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Why Preserving Telecommunications Competition Requires and Alternative Future

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Good afternoon.

Thank you, Shaun and thank you, Johnny for that very kind introduction. It's great to see such a large turnout. Thank you very much.

As I take on the Chairman role at Optus, I want to talk to you about three things I think are important:

- First, I want to give you a glimpse of Australia's future by looking at how "Digital Natives" use communications.
- Then I want discuss the implications for Australian business and the economy: both opportunities and threats.
- The third thing I want to argue that all of this is at risk: A perfect storm of public pressure to deliver on the NBN rollout. This is a storm that is a result of the confluence between the electorate's impatience and desire to see NBN rolled out and some very clever leveraging by the incumbent of its power. That is creating what I describe very soberly the biggest risk to telecommunications since it was introduced in 1992.

Now at Optus we don't just say "Yes", we actually propose solutions. That's what 'Yes' stands for.

So I am also going to outline the three reform that we believe are essential to get that competition moving forward.

So let me begin let me talk about what we call 'A Window Into the Future'.

A Window Into Tomorrow:

Now I have been around a while. Shaun mentioned that I was CEO for nearly eight years. And prior to that I ran the Mobile business.

So it astounds some of our younger staff when I say that almost fifteen years ago, you couldn't send SMS between carriers; and they don't believe me.

In fact, I can remember the specific conversation where the three CEOs of Optus,

Telstra and Vodafone first agreed to turn inter-carrier SMS on.

So we flicked the switch: and we sat back and nothing happened.

We looked at it and scratched our heads. We were all a bit taken aback so we did a bit more digging and we discovered that it had taken off in the under thirty cohort.

So we got our marketing people to do a bit more research into this; to say OK what it is about these people in their thirties that we can spread to the rest of the base.

And marketing people being very good at spending money spent a fortune looking at this.

While they were still doing the research it took off everywhere else – it basically went viral.

As the under 30's sent texts to their parents and work colleagues, this new superior way of leaving messages just took off. At its peak in 2012, Optus customers sent 23.9 billion SMS messages.¹

And so it has proven in wave after wave of new communications ideas: smartphones; Facebook; WhatsApp: the behaviour of the under 30s is a great predictor of what the future holds for the wider populations.

Data is defining and shaping our lives

So it is a timely moment to be here today, asking what does the future look like. Australians are already showing a very high aptitude for using data.

In the 2014 financial year, Australians each used around 2GB of data. We estimate that that is the next five years that's likely to get up to more in the region of 10GB.²

If you look at households in Australia today, 38 per cent of Australian households have four or more internet-connected devices.

But again, if we look forward we expect to see by 2020, that figure will increase; in fact we expect it will have doubled. And Australians will have six or more devices connected to the internet.

That's where we bring in the Digital Natives. What is a digital native? Well we describe a digital native as someone who has come of age in an era when the internet is pervasive.

¹ Optus data.

² Cisco VNI Mobile 2014, Nielsen and Microsoft reports 2013, ACMA 2012-2013, and Strategy estimates based, Telsyte "Australian Media Tablet Study" 2013-17, OzTam Multi Screen Report, ABS Internet Activity 2013

So in fact these days you can pretty much stretch it up to someone who is thirty nine years old. So probably a large chunk of people in the room; in fact 18-39 year olds represent around 21 percent of the population.

Looking at their behaviour allows us to take a close look through a window into the future.

So let look at some interesting stats about these guys:

Here's a stat that almost says it all. 89 percent of smartphone owners aged between 18-24 reach for their phone within 15 minutes of waking up in the morning.

So what makes Digital Natives tick?

- First and foremost, they are socially switched on. They're 64 percent more likely to be early technology adopters.
- Social media is embedded in their lives. Advertisers increasingly use FaceBook and other social media to reach them.
- They view their entertainment on the web rather than watch traditional TV. They assemble their own video selections to watch.
- They're content creators – uploading photos to Instagram and videos to YouTube.
- Their mobile phone is their lifeline. In fact, one in two say they can't live without their mobile.

Digital Natives use a lot of data – in fact more than twice the data of their parents' generation and six times that of silver surfers.

There is one other important point to consider when marketing to these guys. Unlike their parents, Digital Natives are spending most of their time looking at the phone (58%) not holding it to their ears.

Now I know there will be a lot of tut tutting among my generation: "Paul are you saying our future is a society of anti-social Australians with their heads stuck in screens everywhere they go?!"

No: What I'm saying is that the adaption of smart phones and high speed networks will be totally embraced by Australians and will radically change how we undertake almost every activity.

