



SPC Network



PAST



PRESENT



FUTURE

**30 YEARS AFTER PRIVATISATION:
IS THE TELECOMS MARKET WORKING?**



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About SPC Network

SPC Network was founded in 2003 and has worked for over 30 clients worldwide. We undertake Strategic Policy Development for clients in networked industries, by combining the knowledge of our consultants with specific and valuable skills to ensure rigorous analysis and exceptional advice. Our core consultancy team and network of partners have substantial experience in industry and consulting and so we understand the practical issues and challenges facing the market. Through advanced academic training, we have developed the key skills and rigorous approach needed to support our clients win the policy debate.

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This report has been commissioned by UKCTA and has been prepared by SPC Network. The various member companies of UKCTA each have their own corporate views on the subject matter and while in general terms most support the conclusions of this report, they represent a range of viewpoints and it cannot be assumed that all UKCTA members support every aspect of the report.



TABLE OF CONTENTS

FOREWORD

ENABLING INNOVATION FOR ENTERPRISE CUSTOMERS 1

(Prepared by SPC Network Ltd)

EMPOWERING CONSUMERS THROUGH DISRUPTIVE TECHNOLOGY 4

(Prepared by SPC Network Ltd)

ENSURING SERVICE QUALITY: TIME FOR A CHANGE IN APPROACH? 8

(Prepared by Webb Henderson)



Enabling Innovation for Enterprise Customers

Companies and public sector organisations in the UK collectively spend around £16 billion per annum on fixed and mobile services. Communications technology is essential to their operations: it provides the main means of trading with suppliers and customers around the world to expand their businesses and contribute to economic prosperity.

However, despite their size and importance, business connectivity markets have been something of a regulatory Cinderella as the policy focus has been on residential broadband. To give just one example, Ofcom has produced Consumer Experience Reports annually since 2006, but has only produced two Business Customer Experience reports in 2009 and 2010, and even these were mainly focused on consumer broadband used by businesses.

“Customers have to suffer slow delivery and we are perceived as inefficient.” *(SME manufacturer of educational games)*

The digital economy offers new and exciting opportunities for public and private organisations of all sizes to innovate, to expand their market and

to work more efficiently. Without an appropriately configured communications infrastructure, however, the opportunities of the digital economy are beyond the reach of many organisations. To take advantage of these opportunities, users of communications technologies have some clear needs:

- **Security** is crucial, especially given the trend towards cloud computing.
- **Seamless access** at high and reliable speeds from a variety of sites and devices.
- **Quality of Service (QoS):** The availability and adherence to very high Service Level Agreements are a top priority for enterprises.
- **Bandwidth:** sufficient and flexible bandwidth to support their requirements.
- **Platform integration:** Corporations are demanding that their various communication service platforms, fixed and wireless, are integrated seamlessly, and that interoperability across platforms should be supported.

The current state of enterprise communications availability makes flexible, national and international network configuration and the integration of advanced IT

“We can’t use DSL-based broadband services because the repair time on broadband access is woeful and so we have to buy leased lines to ensure the repair times we need.” *(Merchant acquirer)*



capabilities into enterprise networks extremely complex and resource-intensive.

The overall challenge for suppliers of communications to enterprises, therefore, is to meet these rapidly changing needs. This in turn requires a market that functions well: allowing suppliers to provide innovative products, services and price structures. However, there are several problems with the supply side of the market today that make it difficult for communications providers to meet this challenge. Particular problems include:

- Inconsistent availability of services and bandwidths;
- Innovation and differentiation are constrained by lack of access to infrastructure resulting in 'me too' competition;
- Little opportunity to create pricing structures that reflect customer value rather than the cost of wholesale inputs.

The overall picture for business customers remains inconsistent: in some areas the UK is better than many of its international competitors but it still lags behind on a number of indicators: for example, the UK has amongst the highest prices for leased lines in the G7 group of industrial economies. Satisfaction levels are also mixed, with sizable minorities of businesses dissatisfied with the current maximum speed of broadband access and with the fact they do not even get the speed of access they paid for.

