



Paul O'Sullivan
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The role of investment & capital in Australia's competitiveness

Good afternoon. It's a pleasure to be in Melbourne and speaking at this AICC luncheon.

Optus has been a long time sponsor of the AICC because we think it makes a vital contribution to Australian business and society and provides tremendous leadership.

Another one of our sponsorships is Cirque du Soleil – an amazing troupe of artists and acrobats from Canada. They are currently touring Australia and come to Melbourne next year.

But of course there has also been plenty of media coverage about another group of North American performers, who have stunned Australia with their very public displays of tightrope walking, fire eating and back flipping.

Today, I can expose this for what it really is - a simple piece of copycat guerrilla marketing.

So let me clarify that Optus is associated with Cirque du Soleil – not with its rival troupe the cunningly named *Cirque du SOL*.

But while our industry can sometimes resemble a circus, the issues at stake are of critical national importance.

So today, I want to do four things.

First, I will argue that our broadband infrastructure is of profound importance - to Australia's national economic performance and to all of us as individuals.

Secondly, I want to look at Telstra's claim that in order for Australia to get a high speed broadband network, Telstra has to be treated as though it is some kind of national champion.

Thirdly I will examine Telstra's public statements on this issue and show you how contradictory and misleading they have been.

Fourthly, having given that claim the short shrift that it deserves, I will outline a better way forward in making Australia world-competitive in broadband.

The importance of Australia's broadband infrastructure

So let me start with the claim that Australia's broadband infrastructure is of national economic importance.

The lessons of economic history are clear – nations with superior technology and infrastructure achieve superior economic performance.

For example, the British outperformed other European nations in trade because of better maritime and naval technology. British ships had better navigational tools; and the British navy had better engineered ships with superior gun power.

A more recent example is the inter-state freeway system commenced in the US in the nineteen fifties. This system facilitated the creation of a large single market across the USA – which created open competition between local producers and huge scale capabilities for the winning companies which they took overseas.

In the twenty first century, there is growing evidence that a nation's telecommunications and broadband infrastructure, similarly, will be a key determinant of its national economic performance.

Whatever your line of business, you will be doing more and more of it over the internet, and the more of your customers who have broadband, the more critical a channel to market it is becoming for you.

Travel is one good example. In 2003 Qantas noted that 25% of domestic bookings and 6% of international bookings were made online.¹

In 2005, JetBlue Airways in the USA reported that 77% of its bookings come through its website.²

In its 2006 results, Qantas noted that selling and marketing costs were down 6.4%, with a major driver being reduced commissions as sales continue to migrate towards direct channels such as on line bookings.³ That is a clear example of the efficiency benefits of the internet.

Banking is another good example. A report prepared for the Australian Bankers Association earlier this year noted that the use of EFTPOS had doubled since 2000, the use of ATMs was up

¹ Qantas 2002/2003 Full Year Results Presentation, 21/08/2003

² "Airline seeks online bookings boost via IT upgrade" Computerworld, Patrick Thibodeau, 23/06/2006

³ Qantas 2005/2006 Full Year Results Presentation, 17/08/2006

over 50%, but the use of cheques had nearly halved. As the report commented:

‘bank customers have increasingly been shifting away from traditional ways of transacting..towards electronic forms ...the latter are generally cheaper, and often involve zero fees.’⁴

There is ample evidence of the economic benefits which nations gain from increasing broadband take up and improving broadband infrastructure.

In the UK, a study by the Centre for Economics and Business Research (CEBR) found that based on forecast growth in the number of broadband connections, by 2015 annual UK GDP could be up to 21.9 billion pounds higher than it would otherwise have been.⁵

And a recent US study concluded that: “broadband has a significant positive effect on the growth in the number of business establishments, increasing growth, by almost one-half of one percent.”⁶

⁴ Hawtrey, ‘Fees for Banking Services – Report prepared for the Australian Bankers Association’, May 2006. Downloaded from www.bankers.asn.au, 22/8/06.

⁵ A Competitive Model for National Broadband Upgrade, report by ACG and dandolo partners, 10 July 2006 p6

⁶ “Measuring broadband’s economic impact”, Lehr, Osorio, Gillet, MIT, January 2006

Unfortunately, Australia is handicapped in capturing the important economic benefits which broadband can deliver.

