

Telkom submission on THE DRAFT "2013 CALL TERMINATION REGULATIONS"

Response to invitation to submit written representation on draft Regulations published by: Independent Communications Authority of South Africa (ICASA) (Gov. Gazette 36919, of 11 October 2013)

Submission by Telkom SA SOC Limited

Telkom SA SOC Limited, herein "Telkom", welcomes the opportunity to provide written comments on the Draft "Call Termination Regulations" published by the Independent Communications Authority of South Africa, "the Authority" on 11 October 2013.

This document is Telkom's submission in response to the invitation to submit written representations on the proposed draft regulations (Government Gazette 36919 of 11 October 2013).

Telkom would welcome an opportunity to participate and make oral submissions, should the Authority decide to schedule public hearings as part of this regulatory consultation process.

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EXECUTIVE SUMMARY

The Authority issued "Draft Call Termination Regulations" ("the draft Regulations") on 11 October 2013. These draft regulations contain three key proposals:

- to reduce MTRs from 40c to 10c between March 2014 and 2016;
- to leave FTRs unchanged at 12c/19c (W0N/B0N) for this same period; and
- to increase MTR asymmetry for new entrants.

Telkom supports the Authority's proposal to:

- Significantly reduce MTRs, and
- Increase MTR asymmetry for new entrants.

We further recommend that the Authority:

- Introduces parity between FTRs and MTRs immediately; and
- Removes the WON/BON differential and sets a single FTR.

A significant reduction in MTRs

Lower MTRs will reduce the cost to communicate for the majority of South Africans. Most South Africans use a mobile phone and the price of mobile calls is therefore a key factor in the overall cost to communicate. Reducing MTRs will possibly make the largest single contribution to reducing the cost of communication in South Africa.

Lower MTRs will also promote competition among the mobile operators. New entrants into the mobile market typically face a net outflow of call traffic so lower MTRs will help these new mobile operators to compete. Lower MTRs will also reduce off-net/on-net price differentials which will help boost mobile competition. A more competitive mobile sector will help all South Africans by reducing prices and stimulating innovation.

Lower MTRs and parity between FTRs and MTRs would help address long-standing problems in the South African telecoms market. It would limit the cross-subsidies from fixed operators to mobile operators which have continued long after the mobile network roll-out has been completed.



An increase MTR asymmetry for new mobile entrants

New mobile entrants face a net outflow of calls to other mobile operators. Setting higher MTRs for new entrants would help them gain market share and allow them to compete more effectively with the incumbent mobile operators. A more competitive mobile market would benefit all South Africans.

Many countries around the world have adopted a similar policy in order to support new entrants in the mobile market.

FTR-MTR parity

In South Africa, the gap between MTRs and FTRs has meant that fixed operators have been subsidising mobile operators for many years. Between 2001 and 2013, Telkom effectively subsidized the mobile operators to the tune of R55 billion through interconnection payments. While there may have been some justification for this cross-subsidy in the early days of mobile network roll-out, this practice should not have continued for so many years in South Africa. It has caused unfair competition. Parity between FTRs and MTRs would begin to address this long-running and unjustified cross-subsidy and would help create a level-playing field between fixed and mobile operators.

Operators in South Africa face an increasingly converged telecommunications market. In this context, differentials between FTRs and MTRs cannot be justified. ICASA has a statutory obligation to support this convergence process.

A single FTR

The differential FTR between calls that terminate within a calling zone and beyond a calling zone also cannot be justified in a converging market. FTRs should be set at a single rate, at parity with MTRs.

1. INTRODUCTION

Ensuring that all South Africans have access to affordable communications is a critical part of the country's national development objectives. Telkom supports policies and regulation that will stimulate the growth and development of the ICT sector in South Africa. These policies and regulations should take into account the specific circumstances of the South African market.

