

Quasi-mergers in Telecommunications

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Emerging Competition Issues in Regulated Network Industries
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Outline

- **Consolidation and cooperation are natural features of telecom markets**
- **Characteristics of observed mergers and alliances**
- **Alliances: benefits and risks for competition**
- **What are the likely changes in the US and the EU that could trigger further cooperation?**
- **Will the associated benefits be achieved through mergers or alliances?**
- **Are expected alliances a source for antitrust concern?**

Consolidation and cooperation are natural features of telecom markets (1)

- Cost savings in service provision
 - From scale economies and economies of density at the horizontal level
 - From scope economies in related segments
 - From transaction costs and hold-up problems at the vertical level

- Strong pressure from the demand side
 - Network effects and switching costs
 - Complementary services to be offered in bundles

- Sunk costs
 - In R&D
 - In brand image

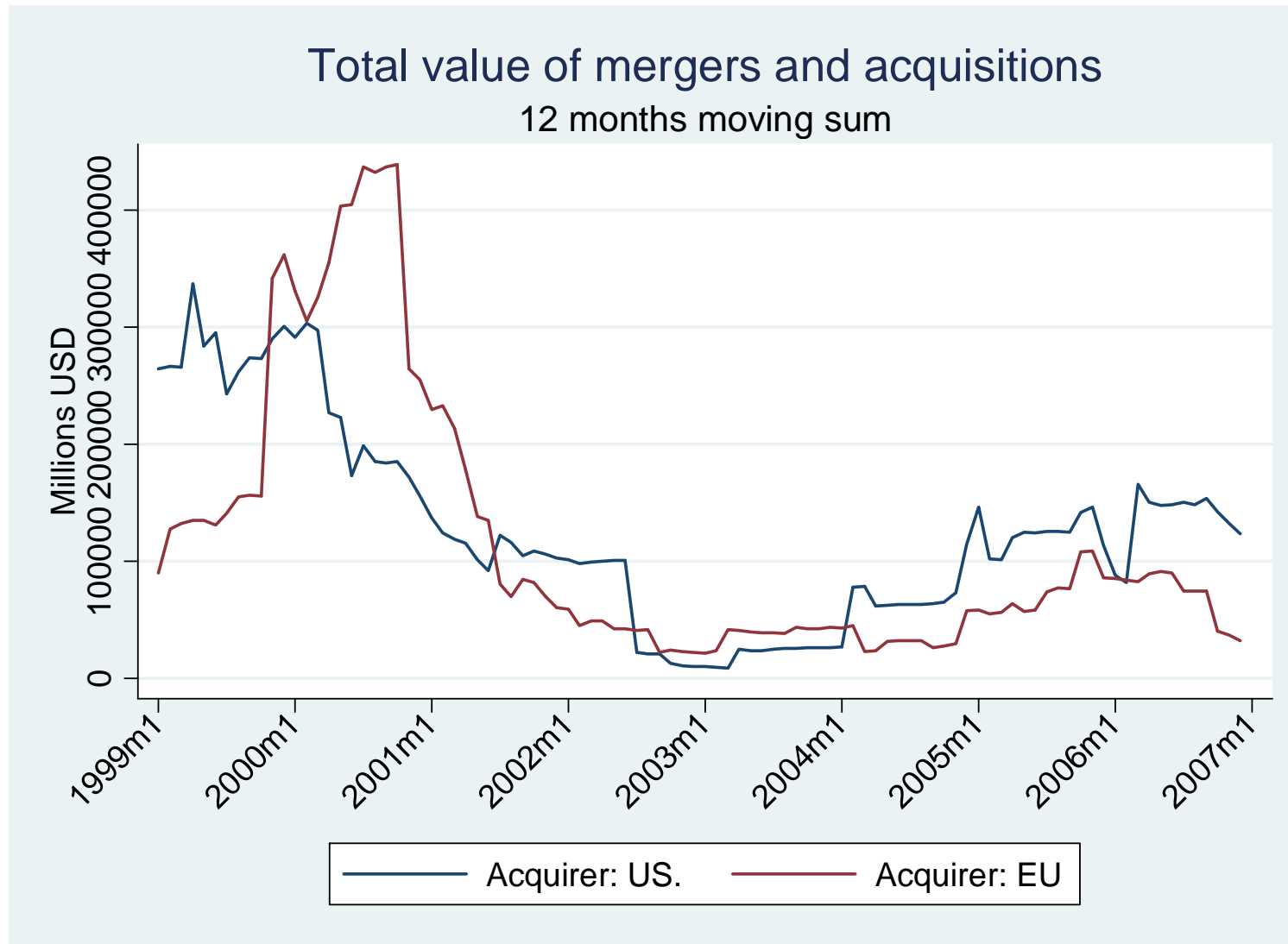
- Need for cooperation
 - Interconnection
 - Standards setting