Over 80% of private sector employees and businesses are unable to obtain business communications services based on competitive access for anything other than

“Who cares about small towns? The priority is highly populated areas – the smaller towns suffer” (*Regional publishing company*)

residential-style broadband products. These companies exist in something of a postcode lottery, where access can be obtained in

some towns and cities but not in others. Our research found that, even within towns, access speeds tend to be higher in the town centre than on business parks.

One cause of these problems is that Ofcom has a regulatory bias towards residential markets and does not give the same degree of attention to business markets. For example, Ofcom has taken very different approaches in the Wholesale Broadband Access market review and the Business Connectivity Market Review. Ofcom's regulation of wholesale broadband has largely set the pace for other EU countries. Ofcom was the first regulator to introduce geographic markets following the success of Equivalence of Input in driving the take up of Local Loop Unbundling (LLU), which addressed the underlying structural problems in the market and so created the conditions under which



competitors could challenge BT's position. By 2013 approximately 90% of UK households are in unregulated wholesale broadband markets due to competition in local exchanges.

By contrast, Ofcom has taken a very conservative approach in the business connectivity market. The underlying structural causes of market asymmetry have not been addressed and Ofcom seems to be regulating to maintain, rather than challenge, the status quo. It has been too quick to dismiss new remedies to change the structure of the market, which would help address many of the issues raised in this report.

To allow communications providers (CPs) to overcome the market problems identified above and meet the evolving demands of private and public sector organisations, we propose that Ofcom should allow regulated access to BT's passive infrastructure in order to stimulate competition in downstream, active markets. Ofcom should not, as it does now, restrict the uses of passive inputs to specific purposes. Two UKCTA members, KCOM and Virgin Media, have different views on the need for passive infrastructure access and have set out alternative proposals to promote investment and innovation.

Our proposals would have three key benefits:

- i) They would allow and incentivise CPs to become innovative and respond to customer needs by setting their own service parameters that are independent of those supplied by the Significant Market Power (SMP) operator.
- ii) They would promote pricing innovation as CPs could de-couple retail prices from wholesale costs. They would then be able to set prices according to customer value.
- iii) They would lead to improved Service Level Agreements as CPs would not be dependent on the service quality provided by the SMP operator.

Regulated access to passive infrastructure would be an exact parallel to LLU access and could allow the business connectivity market to replicate the dynamism of today's residential broadband market based on local loop unbundling and independent competition from other non-BT networks. It is now time for Cinderella to go to the ball.



Empowering Consumers through Disruptive Technology

In the 30 years since BT was privatised, and the ten years since Ofcom became the sector regulator, the UK communications market has evolved rapidly. In 1984 there was a single supplier and a single service. Today there are myriad suppliers offering a plethora of services. The consumer in 1984 was unused to competition and choice in communications services, whereas her counterpart today is empowered with choice between suppliers and services. However, much of today's telecoms policy concerns consumer protection, with an apparent underlying assumption that all consumers are vulnerable and unable to operate in competitive market.

This report explores the extent to which the empowered consumer in the second decade of the 21st century needs protection in the modern telecoms market.

Consumers are empowered when three conditions are met:

- i) They have choice between alternative products and suppliers;
- ii) They have the ability to exercise that choice, for example through well designed switching processes; and
- iii) They have access to the necessary information with which to make an informed choice.

Consumer protection, on the other hand, seeks to prevent harm from happening whether or not the consumer is prepared to switch but, should a consumer suffer harm, for example from excessive pricing or unfair contract terms, they can seek and claim redress.

In the past 30 years, Ofcom and its predecessor, Oftel, have introduced a number of measures to introduce competition in most areas of the market, where appropriate, in line with its obligations under the Communications Act 2003. The UK broadband market, which is the primary focus of this report, is amongst the most competitive in Europe and the OECD. Most consumers have choice between alternative products.

Consider the question of information about products, for example. Here individual suppliers and commercial organisations already provide most information a consumer needs either voluntarily or through a self-imposed code of practice. Consumers can, for example, find information about speeds and switching processes from suppliers' websites and a number of price comparison services (e.g. Moneysupermarket.com) exist to provide further information.



