Our cellphone woes are real, but forcing in competitors isn’t the answer

MARTHA HALL FINDLAY
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Who knew the normally rather staid Canadian telecom world could provide such entertainment? This summer we witnessed heated rhetoric, political populism, multi-million dollar ad campaigns and a good dose of patriotic flag waving, all over whether Verizon, a big U.S. telecom company, should be “allowed” to come into the Canadian market. More specifically, whether it should be able to do so through acquisition of one of the new, small entrants who were subsidized in 2008 by the Canadian government (and thus by Canadian taxpayers) by way of spectrum set-asides, only to stand to reap even further advantage over the incumbents in the upcoming spectrum auction.

Now, with the new multi-million dollar government ad campaign attacking the incumbent telcos, it has become downright nasty.

The government, seizing an opportunity to capitalize on deep public anti-cell-phone-company sentiment, claims that Canadians needed more competition in the wireless business in order to lower prices and improve service for consumers.

For their part, Canada’s incumbent wireless telcos, Rogers, Bell and Telus, expressed outrage at the idea that the Canadian government would give an “unfair advantage” in the form of extra access to spectrum to a large U.S. company – one that clearly didn’t need Canadian taxpayers’ help.

The political opportunity is obvious – Canadians love to hate their cellphone companies. It’s no surprise – “hidden” fees, contracts beyond agreed-to terms, astronomical international roaming charges without prior warning, trying to reach live (and helpful) customer service reps an ordeal… The list is long. Thanks to customer “service” that has been anything but, Canadians have no sympathy right now for the incumbent telcos.

But good public policy must be based on economic realities – not on emotion. It requires comprehensive, objective evidence. Spectrum set-asides involve significant costs to Canadian taxpayers. Ill-advised decisions can have unintended consequences. We need to be sure, first, if additional competition is really needed. Only if so, then why; and only if so, whether spectrum set asides and similar artificial inducements are better or worse than other options – for example, removing our current foreign-ownership restrictions on telecommunications enterprises.

So far, however, we’re letting impassioned rhetoric, on both sides, claim the discussion. Worse, we’re ignoring some big red flags. For example, one of the much-supported, much-encouraged “new,” “small” entrants that benefitted from the 2008 spectrum set-aside – indeed, the one at the centre of the Verizon firestorm, Wind Mobile – is already owned and controlled by a huge foreign company. At the time of the 2008 spectrum set-asides it was controlled by the Egyptian enterprise Orascom. Already huge in its own right, Orascom was combined in 2011 with VimpelCom, headquarted in the Netherlands.

So why all the fuss about "letting in" big, bad, foreign Verizon? VimpelCom is twice the size of Verizon by number of subscribers – over 200 million worldwide. VimpelCom's 2012 global wireless revenue of $23 billion was lower than Verizon's ($76 bbillion), because it operates in less affluent countries. To put things into perspective, in 2012 Canada's so-called Big Three had fewer than 25 million customers combined (a mere one-eight the VimpelCom number) and wireless revenues of only $18 B – combined.

Yet, in addition to that big 2008 spectrum subsidy, VimpelCom, as a "new entrant" via Wind (or whoever acquires Wind if it is sold), will benefit from even more subsidy via the upcoming spectrum auctions. So why was the idea of allowing the same type of advantage for Verizon all of a sudden such big news?

The even bigger question, another which no one seems to be asking, is why, even with these advantages, does VimpelCom (by putting Wind on the block), now want out of the Canadian market? Is it a coincidence that VimpelCom wants to leave, and Verizon has declined the "invitation"? None of the other big international players such as Vodafone and O2 have expressed much if any interest in Canada – and none are participating in the upcoming spectrum auction.

Maybe those outside are not interested, and the new ones here are failing, because (sacrilegious as this may sound) the wireless industry in Canada is already pretty competitive.