Consolidation and cooperation are natural features of telecom markets (2)

- Merger waves in Telecoms are also the result of structural changes:
 - Exogenous innovations that spill over from other sectors
i.e.: Convergence of technologies

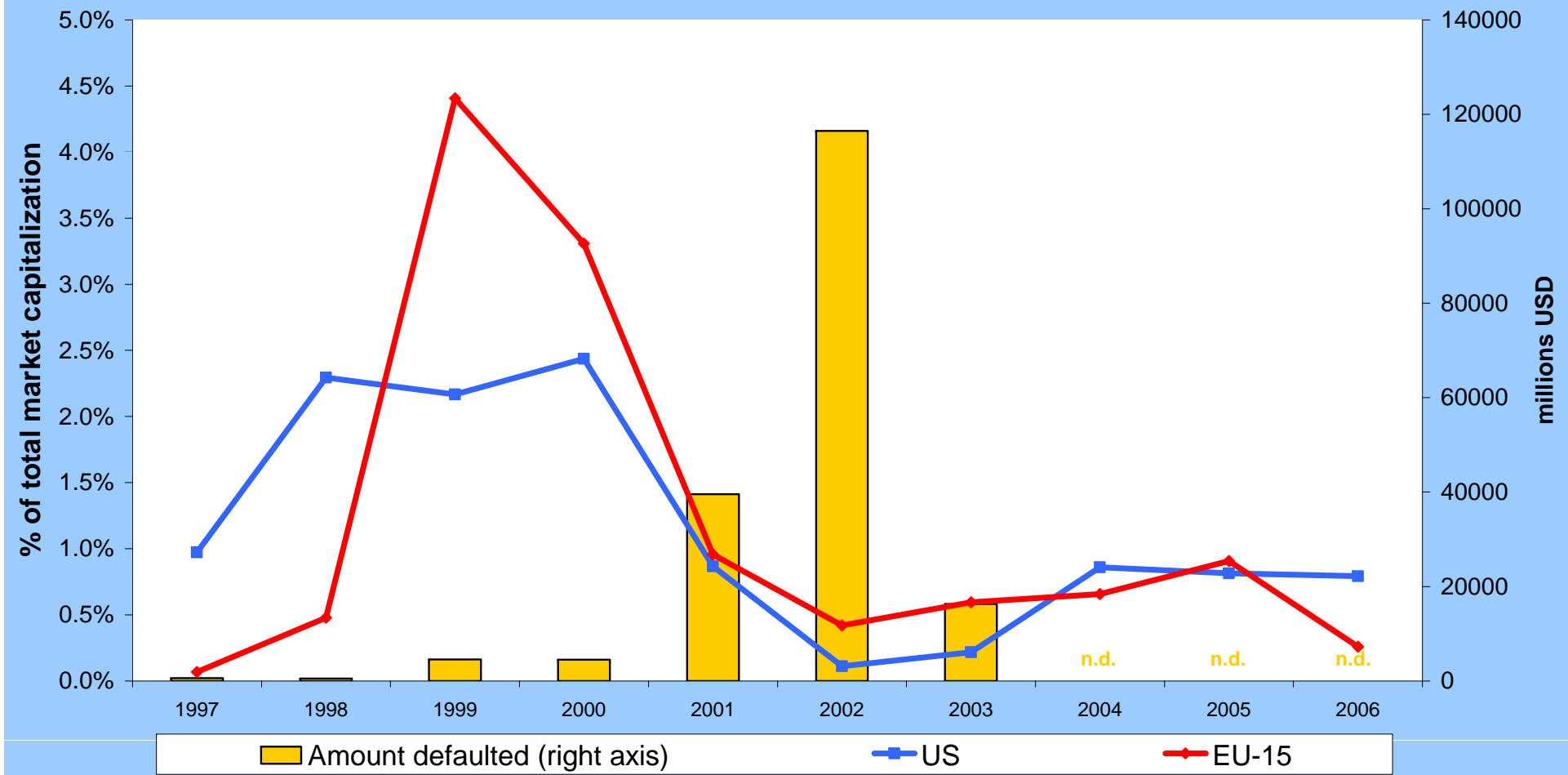
 - Regulatory changes
i.e.: AT&T break-up and the Telecommunications Act in the US
The Telecoms liberalization process in the EU

Consolidation and cooperation are natural features of telecom markets (3)