Australia's broadband infrastructure is poor by world standards – meaning that the speeds available to you are low, and the pricing for what you get is high.

A study by Spectrum Strategy Consultants, surveying the bandwidth - which is a measure of volume, speed and capacity - delivered by the incumbent telco in 16 countries, found Telstra did poorly.⁷

Furthermore monthly prices were higher than all but two of its peer companies.

Until about two years ago Australian broadband competition was very limited – giving Australia high prices and low bandwidth.

As a result, Australia's broadband penetration levels are low – with 13.8 broadband subscribers per 100 inhabitants, Australia only barely reaches the OECD average⁸ – a position that is propped up by the presence of the former eastern Bloc communist nations in the survey.

⁷ A Competitive Model for National Broadband Upgrade, report by ACG and dandolo partners, 10 July 2006 pvii

⁸ OECD broadband subscribers per 100 inhabitants, by technology, December 2005

And why was competition so limited? Because of the dominance of the incumbent operator.

Australia is not unusual in this regard. International management consultants McKinsey have found that incumbent telcos such as Telstra will “delay any serious move into broadband until it starts competing for their valuable customers.”⁹

Now, Optus is playing a very important role in fixing Australia’s broadband problems.

It was our entry into the retail DSL market in 2004 that prompted Telstra to drop prices dramatically. Over the following two years, our competition and that of others has helped increase Australia’s uptake by more than 100%.

And we are going further, by investing \$150 million in our own national broadband network. It uses the very latest technology called ADSL2+, letting us deliver much higher speeds than those currently offered by Telstra in its retail DSL service.

Customers close to the exchange can receive up to 20 megabits per second.

⁹ Making Sense of Broadband: The McKinsey Quarterly, 2003, Number 2, pg. 4

¹¹ www.ncc.gov.au Frequently Asked Questions – What are the benefits of National Competition Policy?

And we estimate that a significant percentage of customers will receive at least six megabits per second.

The six megabits number is an important hurdle. It's the speed at which decent video streaming can occur – hence it has important consequences for business, education and social use.

Now there is widespread agreement that even ADSL2+ is not the end of the road. Especially as technical issues may reduce the reach of this technology.

Australia needs to upgrade its broadband infrastructure even further.

Is Telstra the National Champion?

But how this should happen is a matter of intense debate.

Which brings me to my second question for today. Should we treat Telstra as a national champion?

That is what its executives appear to be suggesting, with their proposal that Telstra build a high bandwidth fibre to the node network.

In exchange, they wanted Telstra to receive a holiday from the current access rules.

These rules apply to a wide range of facilities with natural monopoly characteristics – such as rail networks, electricity grids, gas pipelines and telecommunications networks.

This follows the Hilmer competition reforms of the mid-nineties.

So in all of the industries I have mentioned, competitors are allowed access to bottleneck infrastructure at a price that gives the owner a decent return on its investment.

The evidence shows that this has brought significant consumer benefit. For example, the average price of electricity fell 22% between 1991 and 1998 and gas prices for residential customers fell 22% between 1993 and 1998.¹¹

Yet in December 2005, Telstra said:

“Telstra will begin building its new IP broadband network as soon as next year if its shareholders’ investment is protected from regulations that would otherwise allow competitors to piggyback on the multi-billion dollar project.”¹²

¹² Telstra Media Release “Telstra seeks investment certainty for IP network” 1/12/2005

Now some would say that we should not look this gift horse in the mouth.

Telstra's executives have told us they are here to help us.

Mr Trujillo said recently "I'm not doing it for the money, right? I'm not doing it for the pleasure, I've already had bigger titles than this."¹³

He also said Australia has "... an even larger future. I am here because I want to be part of that future ... to expand choices and opportunities for all Australians..."¹⁴

In fact, as late as last Sunday week, Telstra's CEO promised that his team's motivation was "to do the things that ... are important for all of Australia."¹⁵

Well, let me suggest to you that Telstra is doing nothing more than running the old 'national champion' argument. That is, give us special treatment at home, free us from onerous regulation, and we will become big and strong and operate at world class levels.

