

Submission for the Licensing Framework for Third Generation Mobile Services

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Comment :

Dear Sir,

Licencing Framework For Third Generation Mobile Services An Industry Consultation Paper

The Hong Kong Democratic Foundation (HKDF) is pleased to tender its comments on the Third Generation Mobile Services consultation paper by the Telecommunications Authority (TA).

We are confining our comments to only the economic issues of licensing Third Generation Mobile Services (3G).

With reference to paragraph 3.8, we agree that current 2G service providers that are not successful in securing a 3G license in the forthcoming allocation exercise should have the opportunity to evolve their 2G networks to 3G when suitable equipment becomes commercially available. However, since we are most strongly of the opinion that 3G licenses should only be issued through a tendering system, we propose that 2G service providers that fail to secure a 3G license should only be allowed to evolve their networks to 3G upon payment of a premium. This premium should be levied by a broadly similar mechanism to that which the government uses for the variation of land leases. The premium should reflect the market value of 3G license rights as at the time of the relevant negotiation.

We agree with the proposal in paragraph 4.3 that the introduction of new entrants, in addition to current 2G and landline service providers, will be beneficial to market development and to consumers.

As far as paragraphs 4.13 and 4.14 are concerned, we most strongly disagree with the TA's proposal to select 3G licensees by evaluation based on merit. We believe this conclusion has been reached based on a total misunderstanding by the TA of the economic drivers of this type of service provision and that the arguments put forward in paragraph 4.12 are entirely without justification and merit. Our rebuttal of these arguments is set out below.

Paragraph 4.12(a)

Spectrum auctioning might increase operating costs, but only to the extent of the interest charges on any additional bank financing this process might necessitate a service provider having to secure. However, in a market environment where there is no monopoly and keen competition prevails, service price is determined by market forces and not the cost base. This has been clearly demonstrated by the experience of service prices for the existing mobile services.

The argument that additional high entry cost necessitated by an auction process would have a serious dampening effect on the rollout of 3G services is a completely specious one. The motivation and incentive on licensees would be to secure a return on their investment as early as possible by establishing their services as quickly as possible and as attractively as possible to potential consumers. This is how the free market system operates.

Paragraph 4.12(b)

Firstly, we highly recommend that bidders in any auction process first have to pre-qualify by setting out the services they would propose to offer and demonstrating the availability of adequate financial resources to provide these services. Only those candidates that met suitable criteria would be allowed to enter the bidding process.

With regard to the question of domination of the market by a small group of companies, as long as this does not come about through anti-competitive practices, there is no reason for this to be regarded as an undesirable situation. If there was provision in the license allocation process to ensure awards to smaller operators, it is inevitable that these would be bought out by large companies and probably within quite a short period of time. Recent developments elsewhere in the world regarding mergers in the telecommunications, IT and entertainment industries clearly indicate that these are businesses that by their very nature can be best sustained over the long term by extremely well funded organizations.

Paragraph 4.12(c)

If pre-qualification to a set of suitable criteria is a pre-requisite to entry to bidding, then it should be possible for the TA to ensure through this process that auction participants are likely to be serious operators rather than license speculators. Irrespective of this, the market place is an arena where goods and services are traded, therefore the trading of a 3G license, rather than development of service, by the initial licensee should not be seen as negative.

Furthermore, it appears to be well accepted in this industry that there are considerable benefits to be accrued to those that can provide new services quickest, therefore slow roll-out of services is unlikely to be a real issue.

If a licensee were to bid too much and be financially unable to proceed with the provision of service, either in the short or medium term, provided there is sufficient demand for 3G services, there is unlikely to be a shortage of candidates to pick up a license at a discount. If there is not sufficient demand for 3G services then it will not matter if that particular license is not used.

Paragraph 4.12(d)

The extent of development of the next generation of telecommunications and Internet services will be dependent on technological innovation and market demand, not on any pre-judgement by the TA on investment risk analysis. Please see our comments in the paragraphs below, which are also pertinent to the rebuttal of paragraph 4.12(d).

By way of further rebuttal of the TA's arguments in paragraph 4.12, we would refer you to the articles by Mr Simon Pritchard in the March 2000 Business News section of the South China Morning Post and Mr Jake van der Kamp's Monitor columns in the 29th April and 6th May 2000 Business News section of the South China Morning Post.

HKDF Comments in Support of Award By Auction

The spectrum for wireless telecommunications is a limited asset, which is held by the Hong Kong Government on behalf of the community. It is therefore the Government's obligation to ensure that this asset is used in the best financial interests of the community as a whole, just as it does in the case of land. It would not be in the community's interest for this asset to be given away free of charge. This is not the Government's view as far as land is concerned, therefore there is no logic as to why it should be its view as far as the spectrum for wireless communications is concerned.

The operating costs of wireless communications services are relatively constant irrespective of the number of users. Therefore profitability is driven by market share and market share by price and/or attractiveness of content. This has two implications, investment cost (license cost and infrastructure cost) is not a major determinant of service price charged and innovation is bound to be an important factor in market share acquisition.

It should also be taken into consideration that, compared with landline telecommunications services, which are almost essential to social and economic development and the current generation of wireless services, which provide an important convenience that in turn brings economic benefits, 3G services are more of a "premium" rather than an essential service. Therefore 3G services will be more price inelastic and thus service innovation rather than low pricing is more likely to drive market share.

When wireless telephone services were first introduced into Hong Kong, no one would have predicted that penetration would reach more than 50% of the population, as is the situation now. This was the result of rapid technical and service innovation. The same scenario is likely to be played out with 3G services and certainly the example that innovation will lead to increased market share is already there for all successful licensees to continue to follow. 3G license fees, that in today's terms might be perceived as expensive, are more likely than not to be seen in five years time as having been cheap, as a result of the innovations that will take place between now and then.

Other Comments

No company or related company should be allowed to hold more than one 3G license.

Summary

The HKDF is of the very strong view that the wireless spectrum is a valuable and limited public asset that should not be given away free of cost.

The HKDF emphatically supports the allocation of 3G licenses through an auction system similar to that used by the United Kingdom, with potential bidders first having to pass a pre-qualification process. Using the recent United Kingdom auction as a benchmark, we would estimate that such an auction for 3G service provision in Hong Kong would generate between HK\$15 billion to HK\$30 billion for the public purse.

While agreeing that existing 2G mobile operators that fail to gain a 3G license be allowed to evolve their networks to 3G, when this becomes feasible, they should be charged a suitable premium.

Yours faithfully,

G W H Cautherley
Vice Chairman