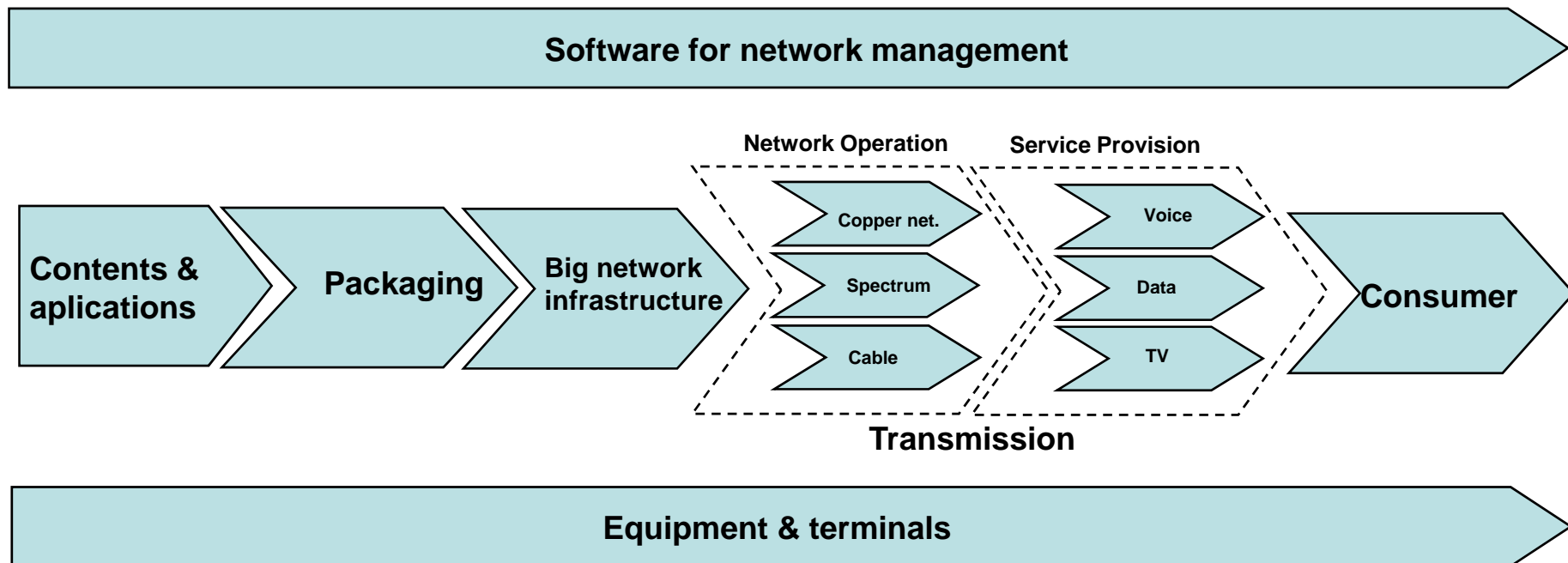
Consolidation and cooperation are natural features of telecom markets (4)

Total value of mergers, acquisitions and defaults



Consolidation and cooperation are natural features of telecom markets (5)