- The two incumbent mobile operators have benefitted from almost twenty years of elevated and unsustainably high MTRs. This has resulted in a long-running cross-subsidy from fixed operators to mobile operators. While such a cross-subsidy may have been justified when the mobile operators were new to the market, this practice should not have continued for so many years. The high MTRs charged by the incumbent mobile operators now simply serve to maintain higher retail prices and weaken competition.
- Reducing the cost to communicate is a critical priority for South Africa and regulatory intervention is rightly targeted at ensuring affordability and availability of communications services for the majority of South Africans. Significant reductions in MTRs will support this this objective.
- Convergence of markets, technologies and services between the fixed and mobile markets is stronger in South Africa than in many other countries. The regulation of termination rates should take this into account by avoiding rates that create distortions in competition between the two segments of the market. This should be recognized by the alignment of FTRs to the MTRs of the largest mobile operators.
- The majority of the incoming fixed traffic in South Africa is local. In this context, the current differences in FTR national and local rates are unnecessary and impose additional costs on Telkom (and therefore its customers) without accruing any corresponding benefit. A single FTR is therefore preferable to a dual rate which differentiates between within zone calls and beyond zone calls.
- The mobile market is still characterized by the dominance of the two incumbent mobile operators, MTN and Vodacom. The two smaller mobile operators, Cell C and Telkom Mobile are not competing with the larger operators on a level playing field. MTR asymmetry will help to address this by supporting them to compete effectively in the market.

In this context, we support ICASA's proposal to significantly reduce MTRs and to increase MTR asymmetry for new entrants. We also propose an immediate move to FTR:MTR parity and the replacement of the WON-BON differential FTRs with a single FTR.

Telkom has not included any views on the legal validity or otherwise of the process being embarked upon in this instance by the Authority but Telkom's rights in this regard remain reserved.

The remainder of this submission is structured in the following way:

- Section 2 reviews the background to termination rates and their regulation in South Africa;
- Section 3 contains our comments on the proposed level of MTRs in the draft Regulations;
- Section 4 discusses our view on the relative value of FTRs and MTRs;
- Section 5 discusses mobile asymmetry; and
- Section 6 concludes.



2. Background

Termination rates are a critical regulatory issue in many countries around the world. The level of termination rates has far-reaching effects on the market. It impacts the prices that operators charge their customers, the evolution of competition and operators' investment incentives.

2.1. Impact of Termination Rates on the telecommunications market

Under the Calling Party Pays system of charging which is used in most countries around the world including South Africa, operators hold Significant Market Power in the market for termination on their own network. Regulators therefore intervene by controlling the rates that operators set for terminating calls. This line of reasoning is accepted by regulators in most countries and the regulation of termination rates is now common.

There is a large body of literature on termination rate regulation. The key issues that are considered include the impact of termination rates on competition and retail prices as well as the incentives that operators have to invest. The debate about the optimal level for MTRs continues around the world but it is generally accepted that reductions in MTRs from their historically high levels have benefitted customers. Broadly speaking, this has happened in two ways:

- Firstly, it is expected that lower MTRs lead to a reduction in the retail prices of both fixed and mobile off-net calls as operators pass through the lower MTRs into their retail off-net call prices.
- Secondly, the likely reduction in off-net/on-net price differentials would improve mobile competition as smaller operators would find it easier to attract customers from larger operators.

Since termination charges drive both revenue and costs for operators, considerations must also be made about the how changes in termination rates may impact operators differently. Large, well established operators generally receive positive net revenue from termination charges while for new operators, termination charges generally represent net payments to other operators. In many countries termination rates are set asymmetrically between new and incumbent operators, partly to account for this.

2.2. History of termination rate regulation around the world

MTRs and FTRs have been regulated in many countries around the world for some time and these rates have generally been falling. This is primarily because regulators have progressively reduced these rates.

Internationally, European regulators have led the way on this. In 2009 the European Commission set out guidance for telecommunications regulators in the EU about how they should set fixed and mobile termination charges. The effect of this was to lower termination rates across Europe and introduce greater harmonization in the way that fixed and mobile termination rates are set.

The downward trend in European termination rates has also been seen in other parts of the world. Mobile termination rates have fallen significantly across the OECD (Figure 1).





Source: OECD 2012

2.3. History of termination rates in South Africa

In South Africa, MTRs have fluctuated over time. They went up in the late 1990s before the entry of Cell C and began falling around 2010. Throughout the period, MTRs have remained significantly higher than FTRs. Between 1994 and 2009, MTRs were, on average, almost five times the level of FTRs. MTRs have fallen considerably since 2010, but they are still over three times the current level of FTRs (Figure 2).





The original justification for this asymmetry between FTRs and MTRs was to support the entry of the new mobile operators. However, since their launch, the mobile industry in South Africa has grown rapidly. The two incumbent mobile operators now have 49 million subscribers between them - there are almost 13 times as many mobile subscribers as fixed subscribers in South Africa. Despite this, the MTRs for the two large mobile operators remain significantly higher than FTRs. This means that Telkom subsidises dominant incumbent mobile operators.



