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SESSION 5B

*COMPETITION AND REGULATORY CHALLENGES IN
THE DIGITAL ECONOMY – SMALLER MARKETS*

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Agenda

1. Competition issues in the Digital Economy for smaller markets
2. Possible responses and their challenges
3. Conclusions



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1. Competition issues in the Digital Economy for smaller markets



1. Competition issues in the Digital Economy for smaller markets (1)

Telecommunication services can play a **critical role in accelerating economic development** in smaller markets.

Information is the lifeblood of markets and bringing **even modest communications services to previously under serviced populations can accelerate the process** of transitioning from subsistence to market-based activity and moving into more sophisticated forms of economic activity.

As communications technologies evolve and become more sophisticated and efficient, telecommunications can have larger impacts sooner on lower income populations.

In this sense, the rise of OTT services have provided consumers with **an innovative and low-cost alternative to traditional methods of communication and broadcasting** and likely contributed to some form of economic and social development in these smaller economies.



1. Competition issues in the Digital Economy for smaller markets (2)

However for telecommunications (including OTT services) to continue playing this important role in smaller economies, it is **critical that communications infrastructure investment is built**, upgraded and maintained.

It is well known that the growth of OTT services is likely to **add to the network costs** incurred by mobile network operators (without a corresponding increase in revenues) and/or to **contribute to falling revenues**, through substitution of voice and SMS services.

The result is that **operator margins and cashflows are likely to contract**, perhaps significantly, leading to a decreased ability for traditional telecommunication service providers to make this **critical investment in infrastructure**.

In smaller and developing economy this problem is compounded by the problem of **low ARPU** and therefore a relatively **low capacity for infrastructure investment**.

1. Competition Issues in the Digital Economy for smaller markets (3)

The effect of OTT services on competition, and consequently operator revenue, is even more prevalent in smaller markets.

- With OTT services offering substitutable services to traditional telecommunication service providers, they are effectively **acting as an additional competitor**.
- As shown below, markets with smaller populations generally **cannot support a large number of operators**.
- The advent of OTT services is therefore more likely to lead to **unsustainable competition** in these smaller countries resulting in low margins and low infrastructure investment levels.

Country	Population	GNI per capita (PPP)	Number of mobile operators	IDI 2012
Estonia	1,329,000	23,280	3	7.28
Bahrain	1,318,000	31,820	3	6.30
Timor-Leste	1,210,000	6,930	1	-
Fiji	875,000	7,390	2	3.99
Djibouti	860,000	-	1	1.77
Guyana	795,000	6,160	2	3.08
Bhutan	742,000	7,170	2	2.40
Macao, China	557,000	101,750	4	7.65
Solomon Islands	550,000	1,390	1	1.97
Luxembourg	531,000	60,950	3	7.93
Malta	419,000	26,830	3	7.25
Brunei Darussalam	412,000	67,530	2	5.06
Maldives	338,000	9,720	2	4.53



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2. Possible responses and their challenges