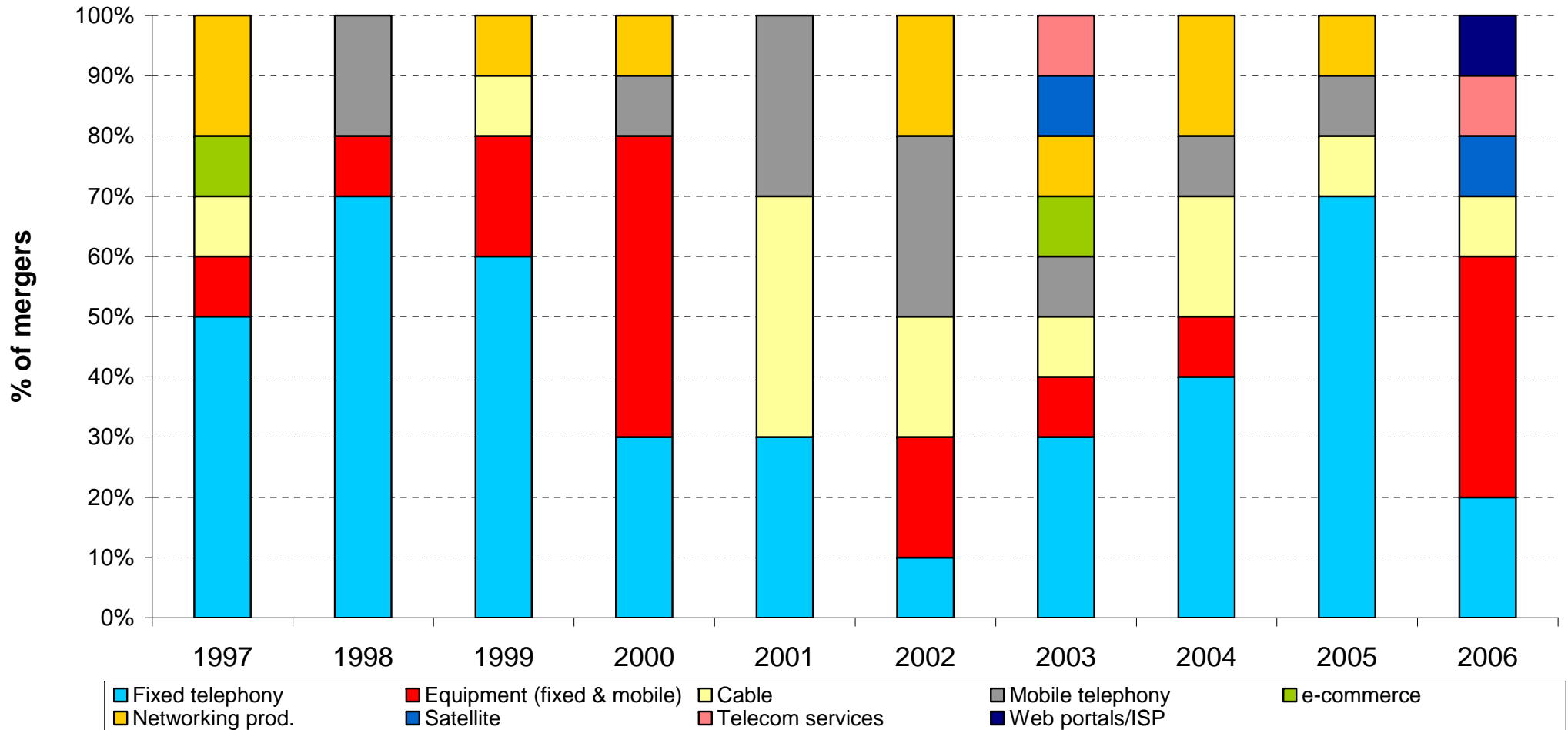
Convergence of technologies



Characteristics of observed mergers (1)