That leads me very nicely my second point which is that this revolution in behaviour has huge implications for business.

Let's start with my own industry.

For the first time ever, voice calls and SMS usage – and revenues from them – are in decline.

Since 2012, our business has seen a 12% decline in SMS usage and a 6% decline in voice usage. And this trend is visible in Mobile operators across markets where 3G is widely adopted.

Instead of making traditional voice calls and texts, customers are using Viber, Facebook, Facetime or Skype on their mobiles.

Telcos only see this activity as data traffic – as the customer is connecting to an App via the internet.

In some markets it's having a big impact. The Dutch telecommunications company, KPN announced a profit downgrade, blaming the increased use of apps like Skype and WhatsApp.³

Ovum forecasts that by 2016 telcos will have lost \$54 billion in SMS revenues due to social messaging apps.⁴

As a result of this shift, the market capitalisation of the world's top five telcos has declined 13 percent between April 2012 and March 2014. Over that same period, the top five tech giants grew by almost 30 percent.

When you look at cash reserves the trend is even more pronounced. While the telcos have increase increased cash by 5 percent over this period, the tech giants have increased their cash reserves by 42%.

However, at Optus we back ourselves to win in a competitive market: Optus has made significant investments to meet consumers' demand for data.

- We've spent \$2.75 billion upgrading and expanding our mobile network over the past five years.
- We've spent nearly two thirds of a billion on new mobile spectrum to carry more data and to enable us to bring mobile competition to regional Australia. We will hold more spectrum per customer than any other carrier in Australia.
- We've invested in 4G technology delivering world class speeds.

Data growth is set to explode. We predict that mobile data traffic in the Asia Pacific will increase sevenfold by 2018.

We're investing in other ways to be the leader in high quality data delivery: areas such as video quality optimisation on Mobile; intelligent traffic prioritising; and using analytics to anticipate data traffic.

³ KPN media release for Q1 2011 results (21 April 2011)

⁴ Ovum: "Counteracting the Social Messaging Threat", July 2012

This shift is disrupting our industry, and as a Group, SingTel has committed to invest up to \$2 billion over a three year period in new services that can ride on advanced data networks like 4G and the NBN.

With these challenges come opportunities

This boom in smart devices and high speed data networks is disrupting other sectors too, including newspapers, bricks and mortar retail, and free-to-air television, just to name a few close to the people in this room.

Here's an example of how using data from smartphones can change the nature of decision making; in this case on investment in tourism facilities and marketing.

At last year's Singapore Grand Prix we ran a pilot using anonymised and aggregated data from roaming phone handsets to better understand visitor behaviours, who they are and where they go.

But don't take my word for it. Take a look for yourself.

[Video]

I think you'll agree, that's pretty powerful stuff.

Data growth – and analytics – are changing retail, the services sector, the tourism industry... and yes, it's changing the telco sector.

Why Communications Matters: The Debate About Australia's Future

Now let me talk more specifically about what all this means for Australian businesses.

I am keen to be as balanced and factual as possible today – despite the fact that what I will say will be an “inconvenient truth”.

So a good way to reinforce this is to quote none other than the Chairperson of Telstra – who is also the much respected Chair of the BCA, Catherine Livingston.

In a recent landmark speech in Australia's economic future she noted that:

“The speed of innovation in digital technology, particularly as a result of mobile broadband, means that apparently stable business models can be undermined and literally collapse.”⁵

She further added:

“Australian businesses need to be globally competitive, not just to participate in the Global market, but to retain domestic customers and attract skilled employees”.

⁵ Vision for a competitive Australia: Speech by Catherine Livingston to the AICC, 28 July 2014

I couldn't agree more.

What's vital as we reinvent our economy over the next decade is how we use disruptive technologies like analytics and cloud computing.

High-speed 4G mobile networks and the NBN will accelerate disruption, but they will also offer new opportunities – enabling Australia to finally overcome the tyranny of distance.

So what's happening in the telco industry is vital for Australia's economic prosperity.

These opportunities will only come if we have highly efficient, intelligent and low-cost telecommunications services – and as I will show you, that requires strong competition.

Competition is Vital to Keep technology Current and Efficient

In fact, communications technology is evolving so fast that competition plays a more important role here than in almost all sectors of the economy.

Let me show you the power and importance of competition in this area in a way you will relate to.

Every one of you is familiar with the Samsung and Apple duel: and indeed it's a good example of the impact of competition on innovation.

Since 2007, season after season these tech giants have competed in bringing technology to market. We've seen:

- bigger screens
- faster processors
- better cameras
- longer lasting battery life, and
- the introduction of 4G devices.

Ultimately, the customer has been the big winner.

