

Australian retail broadband – price competition has stalled

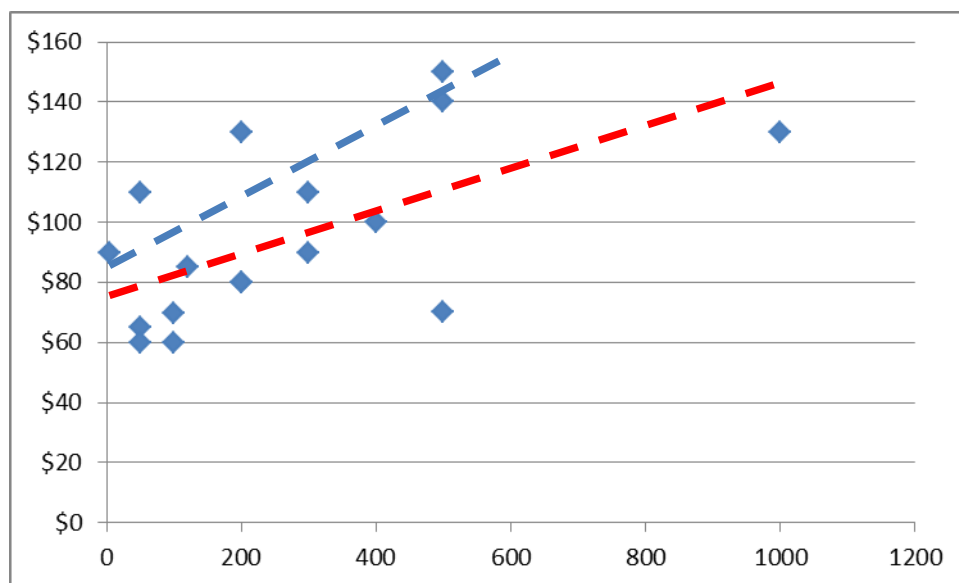
This annual survey of pricing in the retail broadband market shows internet service providers in Australia have stopped competing and/or are marking time until rational NBN pricing is set.

Every September since 2008, pricing of ADSL2+ pricing has been recorded and analysed. In Australia, internet service providers (ISPs) charge customers for a monthly data cap; if a customer exceeds the purchased cap, the speed of the line is slowed until the end of the month. Speeds are not advertised because they cannot be guaranteed. But most customers are aware that ADSL2+ is the best residential broadband service that can be provided over copper today.

“Best fit” as a description of the market

The ADSL2+ plans across the five major ISPs (Bigpond, Optus, iinet, TPG and Internode) are shown in the scatter chart below. The vertical axis shows the monthly cost including a telephony service against the corresponding monthly data cap on the horizontal axis.

Figure 1: ADSL2+ retail pricing, September 2013



The highest dots for any data cap tend to belong to Bigpond (Telstra’s brand) and the lowest tend to be for Internode (now part of iinet). The red dotted line is the “best-fit” line (estimated by ordinary least squares) across all these plans and is $\$77.44 + \$0.066/\text{GB}$. The blue dotted line is fitted to Bigpond and Optus plans only.

The best-fit line describes the retail broadband market. So, for example, with a 200GB plan a customer could expect to pay between \$90 and \$108 (depending on the dotted line used); compared with actual rates of \$80 and \$130 in the chart above.

This “best-fit” approach is very effective at getting a picture of the retail broadband market. It is especially informative when the “best-fit” plan is tracked over time.

Competition has stalled

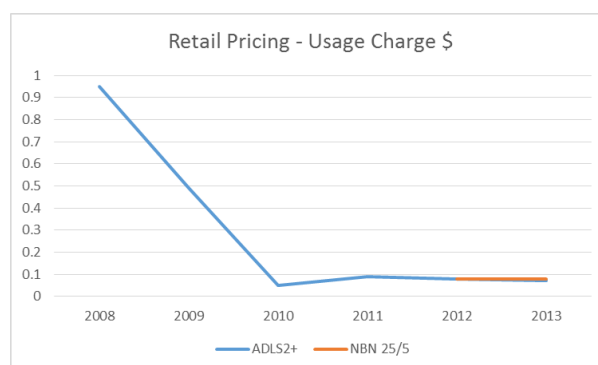
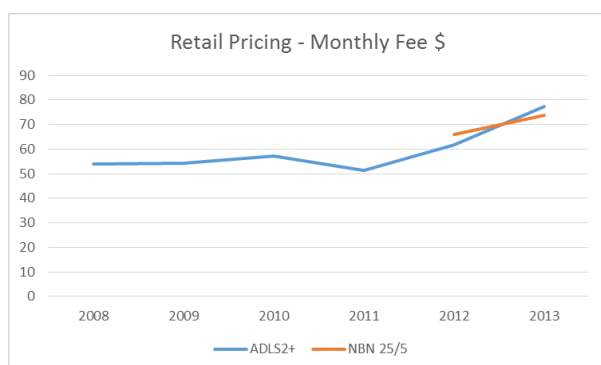
When the plans were first collected in 2008 (as a first step in developing wholesale prices for TarnsACT's wholesale NBN business plan), the cost implicit in the retail plans offered was \$1/GB. A year later, it was half that. In the following year of 2010, it fell to 5 cents/GB. This was partly due to Terabyte plans put on the market by a couple of the ISPs (regarded at the time as marketing stunts). But even if just the two largest ISPs, who did not make such extravagant offers, are used to estimate the best-fit, it is clear they decided to compete in 2010: the cost of data implicit in Bigpond and Optus retail plans dropped from over \$1.70/GB in both 2008 and 2009 to 36 cents/GB in 2010.