Acquiring sectors - US

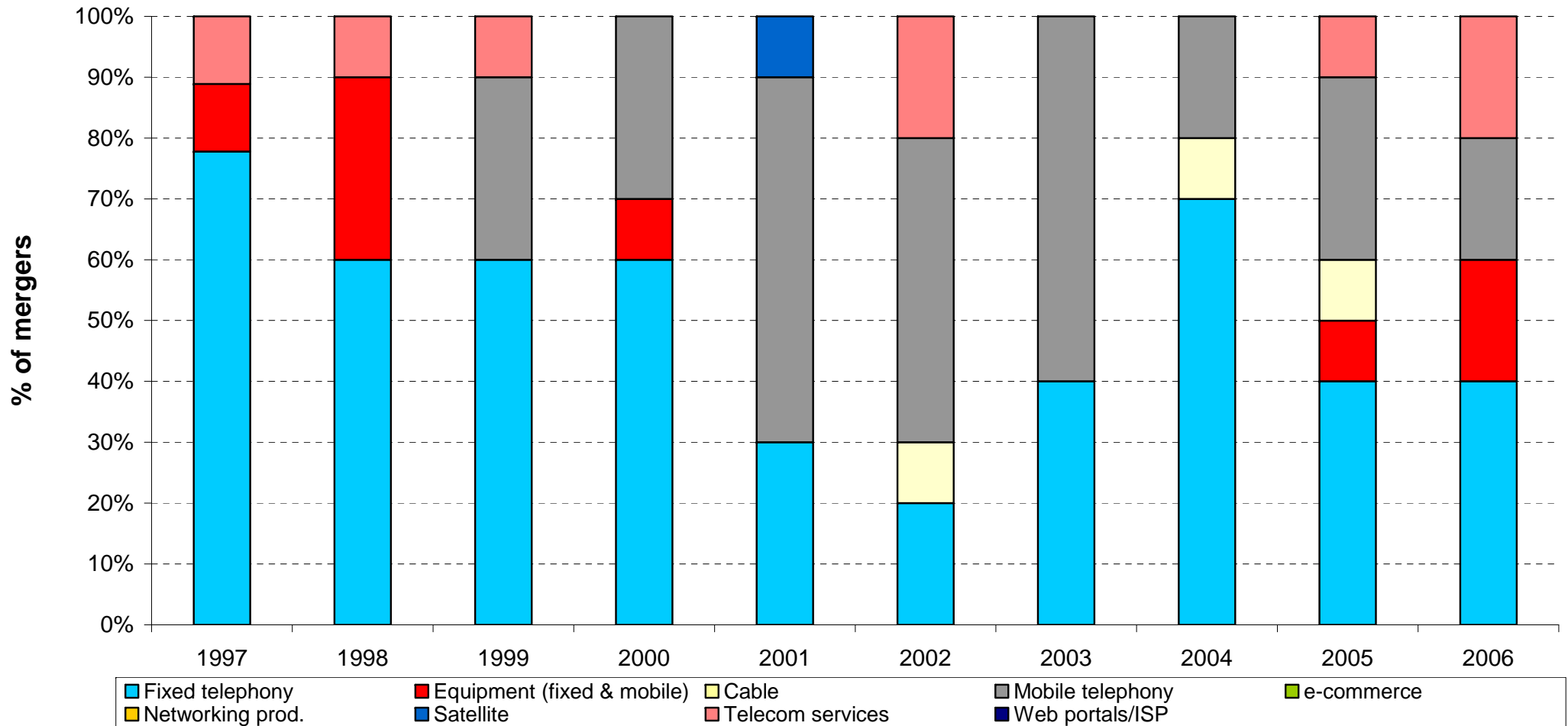
10 largest mergers



Characteristics of observed mergers (2)

Acquiring sectors - EU

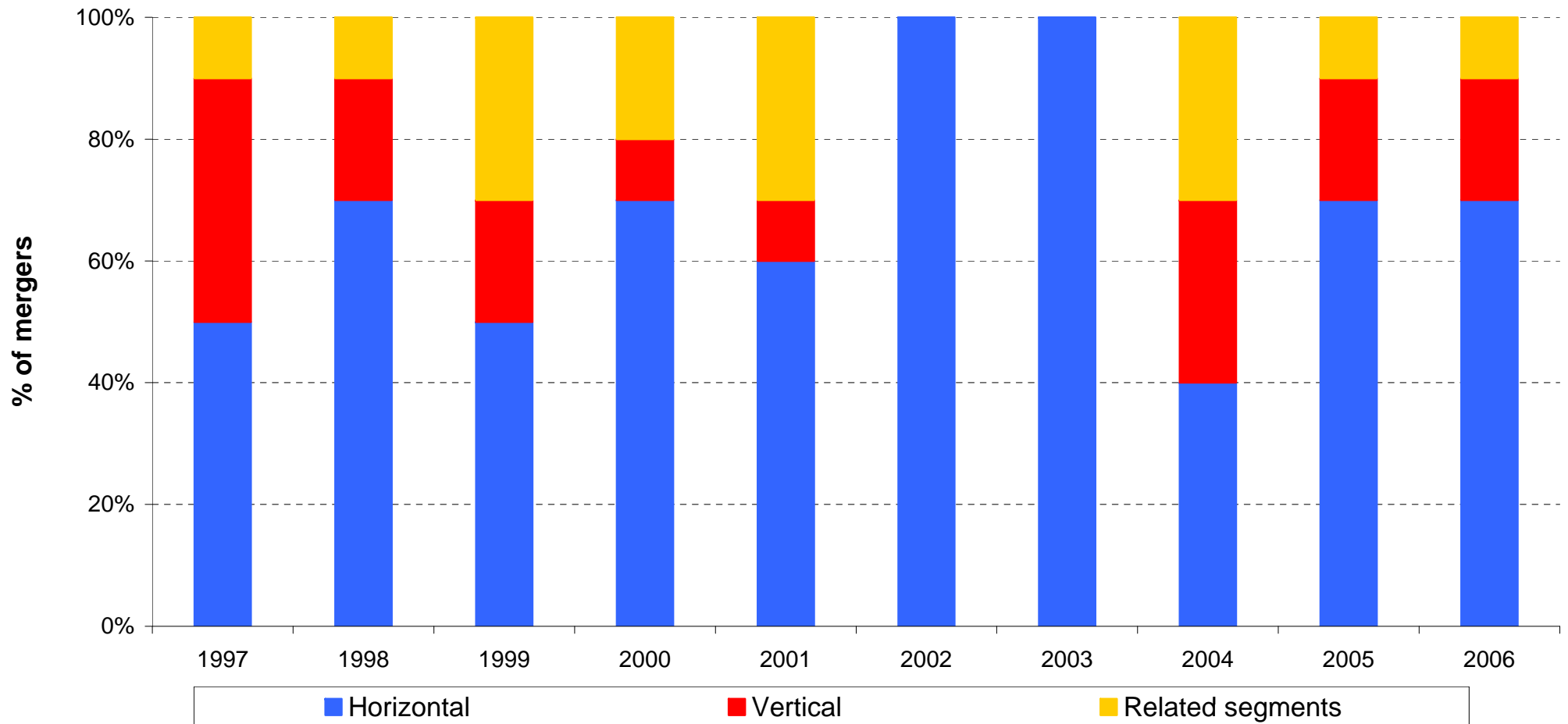
10 largest mergers



Characteristics of observed mergers (3)