¹³ "Sol says it's not for the money" Herald Sun, Scott Murdoch, 14/8/2006

¹⁴ Yesterday, Today and Tomorrow – Telstra's Commitment to Regional, Rural and Remote Australia', Statement by Sol Trujillo to the Telstra Country Wide Advisory Board, 2/8/05

¹⁵ Sol Trujillo interview on Business Sunday 13/08/2006

Look at what Dr Phil Burgess had to say in explaining why Telstra would not proceed with plans to invest in a new fibre to the node network.

“Korea and Japan are moving to 100 megabits for a reason and that’s because...people want...applications that require those faster speeds...that is why it is so perplexing to us why a company that wants to build this out, has the money to do it, has a plan to do it...is being prevented from doing so because of the unwillingness of the regulator to give us the financial assurances that we need to make sure our shareholders are not pillaged once it gets built.”¹⁶

Well, this national champions approach has been comprehensively discredited by Harvard economist Michael Porter, in his work *The Competitive Advantage of Nations*. Porter showed that it is the vigour of domestic competition which produces companies that can take on the world – the very opposite of protecting domestic companies through cosy regulatory arrangements.

But there is another reason why Australia should reject the deal that Telstra’s new management team has proposed.

¹⁶ Transcript from Telstra Fibre to the Node Briefing Q&As 07/08/2006 pp 23 and 24

The new 'fibre to the node' network looks to have been specifically designed to let Telstra re-establish its monopoly in the local loop. Under this design, it is near impossible for Optus – or other competitors – to build our own facilities and 'interconnect' with Telstra.

Even worse, Telstra's proposed network would almost certainly cut off the existing broadband networks put in place under current rules by Optus and other competitors.

In effect, Telstra's competitors would be reduced to reselling Telstra's services on the new network.

Would that be likely to encourage competition?

Well, let me just say that Telstra's current approach to resale has led the ACCC to issue two Competition Notices to Telstra within two years, and in addition Optus is taking legal action against Telstra for breach of the Trade Practices Act.

So at Optus, we believe the ACCC did the right thing in refusing to strike a back door deal with Telstra to allow it to go ahead with its fibre to the node network.

Can industry work together to deliver high speed broadband to us?

Now, Optus much prefers a cooperative and businesslike relationship with Telstra rather than litigation and regulation.

Indeed, when Telstra first proposed building its new network, I publicly and repeatedly stated Optus' willingness to co-invest with Telstra.

After all, with Telstra executives vocal about the need for other telcos such as Optus to share the investment load, we had every reason to think that Telstra would welcome our support.

In August 2005 Sol Trujillo said “We have to get an industry focus on meeting these challenges. Getting the best possible telecoms service to everyone is not going to be solved by Telstra acting alone. We know Optus or Primus won't do it alone...All of the industry – Telstra included – needs to work together.”¹⁷

Sadly, Telstra's actions did not match his statesmanlike rhetoric.

Telstra proposed a close to \$6 billion build out of a six megabit per second broadband network in September 2005.¹⁸

¹⁷ ‘Yesterday, Today and Tomorrow – Telstra's Commitment to Regional, Rural and Remote Australia’, Statement by Sol Trujillo to the Telstra Country Wide Advisory Board, 2/8/05

¹⁸ The Digital Compact and National Broadband Plan: p18 (part of Telstra ASX release, ‘Telstra releases briefing paper,’ 7/9/05.)

So I wrote to Mr Trujillo in October 2005 and asked whether Telstra was “interested in exploring the possibilities for a cooperative approach to the build out of a national high speed broadband network.”¹⁹

He replied: “The Government chose not to pursue our National Broadband Plan. ... Clearly, with the Government’s rejection of our proposal, we have no plans to proceed with a national fibre to the node network.”²⁰

Then Telstra proposed a \$3 billion build out of a 12 megabit per second broadband network in November 2005 if the Government legislated to give it an access holiday.²¹

Then just a month later Telstra announced that the network roll out was on hold.²²

In April 2006, we learned that in fact Telstra was in discussions with the ACCC about using the existing exemption process.²³

So a network build was back on the table but in a more limited way.