3. Reduction of MTRs

The draft Regulations propose a reduction in MTRs for large mobile operators from R 0.40 to R 0.10 between 2014 and 2016.

Telkom supports the significant reduction of MTRs.

- Lower MTRs will reduce the cost to communicate for the majority of South Africans, making telecommunications more affordable and more widely available.
- Lower MTRs will promote competition in the mobile market by reducing the net outflow of funds from the new mobile operators and by reducing off-net/on-net price differentials.
- Lower MTRs will also help redress the long-running cross-subsidisation from fixed operators to mobile operators in South Arica. This is discussed in more detail in Section 4.

3.1 Lower MTRs will reduce the cost to communicate in South Africa

Reducing the cost of communication is a key policy goal in South Africa and Parliament's Portfolio Committee on Communications has recently expressed concern about pricing in the mobile market, especially as it particularly affects the poor.¹

Telkom supports the national policy objectives for the ICT sector; in particular the Authority's aim to reduce the cost to communicate for all consumers. This objective also aligns with the Department of Communications ("DOC") mission statement of developing "*strategies that increase the uptake and usage of ICTs by the majority of the South African population, thus bridging the digital divide.*"²

International experience suggests that lower MTRs can lead to lower retail calling prices. For example, the retail price of mobile calls in the UK has fallen in line with reductions in MTRs (see Figure 3).

¹ http://www.parliament.gov.za/live/content.php?Item_ID=4758

² Department of <u>Communications (2013)</u>



Figure 3: MTRs and average mobile call prices in the UK

Source: Ofcom³

Reductions in the price of communications services are likely to extend beyond the mobile sector. Recent findings by the OECD indicate that lower MTRs can also lead to lower prices for other services such as VoIP. This is illustrated in Figure 4 which compares average prices for VoIP calls to mobile phones with the level of MTRs in OECD countries. This comparison shows a clear positive relationship between MTRs and the price of VoIP calls to mobile phones, i.e. countries with higher MTRs have higher prices for VoIP calls to mobiles.

³ Ofcom. "The Communications Market 2006", "The Communications Market 2012"





Source: OECD⁴

The impact of a decrease in MTRs in South Africa would be felt broadly across the telecommunications market. A large majority of South Africans use a mobile phone⁵ and, for many of them, the mobile phone is the primary means of communication. Given that reductions in MTRs will be passed through to retail prices, at least in part, a significant reduction in MTRs is likely to result in lower prices for a large majority of telephone users, both fixed and mobile, in South Africa. Any reduction in the cost of mobile calls would therefore have a very wide impact on South African citizens. A significant reduction in MTRs would make the largest single contribution to reducing the cost of communication. It would benefit everyone who currently calls a mobile phone and would make telecommunications affordable to even more members of the community.

The increased telephone usage that arises from improving affordability will therefore ultimately support economic development and job-creation.⁶ Many policy and academic studies have found a positive relationship between mobile phone usage and economic development. For example, Waverman, Meschi and Fuss (2005) estimated that a 10% increase in mobile penetration levels was associated with a 0.6% increase in growth rates.

⁴ OECD (2012), "Developments in Mobile Termination",OECD Digital Economy Papers, No. 193, OECD Publishing.http://dx.doi.org/10.1787/5k9f97dxnd9r-en

 ⁵ Nielsen. 2010: http://www.nielsen.com/us/en/newswire/2011/mobile-phones-dominate-in-south-africa.html
⁶ Waverman, Meschi and Fuss, 2005. "The Impact of Telecoms on Economic Growth in DevelopingCountries." In Africa: The Impact of Mobile Phones. Vodafone Policy Paper 3, pp. 10–23

3.2 Lower MTRs will promote competition

Competition between mobile operators is essential for boosting investment, lowering prices and stimulating service innovation. Conversely, a lack of competition results in consumers suffering. A recent OECD study, for example, found that the welfare loss from weak competition in the mobile sector was equivalent to 0.7% of GDP between 2005 and 2009.⁷ Regulatory measures that boost mobile competition will therefore have a major beneficial impact on South African consumers and on the broader economy.