The best-fit plans at every September for retail ADSL2+ are shown in Table 1 following graphs. They include the nearest equivalent retail plans (25/5 Mbps down/up) on the National Broadband Network (NBN).

Table 1: Best-fit retail plans – 2008 to 2013

ADSL2+	Five ISPs		Bigpond + Optus only	
	Fixed mly fee	\$/GB	Fixed mly fee	\$/GB
2008	53.97	0.95	57.02	1.75
2009	54.40	0.49	49.34	1.72
2010	57.31	0.05	41.01	0.36
2011	51.43	0.09	51.45	0.09
2012	61.67	0.08	66.65	0.10
2013	77.44	0.07	83.79	0.12
NBN 25/5				
2012	66.13	0.08	71.60	0.06
2013	73.94	0.08	72.56	0.13

Source: Web-sites and the author



The table and charts clearly show competitive activity between 2008 and 2010. However, in the last three years, the cost of data implicit in retail plans for both ADSL2+ and on the NBN has hovered around 8 cents/GB across all five ISPs; and increased to around 12 cents/GB for Bigpond and Optus.

At the same time, the fixed monthly fee, which stayed below \$60 up to 2011, has increased to over \$70 per month. Also, the premium for NBN over ADSL2+ which was present in 2012 has disappeared.

Table 1 shows that all ISPs are taking margin on AVCs (NBN Co.' line prices) and Bigpond and Optus are additionally taking margin on CVCs (NBN Co.'s capacity prices).

These trends are surprising. Yankee's Asia Pacific Connected View Forecast in June 2011 expected retail ARPUs to remain steady at just under \$60 out to 2015 consistent with previous trends. But they started moving up despite wholesale copper prices not rising. What has happened?

Waiting for realistic NBN pricing?

It is possible that there has not been much movement in retail broadband market because ISPs have been marking time until they can see what they would really need to pay for access to the NBN.

NBN Co. has admitted that "The initial prices (as set out in the SAU) were developed in consultation with access seekers so as to enable a smooth transition for end users from legacy networks to the NBN. As such the initial prices are not the result of modelling of NBN Co.'s costs and demand and NBN Co has been very clear on this in its consultation with access seekers." ¹

The true cost of the NBN has been hidden behind deferred cost recovery (with the ICRA) and an unreasonable terminal value. The former will lead to real increases in wholesale ARPU. The latter is implicit in the promised 7% IRR.

ISPs know that under the current NBN Plan they can expect to wholesale prices to increase in real terms and may be building a margin buffer to help accommodate that.

Table 2: Mark-ups for ADSL2+ and NBN 25/5 plans

Sept 2009 ADSL2+ retail plans					
	Optus	Telstra	iinet	Internode	TPG
GB pm	30	25	25	25	30
Price	\$99.99	\$99.95	\$69.95	\$59.95	\$39.99
ULL	\$16.00	\$16.00	\$16.00	\$16.00	\$16.00
Mark-up	525%	525%	337%	275%	150%
Sept 2013 ADSL2+ retail plans					
	Optus	Telstra	iinet	Internode	TPG
GB pm	300	200	400	300	500
Price	\$110.00	\$129.90	\$69.95	\$89.90	\$69.99
ULL	\$16.21	\$16.21	\$16.21	\$16.21	\$16.21
Mark-up	579%	701%	332%	455%	332%
Sept 2013 NBN 25/5 retail plans					
	Optus	Telstra	iinet	Internode	TPG
GB pm	300	200	500	300	
Price	\$110.00	\$135.00	\$84.95	\$74.95	
NBN cost	\$33.19	\$33.19	\$33.19	\$33.19	
Mark-up	231%	307%	156%	126%	

¹ NBN Co, (2013), "NBN Co Special Access Undertaking"

The buffer that exists against future access price increases can be seen in the mark-ups over wholesale input costs in Table 2 above². In the case of ADSL2+ only the regulated cost of the unbundled local loop is considered. Of course there will be other, less significant wholesale input costs for co-location and backhaul and the ISP will have their own costs too (e.g. DSLAMs).

The mark-up on ADSL2+ plans is significantly higher than on comparable NBN plans³. This is because NBN access prices are twice as much as for ADSL2+.

... Or, is there an emerging oligopoly?

Another (not mutually exclusive) interpretation of less price competition is that margins are rising as an oligopoly is established.

In December 2008, while the choice of an NBN Mark I (FTTN) supplier was pending, there were 126 ISPs in Australia with over 1,000 subscribers each⁴. In April 2009 the Labor Government shifted the goal posts from a “value-for-money” FTTN to the more expensive FTTP with NBN Mark II and a government start-up company (NBN Co.). By December 2012 there were only 76 ISPs with major industry consolidation including M2’s takeover of Dodo and Eftel and iinet’s acquisitions of TransACT, Internode and Adam Internet.

The leaked 2013-2016 NBN Co Corporate Plan reports “Margins in the fixed line market have improved, with Telstra reporting in its December 2012 financial results that PSTN EBITDA margin increased two percentage points to 62% and fixed broadband margin was steady at 39%. For the same period iiNet saw underlying EBITDA margin up 4% to 19% and TPG up 2% to 43%” (p124).

Consolidation is also encouraged by NBN Co. pricing (CVCs) which reward ISPs with scale and could freeze-out new entrants.

What to believe?

Is the NBN reducing competition with the prices of copper based services rising to meet NBN services ? Or, is there a complex transition going on generating short term windfall profits which are likely to unravel, adversely impacting ISPS and their share prices over time?

John de Ridder
30 September, 2013

² In the case of the NBN access cost, the figure has been taken from Table 3 in my December 2012 Submission to the ACCC.

³ This is not a perfect apples-for-apples comparison because of differences in the other costs that IPS incur.

⁴ ABS Cat. No. 8153