ECONOMUSE

Will the TPG-iiNet merger kill competition?

Will TPG drive down prices or will we see a cosy oligopoly emerge in broadband?

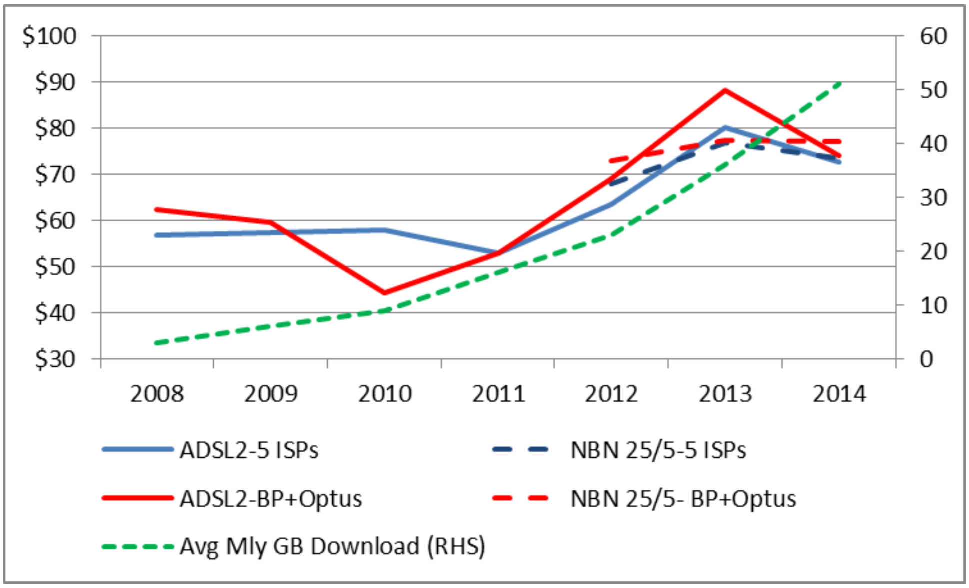
If iiNet's shareholders accept the TPG offer and the ACCC approves this take-over (neither of which is certain), the prospect of vigorous retail competition in the fixed network is dim. The extent of price competition currently is debateable and increased industry concentration is irrefutable.

The ACCC's recent report on the prices paid for telecommunications seems very sanguine about price trends. It reports that "The average real price paid for all types of internet services fell by 2.2 per cent during 2013−14. This is significantly greater than the 0.9 per cent reduction in 2012−13." In nominal terms (before CPI increases of 3% pa), these are increases of 0.8 and 2.1 per cent.

On my estimates, the cost of broadband fell by more than 9% in 2014 after increasing by more than 25% the previous year. That's a bit different.

The ACCC constructs five types of customer based on bill samples and then finds the best plan for each; which is then tracked by year. As it says, increases in data allowances are not reflected in the indices when the price points for the plans do not change.

My alternative estimates are based on my annual survey of ADSL2+ and NBN plans for each of the give major ISPs (Big Pond, Optus, iinet, TPG and Internode). Plot the monthly cost against the data cap on a scattergram and put a best-fit (regression) line through this to get a single plan that describes the whole market.



At September 2014, the best fit line was $70 + 5cents/GB for the 5 ISPs. Using the average monthly download of 51GB in the June quarter last year gives a total cost of $72; which is the end point of the solid blue line in the chart.

The chart may seem to suggest that the growth in cost since 2008 is driven by downloads. That is not so. In 2008 the typical monthly fixed fee was $54 and now it is $70, for both ADSL2+ and the NBN. Also, the implicit price of data (the slope of the best-fit line) fell from a dollar per GB in 2008 to less than 10 cents/GB today. And the share of data in the monthly cost is less than 5% (lower than in 2008).

Incidentally, the ACCC says that the effective price per gigabyte (GB) has fallen from approximately $30/GB in 2007 to less than $1/GB today. This must simply be the price of the plan divided by the data cap. Unlimited data poses a problem for both the ACCC methods and my own.

The increase in the cost of broadband between 2010 and 2013 is of concern. It seems that price competition stalled because ISPs are waiting to see realistic and sustainable wholesale pricing from NBN Co. and/or they are settling into a cosy oligopoly.

Last year saw a decline in prices. As reported in this column, the main factor in the cost decline last year was TPG; perhaps inspired by Exetel's introduction of "unlimited, any-time data" over 100/40 speeds for $90 pm. But, will TPG feel the need to buy market share and/or pass on cost reductions when the merged entity is second only to Big Pond in the fixed broadband market?

And will the ACCC allow the merger to proceed? The ACCC's merger guidelines suggest that it will look at cases with a post-merger market share of greater than 20 per cent; which would be the case (see table).

Before			After		
	Shares	Squared		Shares	Squared
Telstra	41	1681	Telstra	41	1681
Optus	14	196	Optus	14	196
TPG	15	225	TPG/iiNet	27	729
iiNet	12	144	Other	18	324
Other	18	324			
HHI		2,570			2,930
					360
Source: p23, ACCC telecommuncations reports 2013-2014					

Industry concentration is often measured using the Herfindahl-Hirschman Index which sums the squares of market shares. The result of the TPG-iiNet merger increases concentration by 360 points, as shown in the table.

In the USA, the Department of Justice and Federal Trade Commission regard anything above 2500 as "highly concentrated" (2010 Horizontal Merger Guidelines) In such a situation, which already applies here, a merger potentially raises "significant competitive concerns" if it produces an increase in the HHI between 100 and 200 points and is presumed "likely to enhance market power" if it produces an increase in the HHI of more than 200 points. The TPG-iiNet merger would see an increase in concentration of 360 (See table).

If the merger of TPG and iinet proceeds, the only price leader left standing may be Exetel; and it is a minnow. There are bigger fish with established brands that could make a difference; like the supermarket chains. But, there are barriers to market entry that need to be demolished.

The next column will examine how the competitive process can still be strengthened, with or without this merger.

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