The key to effective and sustainable competition in the mobile market is for there to be multiple operators competing with each other. Mobile markets dominated by two operators are significantly less competitive than markets with a greater number of operators. According to the OECD:

"The number of operators is a key factor in ensuring a competitive market.... Few would argue, for example, that the marketing in the Netherlands is more competitive with three facilities-based operators than in earlier years when it had five. Meanwhile, increased competition is readily evidence in countries such as France and Israel that have recently introduced new operators."⁸

Rarely are markets dominated by a small number of operators considered fully competitive. A recent decision by the European Commission, for example, approved a merger between two mobile operators in Austria, which would bring the number of market players down from four to three, but only on the condition that Hutchison 3G would implement a commitments package that would facilitate the entry of new players into the market.

Regulation of MTRs is one of the most important instruments available to regulators for enhancing mobile competition. High MTRs discourage mobile competition in two important ways.

Firstly, high MTRs generate a net outflow of funds from new operators to incumbent operators. New entrants to the market typically have many more outbound calls than inbound calls. High MTRs therefore increase the net outflow of funds from these new operators to the established ones which limits their capacity to invest in the networks and in acquiring customers. This is illustrated in Figure 5 which shows the current level of mobile interconnection payments between from Telkom Mobile and the incumbent mobile operators.

⁷ OECD Review of Telecommunication Policy and Regulation in Mexico, 2012

⁸ OECD Communications Outlook 2013, p43.



Figure 5: Annual interconnection revenue and expenditure in South Africa

Notes: No data available for Cell C Source: Research ICT Africa Policy Brief SA No2 2012

The second way that high MTRs inhibit competition is through the effect that they have on retail prices. High MTRs feed through into high prices for off-net calls compared with on-net calls and these off-net/on-net price differentials are a key constraint on new mobile operators. This mechanism works in the following way: when deciding which network to join, a customer evaluates which operator's retail offer is the best value-for-money for them. In the presence of significant off-net/on-net price differentials, it makes sense for customers to join the network which most of their friends, family and business contacts also subscribe to. This effect naturally favours the large, established operators and makes it more difficult for new entrants to gain market share.

A reduction in MTRs is expected to feed through into a reduction in off-net/on-net price differentials which will help the more recent mobile entrants to compete effectively in the market.

This effect is supported by international evidence. A number of studies have established a positive relationship between termination rates and off-net/on-net price differentials⁹ and there is

⁹ For example: Jeon, Laffont and Tirole (2004) "On the Receiver Pays Principle.""*RAND Journal of Economics*; Hoernig (2007) "On-Net and Off-Net Pricing on Asymmetric Telecommunications Networks.""*Information Economics & Policy*; Armstrong Wright (2009) "Mobile Call Termination in the UK: A Competitive Bottleneck?"" in Lyons (ed), *Cases in European Competition Policy: The Economic Analysis*.

quantitative evidence to support the theory. Figure 6 shows how off-net/on-net price differentials fell in the UK as MTRs were reduced by the regulator.





Source: Ofcom¹⁰

Turkey is a good example of the impact of MTRs on the structure of the mobile market. Turkcell is the largest mobile operator in Turkey. In 2009 it had a market share of 67% and one of the key mechanisms by which it had been able to sustain its market share was by maintaining high offnet/on-net price differentials. This pricing strategy had been helped by high MTRs. The Turkish regulator then reduced MTRs from US¢8.14 in 2008 to US¢1.87 in 2010¹¹ and Turkcell subsequently rebalanced its retail prices.¹² As a result, competition in the Turkish mobile market has now increased. Turkcell's market share has dropped to 51% and market concentration has fallen, as Figure 7 illustrates.

¹⁰ Ofcom, The Communications Market 2006, The Communications Market 2012

¹¹ OECD.<u>http://www.oecd.org/sti/broadband/newoecdreportreleasedondevelopments</u> inmobileterminationrates.htm

¹² P28-29 "Analysis of Turkish Mobile Communication Market and Introduction of Mobile Virtual Network Operators". Uygar BOYNUDELİK. <u>http://www.prepaidmvno.com/wp-content/uploads/2011/05/56573698-</u> <u>Analysis-of-Turkish-Mobile-Communications-Market-and-Introduction-of-Mobile-Virtual-Network-</u> <u>Operators.pdf</u>



Figure 7: MTRs and HHI in the mobile market in Turkey

Note: HHI calculated based on revenue market shares Source: ICTA

Both economic theory and international experience indicates that a reduction in MTRs in South Africa should be a catalyst for lower off-net/on-net price differentials, increasing competition and supporting smaller operators to build their market share. This will benefit consumers through more investment and lower prices.