Nature of the merger - US

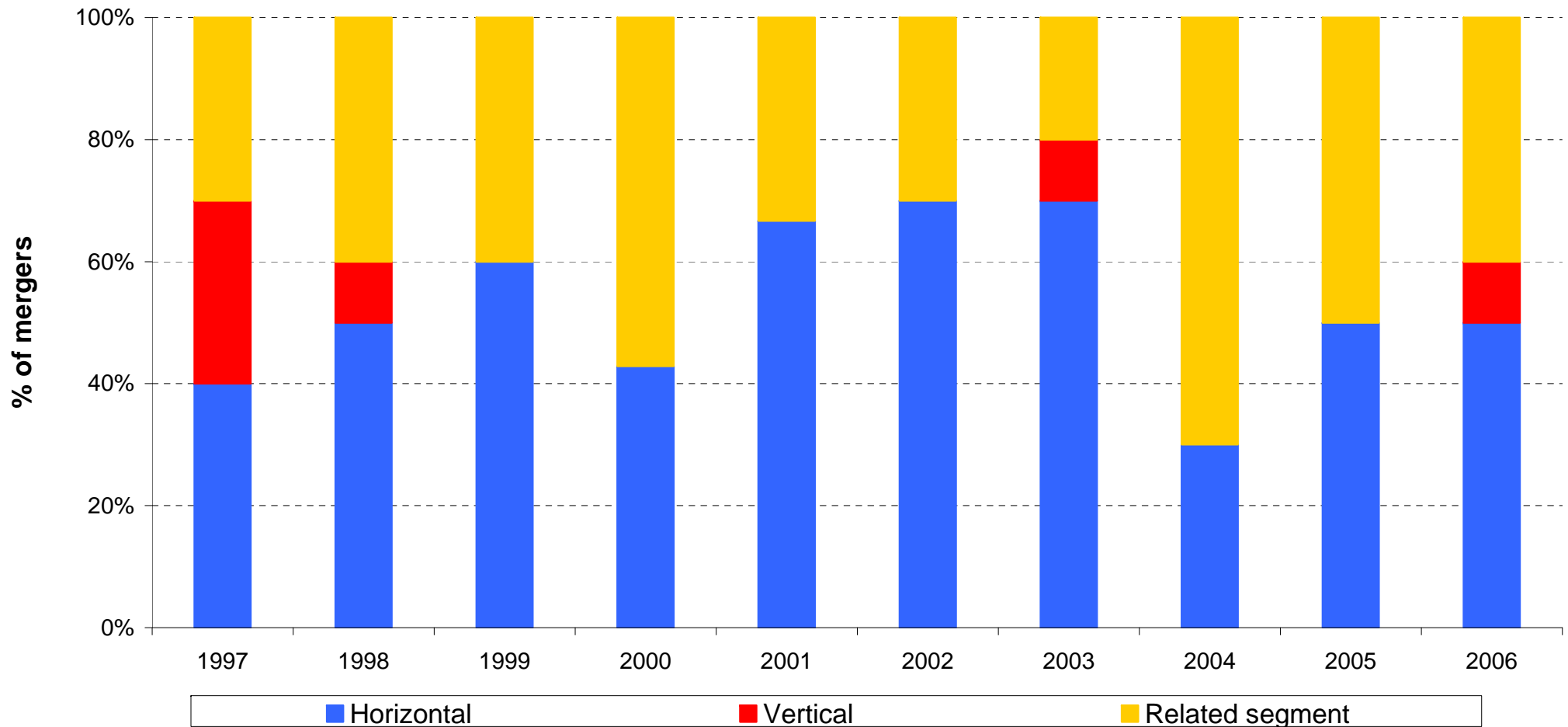
10 largest mergers



Characteristics of observed mergers (4)

Nature of the merger - EU

10 largest mergers



Characteristics of observed alliances

Sectors	Example	Nature of the agreement
Mobile - mobile	3 UK and T-Mobile for 3G networks	Horizontal
Mobile - terminals	iPhone with mobile providers	Vertical
Terminals– software (and mobile)	Microsoft (Windows Mobile) Symbian (Symbian OS) Google (Android / Open Handset Alliance)	Vertical
Terminals – contents	Google Mobile iPhone Apps	Vertical
Broadband - broadband	Not yet but likely	Horizontal
Broadband – mobile	Jazztel – Orange (via VMO)	Related
Broadband - contents	Telefonica (Imagenio) – Digital+	Vertical
Broadband - services	Cisco for VoIP	Vertical
Contents - contents	Yahoo - Google	Horizontal