Despite the market already providing substantial amounts of information to consumers, Ofcom has taken an active role in providing such information, even though its own research has found that accreditation of price comparison websites does not resonate significantly with consumers who do not know about Ofcom or its role.

It is not clear that initiatives of this kind have been very successful. Ofcom's own research also shows that levels of consumer engagement have not greatly increased over time. In fact our research for this report suggests that consumer switching, a strong measure of consumer empowerment according to Ofcom, is more closely correlated with changes in broadband access technology (from narrowband to broadband to Next Generation Access) than it is with information remedies. This is reflected in the fact that the level of consumer complaints about communications services today is very low: Ofcom receives about 0.2 complaints per 1,000 broadband customers and a similar proportion about fixed lines.

All of which suggests that Ofcom might do less to promote switching when many consumers are satisfied, and more to promote the kind of innovation that drives major changes in the choices available to consumers and businesses.

Finally, this report suggests that Ofcom is now too quick to impose a sector-specific consumer protection measure, often using the General Conditions (GCs). Further, as consumers increasingly purchase services in bundles, the GCs may not longer be fit for purpose and cause confusion. In many cases the problem the measure is designed to address could be better solved by more competition or the application (by Ofcom) of consumer protection powers under general legislation.

In a monopoly market, or where there are high barriers to switching between suppliers, one would expect a lot of regulatory focus on consumer protection. For example, 30 years ago one of the regulator's main tasks was to control retail prices and to 'hold the fort' until competition arrived. As the market evolves towards competition one would expect the need for sector-specific consumer protection measures to reduce and for the general consumer protection law to be more useful. Ofcom already has powers under the Unfair Terms in Consumer Contracts Regulations 1999 to investigate breaches of the regulations. It is also a designated enforcer of the Consumer Protection from Unfair Trading Regulations under the Enterprise Act 2002.

In the light of the analysis above, we propose first that Ofcom should undertake a thorough review of the GCs to ensure it remains fit for purpose. Once this review is