4. Symmetry between FTRs and MTRs

ICT is an industry in which operators have to continually invest in order to compete effectively and Telkom spends, on average, R5.2bn per year in capital expenditure.

The high levels of MTRs relative to FTRs in South Africa has resulted in a long-running crosssubsidy from Telkom to the mobile operators. High MTRs have effectively been subsidising the roll-out of the incumbents' mobile networks for over two decades. While this may have been justified in the early days of mobile network development, this rationale has not held true for many years now and cannot be sustained anymore.

This cross-subsidy from fixed operators to mobile operators has a negative effect on the investment in fixed networks at a time when investment into superfast broadband is a critical priority for the sector and for the country as a whole.

In a rapidly converging telecommunications market, regulation should be designed to create a level playing field between traditional fixed and mobile operators to allow them to invest and compete for business.

We propose an immediate move to parity between FTRs and MTRs and an elimination of the WON-BON FTR structure

- Parity between FTRs and MTRs will help address the long-term cross-subsidisation from fixed operators to mobile operators which is unfair and no longer justified.
- Parity between FTRs and MTRs will help create a level playing field in a rapidly converging market place and will further assist the Authority's objective of supporting convergence.
- A single FTR reflects convergence in the marketplace.

4.1. Telkom has been subsidising the mobile operators for two decades

As explained in Section 2, the termination rate for a fixed to mobile call in South Africa has always been set significantly above the rate for a mobile-to-fixed call. Between 1994 and 2009, the average ratio of termination rates for fixed-mobile calls to mobile-fixed calls was 4.6. With the reduction in MTRs over recent years, this ratio has fallen but still remains significant. MTRs are currently still more than three times higher than average FTRs in South Africa.

The result of this asymmetry has been a net flow of funds from fixed operators to mobile operators. Over the 2001-2013 period Telkom effectively subsidised mobile operators by the amount of R55 billion, with interconnection payments to mobile operators totalling almost nine times the value of interconnection revenues received from them.

The original rationale for setting MTRs and FTRs on an asymmetric basis was to support the entry and development of the new mobile operators in the light of expected asymmetric traffic volumes towards Telkom.

The national coverage of the South African mobile networks means that there is no longer any basis for this on-going subsidisation, nor has there been for many years, especially as this subsidy is directed towards dominant incumbent mobile operators. There is no rationale for differential termination rates for incumbent mobile and fixed networks today.

4.2. The market is converging in SA - there is no justification for different FTRs and MTRs

One of the most important trends in the telecommunications sector has been the recent convergence in the use of technologies by licensees from the perspective of the consumer. Consumers increasingly use fixed and mobile services as substitutes for one-another. The process of convergence is generally beneficial to customers and supporting it is one of the Authority's objectives.

Termination rates can be used to support this process of convergence. Large differentials between fixed and mobile termination rates create distortions in retail prices, investment incentives and the ability of different types of operators to compete with each other. Parity between fixed and mobile termination rates helps to address some of these problems.

This effect has been acknowledged internationally. The European Commission, for example, recommended that fixed and mobile termination rates should converge and that the large gaps between fixed and mobile termination rates are "*not in line with the increasing convergence between fixed and mobile telephony and can lead to serious distortions of competition between Member States and operators.*"¹³ The EC Recommendation on the Regulatory Treatment of Mobile Termination Rates¹⁴ also comments that "*significant divergences in the regulatory treatment of fixed and mobile termination rates create fundamental competitive distortions*" since in both fixed and mobile operations there is a requirement for reciprocal network access.

¹³ <u>http://europa.eu/rapid/press-release IP-09-710 en.htm</u>

¹⁴ <u>http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:124:0067:0074:EN:PDF</u>



Although the degree of substitutability between fixed and mobile services in Europe is not as high as it is in South Africa, the EC clearly recognises the potential distortionary impact of different termination rates on competition in the telecommunications market.

Mobile phones are considered to be able to fulfil many of the functions of a fixed-line phone. Large differences between fixed and mobile termination rates therefore are not justified in South Africa where, from the point of view of many customers, the services are equivalent.