Alliances: benefits and risks for competition

Undertakings	Source of efficiencies	Risks for competition
Mobile - mobile	Reduction in fixed costs Increased coverage	Share of information Collusion
Mobile - terminals	Improved value of the system	Exclusivity / Foreclosure at both sides
Terminals – software	Standarization Improved value of the system	Exclusivity / Foreclosure at both sides
Terminals – contents (and mobile)	Improved value of the system	Exclusivity / Foreclosure at both sides
Broadband - broadband	Reduction in fixed costs	Share of information Collusion
Broadband – mobile	Scope economies	Collusion in broadband market
Broadband - contents	Scope economies	Leverage of content mkt power or foreclosure in broadband
Contents - contents	Improved matching (network economies?)	Collusion

Triggers of further consolidation (1)

- Progress in the convergence process:
 - Real-time applications (VoIP, VoD, IPTV) → Vertical integration

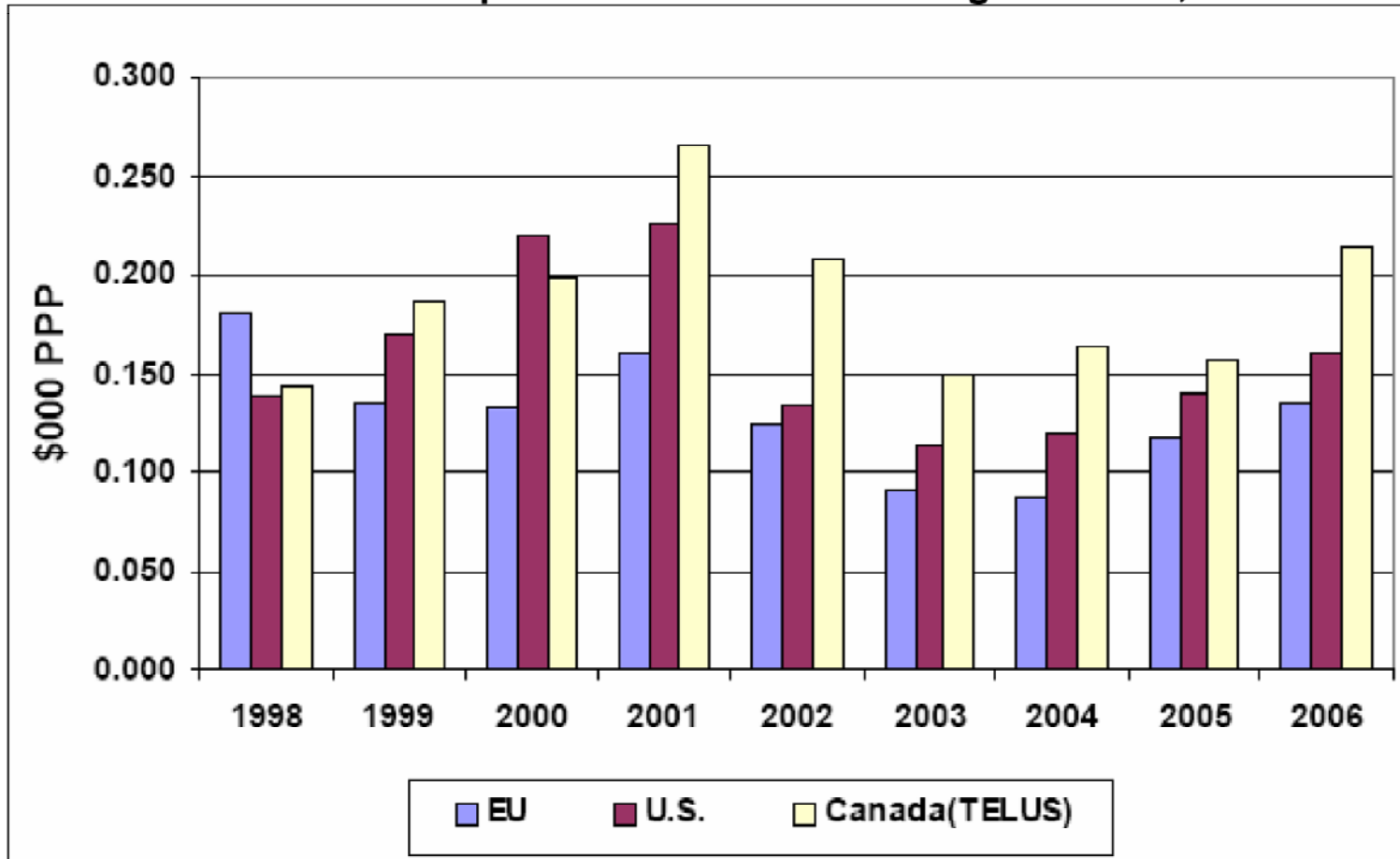
- Regulatory changes:
 - NGNs and infrastructure competition → horizontal consolidation
 - Net Neutrality imposed → Vertical integration