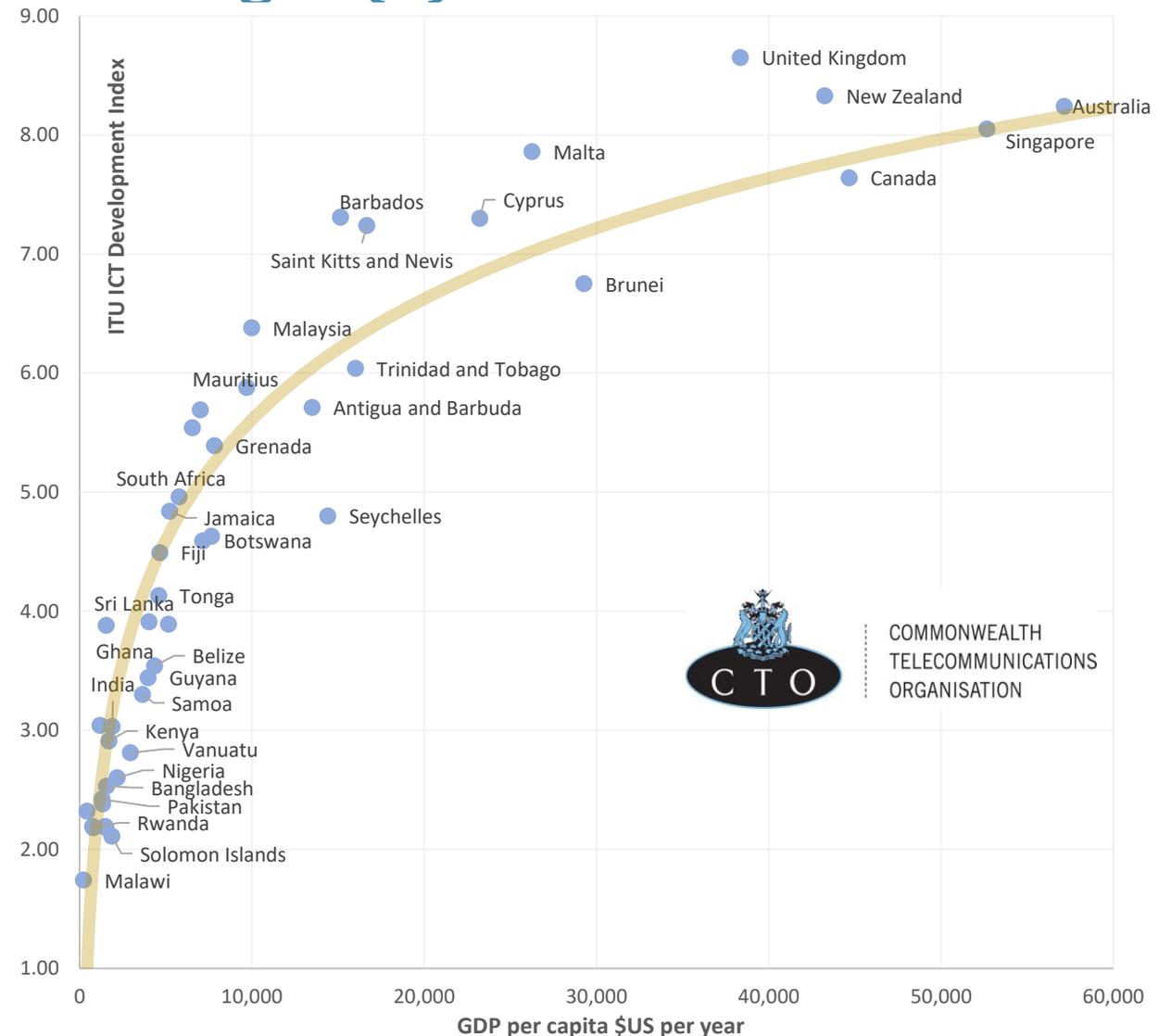
3. Possible responses and their challenges (1)

Commonwealth countries span an enormous range of economic development (see GDP/cap and the IDI). As communications technologies evolve and become more sophisticated and efficient, and the infrastructure becomes cheaper to deploy, telecommunications can have larger impacts sooner on lower income populations.

For this to be achieved it is critical to activate and maintain to the communications infrastructure investment and to ensure that sufficient investment funding is available for new technology upgrades (eg 4G/5G). For this reason, the impact of OTT services on operator revenues and margins is of particular concern in less-developed countries.

The CTO Report focused on the challenge associated with emerging and smaller Commonwealth markets and especially those which had a GDP per capita less than USD10,000 per year.

Source: Commonwealth Telecommunications Office
<https://cto.int/news/ctos-ott-report-highlights-innovative-nature-of-otts/>





3. Possible responses and their challenges (2)

The likely **impact of OTT obligations** on OTT services and the reaction of OTT service providers will depend on a number of factors. In smaller markets, the likely outcome is that OTT services will be withdrawn rather than complying with the regulations.