Convergence of mobile and fixed termination rates has been adopted as policy in a number of countries, including Namibia, Tanzania, Nigeria, and India. The Tanzania Communications Regulatory Authority, for example, supported the alignment of fixed and mobile termination rates in 2007 on the grounds of the substitutability between fixed and mobile services, noting that most retail mobile tariffs made no distinction between outgoing calls to fixed lines and other mobiles. Namibia also introduced a single rate for fixed and mobile termination rates on competition grounds in 2009.

In addition to competition, convergence of FTRs and MTRs can also be justified on the grounds that it incentivises investment in fixed infrastructure. This was the rationale behind the Nigerian Communications Commission setting a single rate in 2009. ¹⁵ Malaysia also used elevated FTRs to incentivise the transition to fibre.¹⁶

¹⁵ "Determination of Voice and SMS Interconnection Rate Issued by Nigerian Communications Commission". NCC. 21st December 2009

¹⁶ http://www.skmm.gov.my/skmmgovmy/media/General/pdf/PI Access Price Review Oct 2012.pdf



Country	Year symmetry was introduced
Tanzania	2007
Namibia	2009
Nigeria	2009
India	2009

Table 1: FTR – MTR symmetry in selected countries

4.3. A unified WON-BON rate is more appropriate to a converging market.

Currently, Telkom has two fixed termination charges: one for calls which terminate within Telkom's 0N area code (W0N) and one for calls which terminate between 0N area codes (B0N). This dual charging structure is referred to as W0N-B0N charging structure.

In a converging market in which customers see mobile and fixed services as substitutes for each other, differentials in FTRs based on geographical location are outdated. The recent elimination of differences between local and national retail call charges on Telkom's fixed network further supports the rationale for disposing of the W0N-B0N differential FTR structure.

In view of this, the Authority should move the industry towards a single FTR independent of geographic information.

5. MTR asymmetry for new entrants

MTR asymmetry provides specific mobile operators, usually new entrants, with higher MTRs than the larger, more established mobile operators.

Two reasons have driven regulators to adopt asymmetrical MTRs:

- to encourage new entrants into the market by reducing the net outpayment of interconnection charges; and
- to account for differences in technology deployment and spectrum allocations which may have the effect of raising a mobile operator's costs.

In South Africa, the new entrants into the market do need support to allow them to compete effectively with the incumbent and now well-entrenched mobile operators.

Telkom supports ICASAs proposal for asymmetrical MTRs for new mobile entrants

- Asymmetrical MTRs will support the development of mobile competition by helping smaller operators compete with incumbent mobile operators.
- Asymmetrical MTRs are consistent with the approach taken by many regulators around the world to support the growth and development of competition.

5.1. MTR asymmetry will support the development of mobile competition by helping new mobile entrants in the market

New mobile network entrants face high costs for entering the market – primarily the cost of network investment and customer acquisition. MTR asymmetry helps to support new entrants to bear these costs while building market-share.

New entrants into the mobile market also typically face strong asymmetries in the flow of voice traffic. This asymmetry typically only diminishes as the market-shares of the mobile operators become more equal.

The asymmetry in traffic flow means that, even if MTRs for different mobile operators are set at the same level, there will be a significant net outflow of termination charge revenue from the new entrants to the incumbent mobile operators for many years. These are funds which could have



been used to invest in building networks and acquiring subscribers to allow them to compete more effectively with the incumbent operators.

This negative effect of asymmetrical traffic flows is compounded by the economies of scale that are enjoyed by large incumbent operators relative to the smaller new entrants. Large, established operators enjoy economies of scale in equipment purchasing, operating costs and site acquisition, which means that their overall average network costs are typically higher than that of a large, well established incumbent operator's network.

Added to this are the costs of customer acquisition which are typically higher than customer retention. New entrants face these higher costs in order to encourage customers to switch away from the incumbent operators. The established operators do not face comparable costs in order to maintain their market share.

In summary, asymmetrical MTRs will help to support the development of mobile competition through reducing the net outflow of termination revenues from the newer operators to the incumbent ones and by helping address the higher costs faced by new entrants. This will have long-term benefits for customers in the form of higher levels of investment and lower prices.

