

ATUG Opinion 17 Aug 05 – Bottleneck assets

ATUG has been following the debate this week over the implications of Telstra's falling revenues from traditional public switched network services (PSTN), including Telstra's preposterous suggestion that the regulatory framework be adjusted to protect Telstra's revenues.

The decline in PSTN revenues has been long forecast and is the reason that other integrated telcos invest in product diversification (broadband) and market diversification (offshore). Even so, Table 1 shows that Telstra's PSTN revenues have only declined about 3.5% in the most recent year, the only year of net decline. History is very instructive when faced with ad-hockery and confected hysteria.

Regulation is being reviewed in the United States, but this overhaul, which Telstra might wish to take as a model for Australia, is occurring in an environment where there is very significant competition between copper and cable networks for PSTN and substitutable services. This is a very different situation to Australia, where Telstra also controls the cable networks in most markets.

Table 1.

	2005	2004	2003	2002
Access				
Line rental revenue	3362	3237	3091	2880
Services in Operation				
Retail	8.05	8.44	8.75	9.07
Wholesale	2.07	1.84	1.56	1.33
Total	10.12	10.28	10.31	10.4
Price per line	332.2	314.8	299	277
Call services				
Local revenue	1284	1504	1567	1643
Local calls	8469	9397	9794	10269
Price per call cents	15	16	16	16
National LD Revenue	1013	1121	1162	1216
National LD Minutes	7743	8520	9161	9170
Price per minute cents	13	13	12.7	13
IDD Revenue	234	266	307	336
IDD Minutes	580	651	740	781
Price per minute cents	40	41	41	43
Fixed to Mobile Revenue	1566	1597	1517	1419
Fixed to mobile minutes	4375	4226	3944	3691
Price per minute cents	35.8	37.8	38.5	38.4
Total PSTN revenue	7709	7984	7916	7755

Even this modest decline in revenue can be attributed in significant part to Telstra's own strategies to migrate customers to more profitable products, such as mobile telephones. Telstra's Financial statements identify all revenue declines in the PSTN as attributable either to migration to new services, or to competitive pricing pressures (see box – the emphases are added by ATUG). Both of these trends are the intended outcomes of a competitive market and benefit the Australian economy.

"Total PSTN products revenue declined by 3.4% or \$275 million.

An increase in basic access revenue was due to previous rebalancing initiatives, offset by a decline in basic access lines and volume reductions across local calls, international direct and national long distance products. The local calls yield has also declined due to competitive pricing pressures and package discounts. Continued growth in fixed to mobile volumes has been offset by competitive pricing pressures, particularly in the business market.

Basic access retail revenue has increased due to a price increase in June 2004 as part of the rebalancing initiatives, offset by a decline in the number of basic access lines due to competition and migration to other products such as ISDN, broadband and mobiles.

Basic access wholesale revenue growth was due to an increase in the number of access lines due to churn from retail as well as price increases as part of rebalancing initiatives.

Local call revenue declined mainly as a result of the 9.9% reduction in the number of calls due to **product substitution to mobiles, fixed to mobile and internet products. The yield has declined in the consumer market as a result of higher package discounts and free call offers, with an acceleration of these discounts in the second half of the year.**

The yield has also declined in the business market due to competitive pricing pressures and in the wholesale market due to increased volume discounts. Customer churn to wholesale has also contributed to a lower yield.

The reduction in national long distance revenue was attributable to the 9.1% decline in call minutes due to shorter call durations **and product substitution to mobiles, fixed to mobile and internet products.** Yield also declined slightly due to increased use of capped calling rates and competitive pricing pressures, partly offset by flagfall increases.

Fixed to mobile yield has decreased due to increased competitive pricing pressures in the business sector, **offset by a higher yield in the consumer market due to flagfall increases.** This was offset by a 3.5% **increase in volumes** due to the continued growth in the number of mobile services in the Australian market.

The International direct revenue decline was mostly due to the reduction in minutes of 11%. This reduction was due to the continued migration to aggressively priced prepaid calling cards and customers using **other products such as e-mail and internet chat facilities.**"

It should be no surprise if customers think line prices are too high, and that PSTN call services are still too expensive. Telstra acknowledges that consumers are voting with their feet - to other products in Telstra's product range, giving an increase in overall sales revenue driven by mobiles and internet to \$22.6 billion.

The Australian Communication Authority's *Telecommunications Report 2003-2004* says (p.24):

“Similar to 2003, most household and small business respondents believe that they are paying too much for line rental. In 2004, 67% of household and 65% of small business respondents thought that line rental was too high. The survey was conducted before the Telstra initiated line rental increases were announced.

In 2004, approximately one-third of household respondents thought that prices were too high for local calls (35 per cent), national calls (37%) and international calls (35 per cent) which is unchanged from 2003. Similar views were expressed by business respondents that prices were too high for local calls (34 per cent), national calls (39 per cent) and international calls (33 per cent).”

The real problem that Telstra identifies is that profit margins in these competitive products do not match the monopoly margins that Telstra has traditionally enjoyed as a feature of the local access network – precisely the reason that the local access network is regulated in the first place.

Local access regulations should indeed be reviewed – but in order to ensure better competition, not to protect Telstra’s PSTN revenues.

Total PSTN revenue increased in the three years from 2002 to 2004, until the first decline in 2005. The increase was supported by the price increases in line access rental that are allowed under the Price Control regime. In principle, line rental increases are to be offset by decreases in call prices, but because the line rental increases at 4% compound, the offsetting call price decreases become relatively smaller each year.

Overall it seems residential and small business users are in fact paying more - and liking it less! This effect is shown by the ACCC Annual Report on changes in prices paid for telecommunications services in Australia 1997-98 to 2003-04. Table 1A shows that residential and small business users paid increased charges in 2003-2004 for the total PSTN package of basic access, local calls, national long distance, international calls and fixed to mobile calls.

Table 1A Percentage changes in the PSTN price indexes by service and consumer group

	Residential		Small business		Other business		Overall	
	2003-04	since 1997-98	2003-04	since 1997-98	2003-04	since 1997-98	2003-04	since 1997-98
basic access	7.3	84.4	7.7	54.2	3.7	38.7	6.8	70.5
local calls	-3.8	-37.3	-3.0	-31.6	-1.6	-45.3	-3.3	-39.2
national long distance	0.8	-25.8	5.3	-20.8	-14.8	-50.6	-1.9	-32.2
international	-5.8	-61.3	-4.4	-69.5	-6.8	-72.6	-5.7	-63.9
fixed-to-mobile	0.1	-13.2	1.4	-23.0	-8.5	-37.8	-2.2	-24.4
Overall	1.4	-11.3	3.1	-11.4	-5.6	-34.6	0.2	-17.9

Source: data supplied by Telstra, AAPT, Primus, Optus (except 2001-02 data, which was excluded from the index) and (until 2000-01) One.Tel.

Telstra has expressed the objective of becoming the most profitable telco in the world. Telstra is already one of the world's largest and most profitable telcos, 19th by revenue, 11th by net income. The world's largest carrier (NTT) is six times Telstra's size by revenue, but only 2.5 times Telstra's size by net earnings.

Telstra's real problem with the PSTN pie is not so much that is shrinking, but that there is less cream on the pie. Bottleneck PSTN assets attract monopoly rents, which demand regulatory intervention to secure efficient outcomes for consumers. Bottleneck assets owned by a vertically and horizontally integrated telco create unique problems of regulatory design. For Australian telecommunication users, this is the core debate in Canberra at the moment.