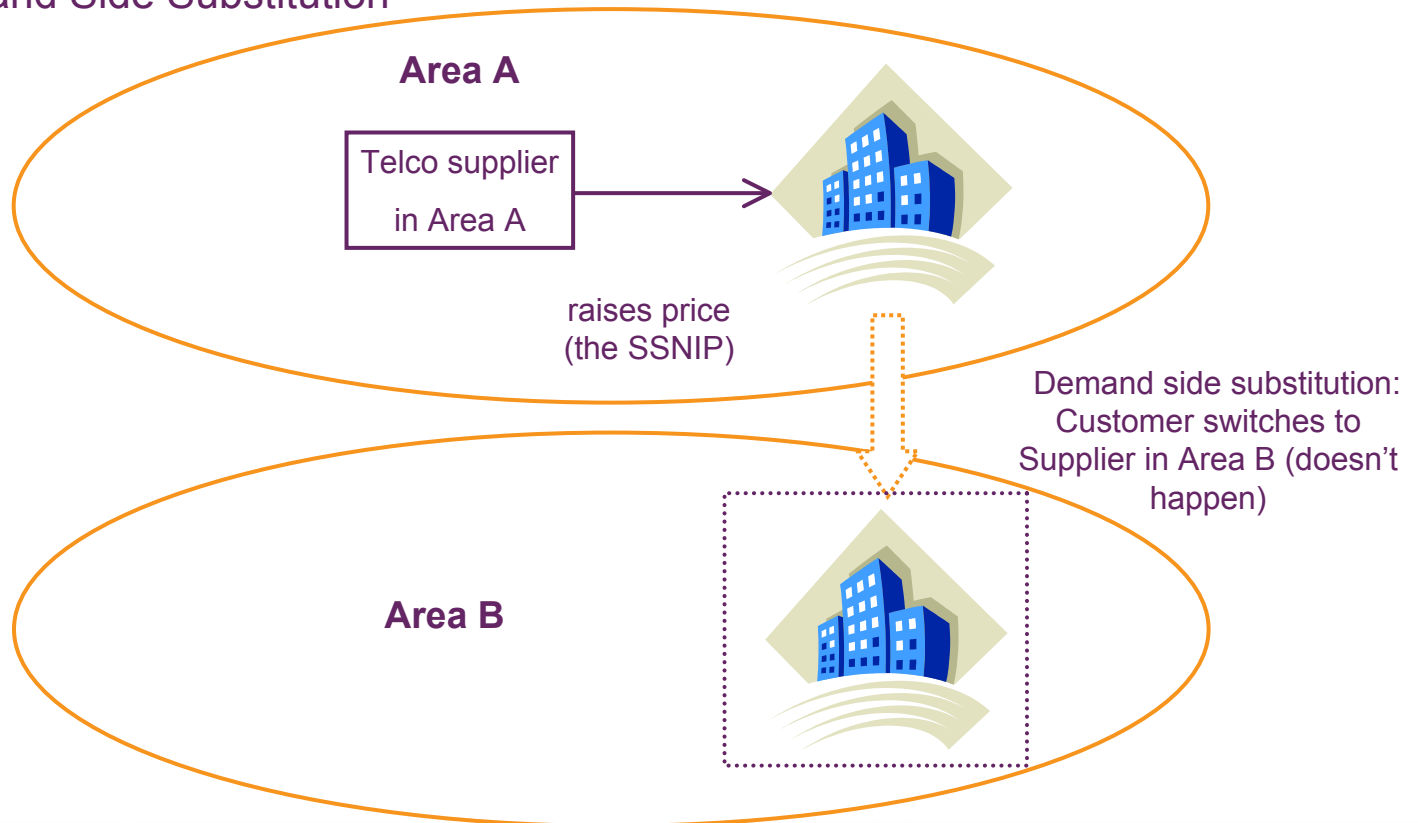
Market Definition Principles

- At Product Level
 - Demand Side Substitution
 - Supply Side Substitution
 - Common Pricing Constraint
 - Cluster Market
- These principles are relevant at the geographic level too

