FLAT-RATE TARIFFS AND COMPETITIVE ENTRY IN TELECOMMUNICATIONS MARKETS

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FLAT-RATE TARIFFS

Widespread in broadband markets
  - increasing popularity in fixed voice markets
Strong support from
  - policy-makers (e.g. OECD)
    • increased uptake, usage of internet access under flat-rate PSTN tariffs
  - consumers
    • ‘insurance’ from unexpectedly high usage fees (Mb usage unknown)
    • very high volume users (subsidy from low-volume users)
  - operators
    • predictable income streams (especially for new entrants)
    • appropriate surplus from risk-averse/uninformed consumers

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LIMITATIONS (I) – WELFARE AND UPTAKE

Flat-rate tariffs prioritise welfare from more usage over welfare from more connections

– users consume until marginal benefit of usage is zero, not marginal cost
  • usage below marginal cost is ‘subsidised’

– ‘average’ flat-rate tariff prices low-volume users out of the market, even though the value of their use is higher than that usage the flat-rate tariff induces from subsidised (high-volume) usage

Flat rate broadband tariffs thus depress the rate of broadband connection purchase

– relative to a two-part tariff
LIMITATIONS (II) - STRATEGIC

What to do when average consumption increases?
- network operators ultimately bear costs of demand variation
- flat-rate tariffs accelerate rate at which risks crystalise

Broadband usage is not costless
- CONGESTION!!!!
  - consumers insulated from price variations, but bear quality degradation
  - ultimately network upgrades required => costs increase

Increase flat-rate tariff?
- costs increase, revenues decrease as low-valuing consumers exit

Set two-part tariff?
- also cannibalises revenues if median usage is less than average from which flat-rate tariff derives
SOLUTION (I) - INTERIM

Two-part tariffs enable the practice of a form of price discrimination
  – connection, usage sold in a bundle
  – menus enable self-selection into tariffs by usage volume

How to engage in price discrimination using another metric?
  – invest in increased connection speed – segregates users on value of the internet connection based on value of time
    • high time-valuers (demand-inelastic) substitute to faster connections
    • low time-valuers (often high-volume, price-elastic users) stay on congested slower connections
    • can continue to price faster connections at flat rate at a high premium
    • although cycle repeats
FASTER CONNECTIONS A SUPPLY-SIDE (NOT DEMAND-SIDE IMPERATIVE) DRIVEN BY FLAT-RATE TARIFF STRUCTURES

US – Pew Internet Survey 2008; OECD 2009

- only 33% of households purchase a connection faster than their operator’s standard speed connection
- willingness to pay a price premium low – revenues per connection from premium speeds only 1.2 times standard speed, despite very high speeds being sold at multiples of 4 to 7 times standard speeds
- applications used differ very little between ‘fast’ and ‘standard’ households

Limits to selling faster and faster connections to existing consumers

- will eventually stop substituting unless new applications emerge
LIKELY DEMAND CURVE FOR FAST BROADBAND

- **Inelastic demand:** Small numbers of customers with high valuations
- **Elastic demand:** Large numbers of customers with low valuations
THE SOLUTION (II) - SUSTAINABLE

The new ‘low-hanging fruit’ is non-internet and low-valuing users

Two-part tariffs
- fixed fee to connect and ‘buckets of megabytes’
- but only at the ‘slow’ ‘low valuing’ end of the market

Competitive incentives
- as long as demand is asymmetrically distributed, an entrant can charge a two-part tariff that will attract low-volume users away from incumbents (adverse selection)
- incumbents left only with (relatively) higher-cost high-volume users => must increase charges for flat rate tariffs, or respond likewise with two-part tariff
OECD EVIDENCE (2009)

Countries that started with two-part tariffs (capped plans) have largely maintained them
- Australia, Belgium, Canada, Iceland, Luxembourg, New Zealand, Slovakia

Capped plans are starting to emerge in some countries where flat-rate tariffs once prevailed
- increase in the percentage of capped plans on ADSL 2006-8
- appear to be offered on low-speed plans (UK, US)
- but fibre connections rarely capped

Flat-rate tariffs more likely to prevail if cable operators were offering flat-rate plans initially
- co-ordinated strategic action?
CONCLUSION

Flat-rate broadband tariffs are a phenomenon of an early-stage technology
• still diffusing
• usage growing as new applications developed

Unlikely to survive as technology, demand mature
• competition, asymmetric usage patterns will lead to tariff differentiation

Tariff structure implicated in a supply-side driven investment in faster technologies ahead of consumer demand, willingness to pay
• speed used as a proxy to separate out high-valuers for the practice of priced discrimination
• possible only because of collective strategic market power
• unlikely to be a stable tariff structure long-term