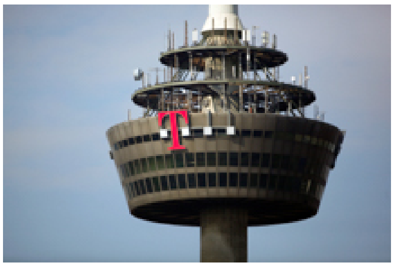
European telecoms will not become a single market

Tuesday, August 26 2014

The failure of the European telecoms sector to live up to its post-regulation-era expectations in the 1990s has led to some high-profile meetings between politicians, regulators and the heads of the leading telecoms companies. Attempts are being made to improve the poor financial performance of the European telecoms sector and the threat this is posing to European competitiveness. Despite full liberalisation of the European telecoms industry in 1998, the sector remains fragmented along national lines. The United States and China have a single telecoms regulator and one authority which allocates mobile spectrum -- Europe has 28 national regulators, which create barriers to the establishment of a single European market in telecommunications. Attempts by the incumbent telecoms companies to move towards a pan-European market model through consolidation have also been hampered by EU anti-trust regulations.



The logo of Deutsche Telekom is pictured on the 266 metre high TV tower in the western German city of Cologne (Reuters/Wolfgang Rattay)

What next

There are many new proposals aimed at transforming Europe into a single digital economy using 5G mobile networks developed jointly with South Korea. This would bring Europe in line with advanced 4G networks that exist in the United States or are currently under development in China. However, in order to implement such proposals, the existing European telecoms business model would need to be overhauled.

Impact

- Sixteen years after full telecoms liberalisation, state monopolies no longer exist, but heavily regulated national 'fiefdoms' remain.
- 60% of telecoms customers are with Europe's big-four operators, but in practice their businesses fracture along national lines.
- European governments have raised 100 billion euros through spectrum sales of 3G.
- 5G developments should provide a massive boost to the European telecoms industry.

Analysis

In the 1990s post-regulation era, European telecoms companies expanded rapidly by adopting a common GSM standard and achieved an impressive 60% profit margin. However, the largest companies borrowed heavily in order to lease spectrum, pay dividends or expand overseas -- and ended up employing too many people.

Price competition ensued, leading to revenue declines which remain problematic still today. New rivals also entered the market in the form of the large internet companies (Google, Facebook and Twitter), offering virtually free services such as Skype or Whats App, which seriously undermined the pay-for-calls business model (see INTERNATIONAL: Chat apps will disrupt telecoms sector - March 13, 2014).

Further complicating the competitive environment, the previous role of telecoms companies (providing network access and services) was also being challenged, as these high-value services were now being provided by new players from the internet and media sectors.

Burden of national regulation

Telecoms are experiencing setbacks due to restrictions imposed by national regulators

Telecoms companies have experienced additional setbacks due to restrictions imposed by national regulators on cross-border transactions and integration. Revenues gained by national governments from the sale of mobile spectrum -- European governments have raised 100 billion euros (132 billion dollars) through 3G spectrum sales -- has created a barrier to the establishment of a Europe-wide spectrum allocation and prevented integrated cross-border service provision.

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These problems have been exacerbated by recent pressures to upgrade the incumbent telecoms infrastructure to handle the increase in internet 'traffic' that will become a data deluge as the 'internet-of-things' unfolds (see INTERNATIONAL: Security will lag 'Internet of Things' - March 21, 2014).

This next infrastructure investment cycle (converting mobile to 4G and fixed-line to fibre) will cost tens of billions of euros. In order to pay for this investment, telecoms companies are seeking to increase economies of scale through mergers and acquisitions (M&A) to enhance revenues and reduce unit costs. However, the EU has until recently viewed this as anti-competitive behaviour, likely to lead to increases in prices rather than improved services.

Telecoms fight back

There are now signals that the regulatory mood concerning consolidation in the European telecoms sector is changing:

- German Chancellor Angela Merkel recently added her voice to calls for European regulators to allow telecoms consolidation.

- The incoming president of the EU, Jean-Claude Juncker, identified fixing the telecoms industry as a key priority and indicated that EU regulators should look more favourably at proposed M&A strategies.

EU regulators are now prepared to accept that four-to-three mergers (where M&A activity reduces the number of firms in a national market from four to three) may not pose a danger to consumers in terms of higher prices or poorer service. Therefore, they are adopting a lighter regulatory touch.

Evidence of this policy shift is already unfolding, as Telefonica's bid for KPN's German subsidiary E-Plus has been recently approved and the decision of Sweden's Tele2 to sell its Norwegian unit to TeliaSonera (also Swedish) looks likely to receive regulatory permission.

Telefonica's bid for KPN's German subsidiary E-Plus has been approved

The principle behind both deals is that they allow consolidation, but also uphold fair competition. This is achieved through EU conditions for merger approval. For example, the EU condition for the German merger was Telefonica's disposal of up to 30% of the new company's network capacity. The beneficiary of the disposal will be Drillisch, a mid-sized mobile virtual network operator (MVNO). The Scandinavian deal will also probably require TeliaSonera and Tele2 to sell some network assets.

Outlook

Two developments have recently unfolded, designed to create a Europe-wide 5G digital economy to compensate for the current slow rollout of 4G networks.

- A pact between the EU and South Korea has been agreed to jointly promote and develop the world's next-generation mobile internet network.

- At the July meeting of the European Council in Venice, proposals were made for the development of a European digital economy, where digital goods and services will be freely available across the region.

These 5G developments should provide a boost for the European telecoms industry. Ubiquitous 5G networks are crucial for the forthcoming internet-of-things connectivity, while driverless cars are not likely to become a reality without flawless, borderless networks.

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In order to actually get to a single 5G European digital economy, both the EU and South Korea will need to harmonise radio frequencies in preparation for the new technology. However, before any of these infrastructures can become a reality, the existing European telecoms business model would need to be overhauled.

Lighter regulation on consolidation (M&A) will not have a significant impact, if the current fractured regulatory regime and unhelpful spectrum rules remain in place. These will deter infrastructure investments by incumbent telecoms operators and foreign direct investments from firms such as AT&T and China Mobile.

A healthy telecoms sector is critical to Europe's growth prospects. Without the removal of independent national regulators and their replacement with a single authority responsible for spectrum allocation, Europe will continue to lag behind its main competitors in North America and Asia. If reform does not occur, achieving single European digital economy will be impossible -- and Europe's productivity and global competitiveness will continue to deteriorate.

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