But that's not my key point.

SingTel looks after over half a billion Mobile customers – 90% of them in developing countries. The costs of these early generation smart phones are beyond most consumers reach.

However, competition has not just driven innovation, it has also fostered efficiency.

In 2011, Xiaomi entered the smartphone market with affordable pricing. Xiamoi offers

similar screen capability, chip processing power and smartphone functionality for a third of the price of the early smartphones. These handsets are now being sold in major markets like India, and for the first time this year, Xiaomi shipped more handsets in China than Samsung.⁶

Take a look at the following to see for yourself.

[Video]

Competition in technology matters because it drives efficiency and innovation. It drives lower prices, transparency and choice, but also upgraded and new technologies and new services.

Thus the policy objectives for the NBN outlined by both sides of politics included two key objectives:

- (1) The availability of globally competitive high speed broadband to all Australian homes; and
- (2) The reform of the market structure so that Telstra no longer controlled the only point of access (the copper) to the majority of homes and small business. This control passed to a wholesale only NBN CO and instead all retail players competed on a level playing field – thus fostering competition around efficiency / innovation among the retail players.

And indeed in the last six days, the Vertigan review has sought to reintroduce competition even at the wholesale layer – recommending a future where NBN Co. is broken into separate competing entities based on technology platforms - for exactly the same reasons.

So what happens when you get competition settings wrong?

Let's look at an example closer to home.

Back in 2004-2005, when Telstra was forced to share its copper network with other providers – Optus invested in the latest broadband equipment (ADSL2+) in certain exchanges.

But only in those exchanges did Telstra reciprocate. Usually, in other exchanges, it didn't bother upgrading its equipment.

Australian telecommunications competition is under threat

And that leads to my most important point: everyone acknowledges the criticality of competition in the communications market.

Yet, as we meet here today, competition in Australian communications is more threatened than at any time since the creation of a competitive market in 1992.

⁶ <http://www.theguardian.com/technology/2014/jul/02/china-xiaomi-quadruples-smartphone-shipments-in-year>

Over the last three years we've seen a reinforcement of the incumbent's dominance of the communications industry. In fact, 22 years after de-regulation of Australia's telecommunications industry, Australia has one of the most dominant incumbents anywhere in the OECD.⁷

Optus estimates that Telstra has 60 percent market share of Australia's fixed voice, fixed broadband, mobile and subscription TV customers. That's almost double the incumbents' share in European markets.⁸

And Telstra has enjoyed over 80% of industry profits over the last few years.⁹

So despite a decade of policy reform, despite copper unbundling and the NBN, Australia has the one of the most concentrated communications markets among comparable regions. And it is going to get worse, not better.

Meanwhile regulators in other OECD markets are working actively to reduce incumbent power.

Indeed, in Singapore, SingTel's residential fixed line business has been structurally separated and has committed to sell down to a minority interest in it by 2018.

But this isn't just about market share – it's about market power.

And, as you know, market power can be used in several ways to reduce competition, such as bundling products, cross subsidising, predatory pricing, or setting prices at anti-competitive levels.

Who will be the beneficiary of large government payments?

Telstra will receive \$8.4 billion over the next five years from the government for disconnection payments, infrastructure leases and NBN access fees.¹⁰

Optus is the scale number two in the industry – a long way ahead of the number three. Yet our revenues last year were \$8.5 billion and our EBITDA just over \$2.5 billion.

And as NBN Co moves to a multi-technology approach, Telstra may play an even broader role in the NBN roll-out – possibly even managing construction and maintenance of the FTTN network.

In its recent audit of NBNC Co, Korda Mentha noted that Telstra could secure up to \$90 billion over the term of its contract with NBN Co.¹¹

Clearly, Telstra will have a steady and very sizeable cash flow stream that it can

⁷ Optus analysis of company reports

⁸ Optus analysis of company reports

⁹ Optus analysis of company reports

¹⁰ Optus analysis of company reports

¹¹ Korda Mentha "NBN Co Limited Corporate Governance Review", 8 August 2014

channel into any or all of its markets to sustain its dominance.

And naturally Telstra will have a clear commercial incentive to use this money and any operating influence it has on the network to carry over its market dominance into NBN services – and extend its lead in mobile and other segments.

Of course, the NBN Co has every right to spend public money for a worthy public policy.

We at Optus support the NBN concept as an economic enabler.

And no-one denies the right of any company to receive fair recompense for goods and services provided. Shareholders of Telstra have a right to seek compensation.

But it is critical to debate the competitive impact of the payments to Telstra, because they will have a significant impact on market outcomes – and ultimately it is money that will come from taxpayers' pockets.