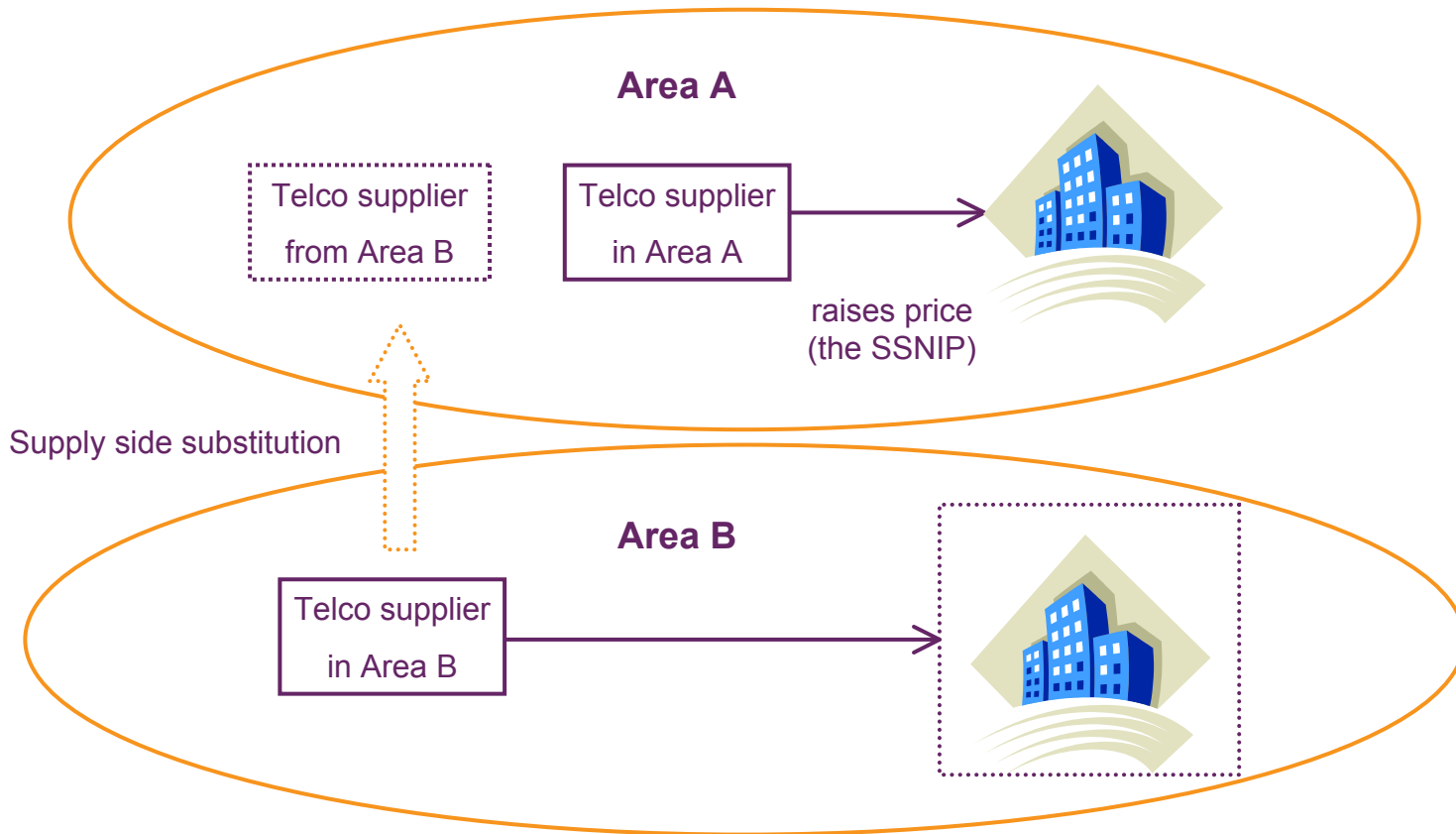
The Principles Applied to Geography

1. The Hypothetical Monopolist Test

i. Demand Side Substitution



ii. Supply side Substitution



Conclusions on The Hypothetical Monopolist Test

- On the basis of direct substitution possibilities, markets are very narrow.
- On demand side, each house or office building could be in a separate market.
- On supply side, this might be expanded slightly, perhaps into groups of adjacent buildings.
- Result is theoretically interesting, but practically not very helpful

Other Principles of Market Definition

1. Common Pricing Constraint - e.g. Uniform Pricing

- Direct competitive pressures uneven, but pressure on prices spread evenly
- Very relevant to telecommunication markets, as prices have traditionally been uniform. This has been the basis for national market definition to date

2. Cluster Market

- Services normally bought and sold together
- In geographic sense, means transactions normally for national service. Suppliers do not sell sub national services – and buyers do not wish to purchase on that basis

Uneven Spread of Competition Puts Pressure on Uniform Pricing

- Result is geographically differentiated prices
- No longer a common pricing constraint
 - Unless departure purely cost reflective, and future changes in each area expected to follow cost differences. Then constraint could be common, even if prices were non-uniform
- Direct competitive pressures differ area by area as before, but no longer spread uniformly by equalisation of pressure on prices
- Analytically, key basis for national market disappears

Recap on Principles of Market Definition

- Common pricing constraint - no longer relevant
 - Demand side substitution
 - Supply side substitution
- } - Suggest very small markets/not a tractable approach
- Cluster market - not usually relevant

Need Approach to Market Definition Which Reflects Competitive Constraints

- Need more practically useful market definition than given by strict application of SSNIP – but one which is not arbitrary. Needs to reflect condition of competition
- Ofcom's approach is to consider homogenous competitive conditions (HCC)
- Distinct from SSNIP analysis which includes in a market all geographic areas that impose a pricing constraint on suppliers in the market