5.2. Many countries have set higher MTRs for new mobile entrants

Internationally regulators have recognised that the application of asymmetric MTRs is necessary to encourage competition, particularly in markets which are dominated by one or two large operators. When MTRs were first introduced regulators typically imposed termination rates that favoured newer operators with smaller market shares. Asymmetric termination rates were applied in the early stages of mobile regulation in Europe in order to ensure competitive mobile infrastructure and providers. The European Commission has also acknowledged that MTR asymmetry for new entrants is an unavoidable necessity to enable them to overcome structural, legal and/or regulatory barriers and notes that these "objective cost differences outside the control of the operators"¹⁷ act as impediments to retail market entry and expansion.

The European Regulators Group (ERG) conducted a study of termination rates in Europe in 2007. As part of this study they compared the level of MTR asymmetry granted to an operator with the number of years that the operator entered the market after the mobile incumbent first launched. The study found that the longer the gap between entry by the incumbent and entry by the operator, the larger the MTR asymmetry applied to that operator. On average, MTRs of operators that had entered between 3 and 5 years after the mobile incumbent are 17% higher

¹⁷ <u>http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:124:0067:0074:EN:PDF</u>

than the lowest MTR in their country, while the MTRs of operators that had entered between 6 and 11 years after the mobile incumbent were 35% higher than the lowest MTR in their country. Telkom Mobile has entered the market 17 years after the incumbents entered the market.

Figure 8 illustrates the level of asymmetry that is currently in place across a number of European countries and how this level is influenced by the age and size of the operators receiving asymmetric treatment. It indicates that MTR premia are higher for newer entrants and for operators with lower shares of the market. In some cases, the MTR for new entrants is over 200% higher than the MTR of the incumbent mobile operator.

Figure 8: MTR premia, market share and time since entry for smaller mobile entrants in selected European countries (2012)



MTR asymmetry has been removed in some European countries. In general this is because the operators that previously benefitted from the asymmetry have reached a level of development that no longer justifies it. In its 2009 recommendation on termination rates, the EC explained that asymmetries can be justified for a limited period while there remain objective cost differences relating to an operator's late entry.¹⁸ For example, in France, the third entrant to the market, Bouygues Telecom, received asymmetric regulation for 14 years after it had launched. Although its MTRs are now at the same level as the first two entrants, this is because it no longer requires support (in 2011 it had a market share of 20% and annual revenues of \in 5.3 billion).¹⁹ It is worth noting that despite this removal of asymmetry for Bouygues Telecom, asymmetric treatment was subsequently applied to the 4th and 5th entrants (Figure 9).





Source: ARCEP²⁰

¹⁸ EC (2009 p10). "Explanatory note on the European Commission recommendation on the regulatory treatment of fixed and mobile termination rates in the EU"

¹⁹ Intelligent Solutions, 2011. "Bouygues Telecom: The Intelligent Telecommunications Company"

²⁰ http://www.arcep.fr/index.php?id=8080&L=0



6. Conclusions

In this submission, we have outlined our response to ICASA's Draft Call Termination Regulations, issued on 11 October 2013.

These regulations contain three key proposals:

- to reduce MTRs from 40c to 10c between March 2014 and 2016;
- to leave FTRs unchanged at 12c/19c (W0N/B0N) for this same period; and
- to increase MTR asymmetry for new entrants.

Telkom supports the Authority's proposal to:

- Significantly reduce MTRs; and
- Increase MTR asymmetry for new entrants.

We further recommend that the Authority:

- Introduces parity between FTRs and MTRs immediately; and
- Removes the WON/BON differential and sets a single FTR.

These proposals would support the growth and development of the sector in several important ways.

- Lower MTRs would reduce the costs of calls made by the majority of South African subscribers. As reductions in MTRs feed through into lower retail call prices, it would have a direct impact on the cost to communicate for the majority of South Africans.
- Lower MTRs and FTR-MTR parity would help address long-standing cross-subsidisation of mobile operators by fixed operators. While this policy of cross-subsidisation may have been justified in the early days of the South African mobile industry, there is no justification for it anymore.
- The South African telecommunications market is rapidly converging. Customers readily substitute fixed for mobile services. In this market context, large differentials between FTRs and MTRs are distortionary and anti-competitive and cannot be justified.



- MTR asymmetry for new mobile entrants will help support them to grow and compete with the incumbent mobile operators. This will deliver long-term benefits to customers through lower prices, investment and innovation.
- A single FTR rate with no WON/BON differential would further support convergence in the marketplace and support fair competition between all players in the market.

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