Sadly it is also the case that this is an “inconvenient truth”.

There is always the risk of our political leaders, on all sides, feeling hostage to urgency from an electorate impatient for NBN rollout and with a short electoral cycle.

NBN rollout requires Telstra to play ball in order for political timetables to be accommodated and that can place enormous pressures on governments to provide incentives for it to do so – no matter what party is in power.

And in the process, the consequences for competition, for the efficiency and modernity of the future services you will receive; can become second order considerations when they should always be the primary objectives of public policy.

Coming back to the Australian industry after two and half years away, the most striking thing in telecoms right now is the sound of silence! The public debate on competition and Telstra's involvement in the NBN is simply not happening.

Today the NBN debate is too often focussed on arguments about delivery platforms rather than the effectiveness of outcomes in the long-term.

Competition, innovation and delivering internationally best practice services often play second fiddle to this – if they are mentioned at all.

Optus proposes reforms to increase competition and innovation

So what's my ask of you today?

I ask you to help Optus ignite this critical national debate.

To my media friends in the room, it's time to go beyond the standard coverage about 'households passed' or the economic and technological merits of Fibre to the Basement versus Fibre to the Node.

The average person in the street is about to be delivered a new industry structure that will stifle true competition and inevitably give him/her inferior and more expensive services in the future.

And the ultimate insult: he / she will be paying for this inferior outcome with their taxes!

Let's give this inconvenient truth the airing it deserves. Let's turn the lights on and make sure every Australian sees what is at stake:

True to our DNA Optus is calling for a Yes to three essential reforms which will protect competition and ensure efficiency and innovation initiatives – the A, B and C of competition for our sector:

- a) Avoid mispending taxpayers money: let's ensure taxpayers money spent for the NBN does not end up being a vehicle for Telstra to marginalise competitors
- b) break-out rules for Telstra's NBN activities. If Telstra is involved in rolling out FTTN and or maintaining it, let's ensure they can't use this to marginalise competitors.
- c) Commitment to ongoing competition reform.

Let me touch briefly on each of these:

- A. Avoid mis-spending taxpayers money: Let's ensure taxpayer funds are not spent to harm competition and damage taxpayers interests. We need to find a way to check how Telstra uses this money. Current competition rules place the burden of proof on the company on the receiving end of anti-competitive behaviour – and ACCC rulings come after the market has been damaged. In Telecoms they are also focussed largely on infrastructure access.

These rules are manifestly inadequate, because competitive outcomes are no longer determined by access alone, particularly as the NBN is rolled out. Capital, cash and access to content are just as important – so we need to change how we think about telco regulation.

This is not, however an argument for more regulation. We can actually improve outcomes with less regulation, but it needs to be different regulation.

Our first proposal is to give the ACCC upfront powers similar to those used by regulators in the European Union to target markets that are open to abuse by a player with a dominant position.

Optus commissioned an in-depth study into the EU's Significant Market Power framework, and it found that the regime had led to more targeted regulation and effective regulation, but also less regulation.

But we also propose that these powers only be applied to the telecoms

industry given the unique situation with Telstra and the NBN payment.

- B. Break-Out Rules: Our second proposal is to strengthen the current separation rules.

Telstra is currently involved in fibre-to-the-node pilots for NBN Co and all the signs are that this a precursor to a greater construction and maintenance role.

If there is one thing the last decade of failed ULL rules has shown: no amount of regulation can overcome the conflict of interest for a retail company to managing access to a wholesale network for its competitors. It literally is asking the fox to manage the hen house.

In the UK, BT's functional separation seems to be working pretty well. The wholesale access is provided by a separate company called Open Reach and no supervision or involvement in this business is permitted for BT even though it financially owns the company. (check facts). We are calling for a similar separation of Telstra.

- C. Finally, I believe we need to continue to be vigilant and constantly review our competition policy settings. As technology and business models change so the policy settings will need to be reviewed to ensure they remain best practice. A current example is the rules around M&A. I will have more to say about this in a future talk.

Where to from here?

Consistent with the statements by Catherine Livingstone, the Harper panel and the Vertigan report I believe it is critical for the government to prioritise competition reform.

And in developing policy recommendations, we need to focus on long-term outcomes.

I'm calling on all of you – and particularly those of you in the media who are in a key position to influence all Australians, to make the threats to competition widely visible and debated.

Because we all benefit from competition – and ultimately, our economic prosperity depends on it.

Let's say NO to actions which risk entrenching incumbent power and say Yes to reform, Yes to competition and Yes to an Australia that stays at the forefront of Communications technology.