Canadian prices are relatively high, this is true. But they are not the highest, particularly when properly comparing voice and data combinations (and Canadians' extraordinary appetite for data). And there are various other factors that are unique to Canada, which maybe players like VimpelCom and Verizon, Public Mobile and Mobilicity now realize.

For example: Our relatively small population and huge geography, combined with our much greater appetite for higher speeds and more data than people in most countries we're compared to, make for very high per-subscriber/per kilometer network costs. Canada's three incumbents spend far more on their networks per subscriber than anyone anywhere else in the world. The ARPU (average revenue per user) is indeed relatively high in Canada, but for it to be useful in assessing competition, it has to be taken together with expense per subscriber – and in Canada the network expense per subscriber is the highest in the world. In going deeper into the numbers, it's clear that it's not just about price (because price is not the only thing Canadians look for); the three incumbents in fact compete with each other, hard, in providing ever-better network speed, coverage and capability.

Another example: Price comparisons (including those by the OECD) don't take into account that a large number of the more expensive (yet more popular) rate plans in Canada also include the cost of the phone. Unlike in some other countries, Canadian carriers have routinely offered "free" phones; an approach that has been hugely popular in Canada. But nothing is ever "free" – the cost of those phones gets built into rate plans with minimum terms. (And Canadians love their expensive smartphones – we have a much higher smartphone penetration among wireless subscribers than in most other countries.)

When network coverage, network investments, smartphone subsidies and extraordinarily high demand for data and speed are added in, rate plan comparisons aren't apples to apples. Canadian prices reflect more actual cost of service than people think.

And, sure enough, the three new entrants aren't profitable at the discount prices they are charging.

Frustratingly, we've seen this movie before. In 1995 the Liberal government of the day was saying exactly the same thing as today's Conservatives, that Canadians were paying "too much" for their cell service and that we therefore needed more competition. Just as in 2008, the government in 1995 set aside spectrum for two new entrants, but Microcell and Clearnet soon discovered some of the challenges described above, and couldn't survive. Clearnet was acquired by TELUS in 2000 and Microcell was acquired by Rogers in 2004 after emerging from bankruptcy.

The 2008 set-asides haven't worked either. Yes, prices for voice plans have dropped somewhat, as happened after 1995, but the new entrants' prices, focussed mostly on voice and text rather than data, and for service in limited geographic areas, are simply not sustainable. Only a relatively small number of Canadians have switched, signed on, and stayed on, because most of us want subsidized smart phones, wide geographic coverage, lots of data and high speeds.

Canadians deserve evidence-based policies and evidence-based decisions. Whether there is sufficient wireless competition in Canada is a fundamental question, but can only be addressed with a thorough, impartial economic analysis. Strangely enough this has been lacking, but a recently released paper by economists Jeffrey Church and Andrew Wilkins provides a comprehensive, comparative analysis of factors such as investment lifecycles, seller concentrations, gross margins and a variety of as-yet under-analyzed factors related to pricing and penetration, in Canada as well as the countries we're usually compared to. They challenge, persuasively, the fundamental assumption that we need more competition in Canada. Indeed, they conclude that not only is the push for a fourth 'competitor' unnecessary, artificially trying to force one may, ironically, lead to less robust networks and higher prices.

Most Canadians don't expect to pay less than is needed for the things they want, but they aren't aware of what their wireless service prices actually pay for. Instead, they feel taken advantage of and angry. But if the problem isn't lack of competition, but lack of transparency and terrible customer service, then expensive ad campaigns, on the one hand, are not the answer, nor is artificial, taxpayer-funded, and in the long run unsustainable interference in the market to force more (un-needed) competition. We need facts, not propaganda – and even less, propaganda that we ourselves are paying for.

Martha Hall Findlay, who served as MP for Willowdale from 2008 to 2011, is an executive fellow at the University of Calgary School of Public Policy, and chief legal officer at EnStream, a mobile commerce joint venture owned by Bell Mobility, Rogers and TELUS.