- Political changes:
 - Attitude towards national champions → European horizontal mergers

- Credit Availability:
 - Pressure to share sunk/fixed costs → Cooperation at all stages

Triggers of further consolidation (2)

**Capital Expenditures Per Line on Fixed-Line Networks:
North America vs. European Union Local Exchange Carriers, 1998-2006**



Source: Crandall 2007

Triggers of further consolidation (3)

US Data				EU-15 Data				
Company	Loops* (2005)	Loops (%)	Market capitalization over GDP (2006)		Incumbent copper lines (2005)	Public sector ownership (%) (2005)	Copper lines (%)	Market capitalization over EU GDP (2006)
Verizon Communications Inc.	49,317,413	31.40	0.82%	Germany	35,600,000	38	21.08	0.56%
AT&T, Inc. **	49,265,385	31.37	1.69%	France	33,150,028	35	19.63	0.51%
BellSouth Telecom., Inc. **	20,703,775	13.18	--	United Kingdom	25,874,403	0	15.32	0.26%
Qwest Communications International, Inc.	14,048,096	8.95	0.12%	Italy	21,917,000	0	12.98	0.41%
Embarq Corporation	7,079,141	4.51	0.06%	Spain	17,266,520	0	10.22	0.72%
Windstream Corporation	3,168,810	2.02	0.05%	Netherlands	6,907,000	21 + 1 golden share	4.09	0.19%
CenturyTel, Inc.	2,194,202	1.40	0.04%	Greece	5,519,381	36	3.27	0.10%
Citizens Communications Company	2,097,812	1.34	0.04%	Sweden***	5,403,000	45	3.20	0.25%
Resto de empresas	9,166,853	5.84		Belgium	4,273,464	50 + 1 share	2.53	0.10%
				Portugal	3,201,757	7 + 1 golden share	1.90	0.03%
				Finland***	3,180,000	14	1.88	--
				Austria	2,749,831	30	1.63	0.09%
				Denmark	1,982,848	0	1.17	0.05%
				Ireland	1,600,000	0	0.95	n.d.
				Luxemburg	241,000	100	0.14	0
Total	157,041,487			Total	168,866,232			

Notes:

(*) ILECs (Incumbent Local Exchange Carriers) telephony loops

(**) Merged in 2006

(***) Telia (Sweden) and Sonera (Finland) merged to become TeliaSonera on December 2002

Sources:

US Data: "Trends in Telephone Service", February 2007, FCC.

EU Data: ECTA Broadband Scorecard, 2006 and 12th Implementation Report, DG Information Society and Media.

Datastream

Mergers or alliances? (1)

Modes of partnering	Characteristics of these modes	Suitable if...
Full Merger	<ul style="list-style-type: none"> ▪ Joint maximization of profits 	<ul style="list-style-type: none"> ▪ Product specialization is not a key competitive factor ▪ Economies of scale are not phase- or product-specific ▪ No limits to firm size ▪ No anti-trust problems
Equity agreements (Joint ventures)	<ul style="list-style-type: none"> ▪ Strong commitment ▪ Governance issues 	<ul style="list-style-type: none"> ▪ Mature and stable industry ▪ Low degree of R&D intensity ▪ Oligopolistic structure
Contractual agreements	<ul style="list-style-type: none"> ▪ Less commitment ▪ Flexible 	<ul style="list-style-type: none"> ▪ Rapidly changing technological development ▪ Uncertainty and high risks ▪ High degree of R&D intensity ▪ Large number of companies

Sources: Hagedoorn (RIO, 1996) and Grandori (1997)

Mergers or alliances? (2)

Who will choose what?

Modes of partnering	Likely segments involved
Full Merger	<ul style="list-style-type: none">Fixed telephony providers <div style="text-align: center;"><p>Broadband ISPs</p></div>
Equity agreements (Joint ventures)	<ul style="list-style-type: none">Mobile telephony providers
Contractual agreements	<ul style="list-style-type: none">Cooperation among vertically- or segment-related players

Are expected alliances a source for concern?

- Possible concerns:
 - Network effects + switching costs increase feasibility of a foreclosure strategy
 - Players with SMP exist: telecom incumbents, some content providers
 - VoIP, VoD and IPTV could drive subscriptions and lead to foreclosure
- On the other hand:
 - Most agreements have strong efficiency reasons
 - Refer to single products/services in a context of increasingly multiproduct offers



- Watch out for agreements involving content providers and SMP operators
- Keep VoIP, VoD and IPTV under surveillance
- Careful with exclusivity and contract duration