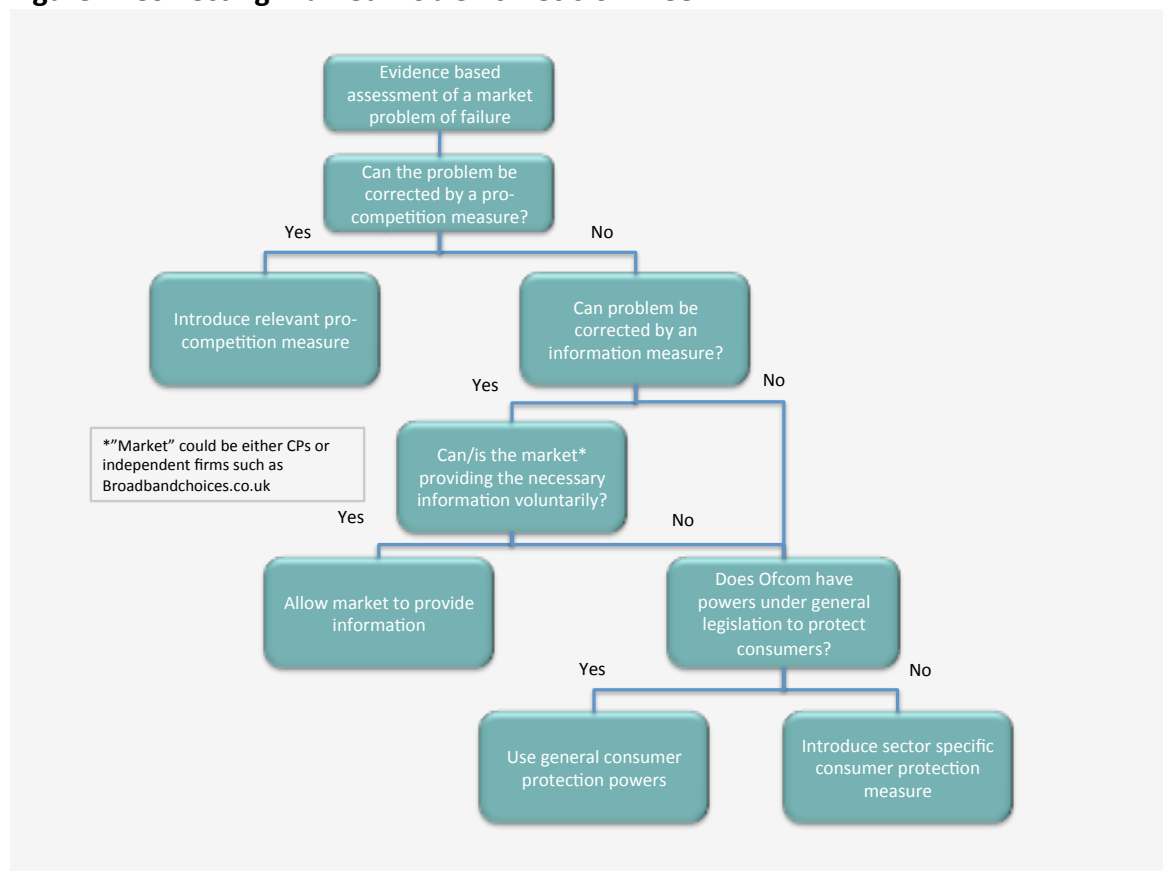


completed then, when an evidence-based assessment identifies a problem or failure in the market, there should be a three-level hierarchy for correcting that problem:

- i) Introducing a pro-competition measure should be the first choice.
- ii) Providing the consumer with information and or facilitating switching should be chosen if additional measures to promote competition cannot be introduced.
- iii) Consumer protection should only be used if neither competition nor consumer empowerment can correct the problem.

We set out below a decision tree that could be adopted to determine which is the best form of intervention to correct a problem.

Figure 1: Correcting Market Problems Decision Tree



At the start of the decision tree is an evidence-based finding of a problem or failure in the market that is negatively affecting consumers. The first question to be addressed is whether that problem is a result of a lack of competition or consumers' inability to take advantage of the competition that does exist. If the former, then Ofcom could correct that by introducing a pro-competition measure, where appropriate, in line with its



obligations under the Communications Act 2003. Ofcom should accept that markets rarely work perfectly, but provided competition is effective then the market will function in the interests of consumers.

If a pro-competition measure is not appropriate or could not correct the problem, then Ofcom should proceed down the right hand side of the decision tree, starting with whether information or facilitating switching would be the correct approach. If these would be right and the market could resolve the problem without Ofcom, then Ofcom should allow that to happen or consider incentives to encourage the market to behave in such a way. If such incentives are not feasible, then Ofcom could become directly involved, either by providing information or reducing switching costs.

If an information measure could not resolve the problem, then Ofcom could use a consumer protection measure, but should prefer to use its powers under general consumer protection legislation rather than introduce a sector-specific measure, such as a General Condition.

When introducing a new information or consumer protection measure, Ofcom should always justify why either a pro-competition or information measure respectively is not appropriate.

We believe that if Ofcom were to follow this approach, its actions to empower and protect consumers would be more effectively targeted and therefore more likely to be proportionate to the problems it identifies.



Ensuring Service Quality: Time for a Change in Approach?

Good quality of service is critical to consumers and businesses and affects competition within UK communications markets. A delay in a telephone or broadband line being installed or in faults being repaired can be a huge inconvenience to consumers and businesses and can also deter switching, in turn undermining the benefits of competition. Poor quality of service has knock-on effects on UK businesses and can impact on the competitiveness of UK businesses (see accompanying Business Services report). Both businesses and consumers in the UK are currently being poorly served from a quality of service perspective. This is largely down to Openreach as most communications providers (CPs) are entirely dependent on Openreach in respect of the quality of service experienced by their customers.

Openreach has an extremely poor record of meeting its current service targets. For example:

- Over a period of almost five years (Aug 2009-June 2014) Openreach has never met its Shared Metallic Path Facility (SMPF) right first time targets;
- Over the period July 2009 –June 2014 Openreach has never met its Wholesale Line Rental (WLR) right first time targets;
- Over the two years from June 2012 to June 2014 Openreach only met its right first time targets for Metallic Path Facility (MPF) in 2 separate months;
- For more than 2 years from April 2012 to June 2014 Openreach has not met its targets for on time Ethernet provisioning;
- For almost five years (August 2009 to June 2014) Openreach has never met its targets for Local Loop Unbundling (LLU fault) repair; and
- For the same period (August 2009 to June 2014) Openreach has never met its WLR fault repair targets.