If the OTT service provider considers that the **obligations are burdensome** or costly and that the market in which they apply represents only a very small number of users of its services, then it may decide simply to **withdraw from the market altogether** (or refuse to comply and accept that its services will be blocked by the operators in response to a direction from the regulator).

Furthermore, they will be very unlikely to want to **comply with obligations proposed by a small country** (even if it might otherwise make sense for them to do so) because they will be considering the risk of setting a precedent.

The result may be that OTT services continue to be supplied in large countries, but are blocked or withdrawn from small ones.



3. Possible responses and their challenges (3)

Smaller countries are often also developing countries where monthly telecommunications bills are **significant consumer expenditures**. Cost-effective **OTT services are particularly attractive to consumers** in this situation. But operators are adapted to low-cost low ARPU operation and small movements in revenue and margins may have significant impacts on operators.

It is important to note here that if a regional regulatory body were to set a **common set of regulations (and/or legislation)**, or if there were to be a common set for an entire region (such as the ASEAN), then the calculus for the OTT service providers might be different. They might, in this case, decide to comply. Regional groupings create countervailing market power.

Consequently, **collective action for smaller countries may be more productive** in this regard if it is decided that OTT services should be regulated.

3. Possible responses and their challenges (4)

The 'Spanish Google incident':

Beware of unintended consequences

In 2014, when the Spanish government implemented a law requiring Google to pay news publishers for aggregating links—the tech giant instead opted to simply shut Google News in Spain. That caused the demise of a few news publishers.

Traffic to all Spanish news sites dropped after the law went into effect: A simple traffic analysis of Spanish digital newspapers in the first three months of 2015 based on data from ComScore also suggests results in line with the aforementioned. The impact of the closing down of Google News and some other aggregators has generated a decline of visitors to the 84 major Spanish online newspapers...

Source:

<https://www.theguardian.com/technology/2014/dec/11/google-news-spain-to-close-in-response-to-tax-on-story-links>

<https://qz.com/1387581/article-11-the-eus-copyright-law-could-give-publishers-power-over-google-and-facebook/>

<https://www.techdirt.com/articles/20150725/14510131761/study-spains-google-tax-news-shows-how-much-damage-it-has-done.shtml#comments>

Google News Spain to close in response to story links 'tax'

New Spanish law requires Google to pay for using publishers' content but search provider says it makes no money from News service



▲ Google is to close its Google News service in Spain after being told to pay companies that own the content it uses. Photograph: Karen Bleier/AFP/Getty

Google is closing Google News in Spain and removing Spanish media outlets from the service following a row with the country's government over new legislation aimed at protecting local publishers that requires the search company to pay for using their content.

The tech giant announced late on Wednesday that Google News would close in Spain on 16 December. A spokeswoman said she was "incredibly sad" to announce the company was shutting the service.

3. Possible responses and their challenges (5)

EU vs FAANG: “the revenge of copyright”

Article 11 (Sep 12 2018) grants news publishers copyright over headlines and news snippets, which would require aggregation platforms like Google News to pay media companies a “link tax” in order to share articles. Article 13 requires platforms that depend on user-generated content, like YouTube, to install software that would scan uploads for intellectual-property violations

Some experts who support the EU law say that what happened in Spain is unlikely to happen across Europe. That’s because, as a bloc, the EU will have much more negotiating power with Google. The company can’t afford to suddenly lose traffic to Google News from 500 million EU citizens. The same argument holds for Facebook.

