

# Submission for the Consultation on Licensing Framework for

## Third Generation Mobile Services

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Dear Mr. Wong,

As a stockbroker, I have had the recent pleasure of hearing two managing directors of existing GSM operators in Hong Kong describe the G3 spectrum here as a license to print money. I am hardly surprised industry operators sing the praises of "beauty" parades. Indeed, I again read in The SCMP that Canning Fok once more cites Hong Kong's "unique" characteristics as making a beauty parade the right way forward for us. I wonder what these unique features are.

Both of you repeat the belief that "sunk" costs have an impact on operating costs. You state, once again, that the price paid by bidders for spectrum affects the subsequent cost of services to the consumer. I am afraid sir that this is complete and utter "tosh".

Let me use some "real" numbers to illustrate the point. Let us first establish the level of revenue that generates an approximate economic break even return for a Hong Kong license and a UK Group 3 winner. Using a 60% penetration rate in Hong Kong and a 50% penetration rate in the UK, with a 10% cost of capital, the total system build out costs in Hong Kong would require annual revenue of HK\$ 200 per subscriber and HK\$ 1600 per subscriber, in The UK, for an operator with a 20% market share. The build out costs are based on local industry estimates of US\$ 200 million for a network in Hong Kong and a total of 7 billion pounds for the TIW UK license and network. I do not believe that the price of services in the UK and Hong Kong will be materially different in five years time, let alone 8 fold different

Your comment that the price of build out directly increases the preparedness of the users to pay more for the same service is mere eccentricity. If an unsuccessful football team pays US\$ 50 million for Ronaldo do they then hike entrance fees by sufficient to generate US\$ 5 million per annum, irrespective of whether their existing 5,000 spectators want to pay their new price ?. The US\$ 5 million, by the way, represents an economic breakeven on the investment at a 10% cost of capital. No. It is a sunk cost. They charge what the market will bear to maximize revenue. Indeed, the presumption that an operator's sunk costs increases my willingness to pay more for the same service is an economic belief that is, at best, odd. I do not suggest you, or Mr Canning Fok, attempt to build

careers as football club managers

The club will not hike entrance fees until the stadium is full. It will then raise prices. If the club becomes very successful, because excess returns on the Ronaldo investment enable them to buy more good players, I can generate further excess returns on capital by filling up a new big stadium. I will put extra capital in to expand my capacity.

This is not possible in the mobile world. Capacity is fixed. The economic rationale for auctioning spectrum is to confiscate the likely excess returns on capital which may accrue if demand is in excess of break even returns on capital. A mobile operator cannot build a bigger stadium.

Fundamentally, you seem to believe that the marginal cost of delivery of airtime exceeds the propensity to use air time while the spectrum, even at 3.00 AM, has spare capacity. There is no economic reason to believe that there is actually any marginal cost to delivery of networked spectrum in the first place.

Indeed, this apparent belief is not reflected by the observed facts of the success of the capitalist world's use of spectrum auctions. If the demand curve were dependent upon the sunk costs of the network the auction process could not even work. As bids rise, my sunk costs, or your "operating costs", would rise and hence the price of airtime, according to you, also rises. As my prices rise, demand would actually fall, according to more conventional economics, and my valuation model will never generate higher revenues. This is reinforced by the obvious point that the revenue model for the entire group 3 GSM market in The UK was the same at the end of 150 rounds of bidding as it was at the start of the auction.

The other points that you seem to believe give a beauty parade a preference over auctions are not valid either. Your consultation document states that free licenses facilitate build out rates. Nonsense. Canning Fok is quoted on page 29 of to-day's Financial Times as saying that their group 3 operation will be up and running by late 2001 in Britain. You also seem to believe that you have some great perceptive superiority in granting yourself the right to foresee the future better than anyone else. You will be the judge of who will provide the most innovative services for the next few decades. In an era of mergers and acquisitions your foresight is inspiring to us lesser mortals.

If the above points, all of which have been raised for Years in other jurisdictions, bore you, so be it. I would make the truly unique point. The absence of a transparent auction based mechanism, if Hutchison and Richard Li controlled HK Tel are awarded licenses their will be an international outcry which makes the Cyberport and The North Point Cruise Terminal arguments mere sideshows. The international investment community will make its final judgement. It will irreversibly decide that we have become smoothly and fully integrated into the Mainland way of doing business.

Stephen Brown