¹⁹ Paul O’Sullivan letter to Mr S Trujillo 12/10/2005

²⁰ Sol Trujillo letter to Paul O’Sullivan 17/10/2005

²¹ Media Release, Telstra strategy for growth, 15/11/05; Telstra’s ASX statement, ‘Telstra Technology Briefing’, 16/11/05, p 6 – 8; Media Release ‘Telstra seeks investment certainty for IP network’, 1/12/05

²² Telstra ASX statement “Fibre to the Node” 21/12/2005

Was this another opportunity for the industry collaboration that Sol had foreshadowed?

Thinking that it might be, Optus and other telcos issued a proposal for joint investment with Telstra in the new national broadband network.

Telstra's response:

“This is a self-serving, pick-pocket plan to rip off Telstra's shareholders and taxpayers. What they are doing is becoming the ultimate parasite on Telstra's network.”²⁴

Certainly some impressive back flipping there!

The Right Way Forward for Australia

I think I have made it clear that I do not support Telstra's recommended approach to telecommunications policy.

At Optus, we think the right path forward has four vital elements: access, investment, competition and leadership.

Firstly, we must retain the ‘access regime’ for bottleneck infrastructure in telecommunications.

²³ ACCC Media Release, ‘ACCC reassures industry on Fibre to the Node discussions with Telstra’, 12/4/06

Secondly, Australia must continue to encourage investment in telecommunications – wherever that investment comes from.

Telstra peddles the myth that it carries more of the burden of investment than its competitors.

The facts show otherwise. A 2004 ACCC report showed that while Telstra's competitors held just 7% of the local network subscriber base, they invested 20% of total amount spent on local network infrastructure expansion.²⁵

So Telstra's competitors actually spend more than Telstra, relative to our market share.

Optus has been the leader in competitive investment, putting more than \$10 billion into Australia since 1992 on building fibre optic cables, mobile base stations, exchanges, satellites and other assets.

Our annual capital expenditure is running at above a billion dollars a year.

Thirdly, competition remains critical.

²⁴ Roz Alderton, AAP Newswire, 21/4/06

²⁵ A Competitive Model for National Broadband Upgrade, report by ACG and dandolo partners, 10 July 2006 p35

That has been the guiding principle in the response by Optus and other competitors to Telstra's fibre to the node proposal.

We released a one hundred page report in June this year, highlighting the flaws in Telstra's model – and proposing a different model which would deliver both high bandwidth and high competition.

Telstra might have decided to abandon its plans.

But the G9 is continuing to develop our alternative model, and we are in continuing discussions with the ACCC.

If our discussions – not just with the ACCC but with other parties such as financiers – progress well, we will have more to say.

We anticipate the process will take a number of months. This is natural given the complex nature of the issues.

But we are determined to give it our best shot.

The fourth element is leadership.

We have seen strong leadership in telecommunications from the Australian Government.

But now it is time to do more.

Whatever Telstra's ownership, upgrading our broadband infrastructure is a continuing challenge for Australia.

In nations such as Britain and France, the Government is working with the incumbent telco and competitors to develop a framework which allows networks to be upgraded - and competition to continue.

In Australia, Telstra has had nearly a year to find a path forward - and failed to do so.

So I call upon the Government to push Telstra to come to the table with the rest of the industry - the G9 - to negotiate a cooperative approach.

Conclusion

Let me conclude by reminding you that behind all the name calling and theatrics, there are serious issues at stake.

The telecommunications industry is a vital element of the Australian economy.

We need to be fiercely competitive and relentlessly innovative.

Optus will continue to be a champion of competition. We will keep investing to bring choice and innovation to more Australians

And Australia clearly rewards competition: In the last year we've gained one percentage point of market share in Mobile from Telstra, raised our share in Consumer fixed line by and are growing our corporate business at five times Telstra's rate.

And we will keep turning the lights on to show Telstra's public statements for what they really are.

That might not suit the self interest of Telstra's imported management team – but it very much serves Australia's interest.

It's a role we're proud to play.