Source:

<https://qz.com/1387581/article-11-the-eus-copyright-law-could-give-publishers-power-over-google-and-facebook/>

DAVID AND GOLIATH

The EU’s copyright law could give news publishers power over Google—if they band together

By Akshat Rathi • September 13, 2018



3. Possible responses and their challenges (6)

Rather than creating new regulation, an alternative approach may be to fall back on existing taxation mechanisms and simply pursue the OTT service providers more aggressively than at present for general tax receipts, whilst then allocating some or all of the funds that are collected to subsidise the network operators.

- This confronts the **challenges which all states are currently facing in collecting corporate taxes from multinational organisations who minimise their tax exposure through transfer pricing and other avoidance strategies**, and who then deploy formidable resources against any other Government seeking to challenge these arrangements.
- This approach also faces challenges in relation to enforcement and sanctions for non-compliance. This is a key issue in relation to **any attempt to impose regulatory obligations on OTT service providers who typically have very few assets in the country in question** and who may exercise control and arrangement of the services from an overseas jurisdiction.
- Further, OTT service providers in smaller countries **do not derive their revenue from local consumers - instead deriving them from advertising sales which are made and taxed elsewhere**. This deprives Governments of the capacity to attach or inhibit financial flows or use them to determine where control and commercial activity actually resides (which is one of the major challenges when assessing tax).



3. Possible responses and their challenges (7)

An alternative response that may be more viable for smaller economies than a regulatory reaction could be **consensual commercial relationships between network operators and OTT service providers** - thereby reducing the risk of service disruption and better aligning the interests of both sides.

Netflix, for example, has concluded a commercial agreement with **Liberty Global** in 2016 to integrate its services into the cable operator's set top box and programme guide, in return for which there is some share of revenues between the two parties.

In this regard, **it would be wrong to think that there is no common interest** between OTT service providers and network operators. It is highly likely that most OTT providers, relying on telecommunications infrastructure, would want the traditional telecommunications industry to continue to function as it has in the past, so that they can scale their own business rapidly at minimal cost.

However it should be noted that, in smaller regions, **mobile network operators may not be able to alter the terms of trade** which currently exist with large OTT service providers due to their size.



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3. Conclusions



3. Conclusions (1)

The problem of competition introduced by OTT players in smaller markets is **something that policymakers should care about** and is particularly acute for operators that form part of this market.

In considering how to regulate competition in these markets, it is helpful to look at the costs and benefits of regulation from an economic perspective - **by weighing up the benefits that OTT services bring to consumers versus the loss in investment capabilities** by operators in infrastructure.

It is also important to consider the particular and unique impact of OTT obligations on OTT services and the reaction of OTT service providers in these smaller markets.

Policymakers in these economies should therefore be aware of these issues going forward - and know their limitations in terms of compliance and enforcement.

Even ways which seek to **make OTT providers make a fair contribution to network investment** (eg well established precedents for compulsory levies on industry participants to fund the ubiquitous availability of networks and services to meet the communications needs of residential and business end users, often described as Universal Service Schemes) are unlikely to work in small markets where there are no or little OTT revenues.



3. Conclusions (2)

In smaller markets (and this may apply more generally), it may be beneficial to remove or relax regulations inhibiting MNO's capacity to **restructure retail tariffs to better align costs with revenues** and/or discriminate between OTT services (e.g. charging more for data bundles which allow VOIP) – in essence, the restructure tariffs to deliver price signals to consumers that better reflect changing costs on the OTT era.

Retail tariffs are likely to require restructuring to reduce impact of revenue erosion from OTT services/arbitrage between historic voice and data pricing. **The biggest challenge may be competitor and customer reaction to changes in tariffs.** These are likely to be more significant.

It is important that MNO, who are making investments have maximum commercial freedom on retail pricing (both in terms of level and structure).

Another important conclusion is that jurisdictions are likely to **benefit from negotiating with OTT players in regional blocs. OTT players are more likely to negotiate and concede terms if there is more at stake.**

Caution: bandwidth prices are highly politicised.

'There is no silver bullet' but we can seek to promote the evolution of new efficient outcomes.



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Thank you

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