As evidenced above, Openreach's service performance in recent years has been consistently poor. It is clear that existing mechanisms for incentivising Openreach to deliver a good quality of service are not working effectively. Given Openreach's position in relevant markets, other CPs and their customers are unable to respond to Openreach's poor service by moving their business. In the absence of true competition, Ofcom must be more robust in tackling quality of service issues in order to replicate competitive outcomes. As it stands today, customers who are willing to pay more for an enhanced quality of service have only limited options available or, where it is possible to pay for enhanced service levels, are forced to pay significant and uncompetitive costs.



Given all of these issues we recommend the following:

- Clear and explicit guidance from Ofcom on what constitutes a fair and reasonable Service Level Agreement (SLA) and Service Level Guarantee (SLG) and potentially an enhanced role for the Office of the Telecommunications Adjudicator (OTA2) in the negotiation of SLAs and SLGs;
- Additional measures to ensure that Matter Beyond Our Reasonable Control (MBORCs) are used appropriately;
- A firm commitment from Ofcom that it will use its enforcement powers (including imposing penalties) if Openreach's service performance continues to fall below minimum standards;
- A review of the existing price control framework with a view to incorporating mechanisms in order to incentivise Openreach to maintain/improve its quality of service, drawing on experience in other regulated sectors;
- A review of the range of service options provided by Openreach and the pricing of these options, with a view to ensuring that consumers who are willing to pay more for an improved quality of service are able to do so at a price which reflects the costs of provision; and
- Publication of data in relation to complaints about Openreach's services.

Each of these recommendations should be adopted across all appropriate markets with a particular immediate focus on services utilised by business customers.

While we acknowledge that Ofcom has begun to give enhanced scrutiny to quality of service issues with its recent findings in the Fixed Access Market Review (FAMR) (see Section 5) and that these are useful first steps, there is more that needs to be done to address the problems identified by Ofcom and industry stakeholders – particularly in relation to services purchased by UK businesses. In this regard, we urge Ofcom to take the opportunity afforded by it in relation to the Business Connectivity Market Review (BCMR) and welcome Ofcom's call for inputs on the quality of service issue.

Finally, we observe that stakeholders have experienced a substantial regulatory lag between the time service levels started to deteriorate and the time Ofcom released its conclusions in the FAMR. Sky first raised Openreach's deteriorating quality of service with Ofcom in June 2010 and continued to raise the issue with Ofcom until 2012 when they formally raised a dispute on SLGs. Despite, therefore, being aware of quality of service issues in relation to LLU/WLR it has taken Ofcom almost four years to tackle these issues in the recently concluded FAMR. As such, we urge Ofcom to:



- Proactively monitor Openreach's performance and to recognise that quality of service is an on-going problem and cannot be left to periodic reviews of the relevant markets; and
- Recognise that poor quality of service affects products in a range of different markets utilised by business and consumers, not just the markets for LLU and WLR services which Ofcom has recently begun to address in the FAMR. This is particularly relevant as Ofcom commenced the initial stages of its review on the Business Connectivity Market in March 2014¹ and is not scheduled to publish its final statement concluding the review and imposing any remedies until February 2016. This creates a risk that the Business Connectivity Market may suffer from on-going quality of service problems until the review is completed in two years' time.

Ofcom and industry stakeholders have taken substantial strides to address market access issues in the telecommunications markets over the last ten years but quality of service remains a critical piece in the regulatory puzzle. Quality of service is complex and covers contractual and market power issues. However, we urge Ofcom to continue to focus on quality of service to help enhance the customer experience and to continue the successes on competition that Ofcom has achieved to date.

¹ Ofcom, *Business Connectivity Market Review*, 1 April 2014, available here: <http://stakeholders.ofcom.org.uk/consultations/business-connectivity-market-review/>



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