- HCC involves identifying a number of areas which have similar competitive constraints and then aggregating them together for the purposes of analysis. Thus, one area within the 'market' will not directly constrain prices in another area of that 'market'.

Identifying Homogenous Competitive Conditions

- **Key relevant criteria:**

Behavioural

Pricing behaviour
Consumer preferences
Marketing strategy
Buyer power

Structural

Number of buyers
Number of sellers
Market Shares
Entry and expansion conditions
Regional limitation of service offerings

Aggregation Methodology

Two key approaches:

- 1. Reflect current extent of competition:** identify geographic boundaries based on where competition exists at present
 - direct measurement of where competition currently exists
 - Not very future proof in a dynamic market

- 2. Forward looking approach:** identify the underlying drivers of new entry or development of competition; predict where entry/competition is likely to occur first
 - Use a variety of indicators to assess competitive conditions in the market – need to take account of all available evidence; undue reliance on one indicator would not be appropriate
 - Maturity and stability of the markets are key in deciding how much weight to give different indicators

Issues Raised by Local Markets

- **Change in Focus of Regulation**
 - Less or no regulation in some areas
 - But some areas identified as enduring monopolies
- **Pockets of monopoly**
 - A non-competitive area could exist within an area classified as competitive
 - Can be created by aggregation: the broader the aggregation, the more likely this is
- **Potential for leveraging from dominant to non-dominant areas**
 - consider issue of anticompetitive bundling
 - contracts covering both competitive and non competitive areas
 - discounts schemes where volumes in non-competitive areas are used to justify discounts in competitive areas

Summary

- SSNIP leads to very narrow markets
- Current basis for national markets is becoming weaker
- Alternative approach is to define sufficiently homogenous competitive conditions directly
- Key criteria: number of suppliers; scope for entry and/or expansion, market shares
- Probably need a forward looking approach if competitive conditions are changing