

How interesting that Hutchison managing director Canning Fok Kin-ning thinks we should not auction third generation (3G) mobile phone licences here when he has been happy to pay the equivalent of HK\$54.1 billion for such a licence in Britain.

“Operators would incur higher operating costs by auctioning,” he says. “The cost would eventually be transferred to consumers in Hong Kong.”

Think about this. Let’s say you are a distributor of mobile handsets that you retail for \$125 apiece and the manufacturers have just raised your cost to \$150 from \$100.

You are stuck. You decide to keep your price at \$125 for the time being to maintain market share but you now lose \$25 for every handset you sell.

You soon ask yourself what good this does you. You are impoverishing yourself, you are dissipating capital that you could put to better uses and your market share gains won’t last anyway when you inevitably raise your price above your \$150 cost.

So you soon do the obvious and pass your costs on to consumers by raising your price.

This is not the way things work when you operate a mobile phone network, however. In a network all your costs are sunk before the first user puts a call through your system.

You start by spending a lot of money getting a network licence, building it out with all its cell stations and fancy equipment, telling people that you have a new network and inducing them to sign up with you.

But once you are up and running your operating costs are minimal. You pay a little for promotions, for the electricity your system uses, for equipment maintenance and for administration. That’s about it. Most of the administration work is actually done by computer.

What is more, even these operating costs do not change with the number of users you have signed up. They are what it costs to run a network irrespective of how many people use it.

Now let’s say you have calculated that you can get an average of \$300 a month per user if you charge \$1 per minute and you need \$30 million a month to break even. This works out to a target of 100,000 users.

Then you find that you are not getting your 100,000 users. They have instead gone to networks that charge them less than your \$1 a minute.

But the equation this time does not say that you will lose 20 cents for every minute of usage time if you drop your charge to 80 cents from \$1. This is different from the distributor whose costs vary with his sales.

Your costs are fixed. The marginal operating cost to you of people using your network is virtually nothing. Every dollar you take in helps you get to that \$30 million a month you need to pay interest and all your other fixed costs.

Your obvious solution in this case is to reduce your charge and, if your competitors respond by reducing their charges, you drop yours again. Unlike the scenario for the distributor your costs do not change with the amount you sell. All that matters is getting the money through the door.

And this is why Mr Fok and our telecommunications regulators who wish to give away 3G licences for free are wrong.

The auction costs of these licences will not be passed on to consumers. That is not the way the economics of this business work.

Networks can only charge what the market will bear. If usage is less than network capacity that charge will be low. It will only go up if demand exceeds capacity. Then the networks will have the upper hand.

It will make no difference to the usage charge whether the licences are auctioned or given away. If networks pay more for their licences than they can recoup it will be their bankers that suffer, not the man on the street.

The only difference is that our government will shortchange itself if it gives away this precious public asset.