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*‘The Changing Face of Australian Telecommunications – and what that means for Australia.’*

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Introduction

My first job at Optus, when I joined the company in 1994, was setting up a distribution network to sell mobile phones. I didn’t know much about mobiles – but fortunately not many other people did either back then.

For the next seven years, I concentrated on the mobile sector – and I learned a lot about what a vigorously competitive industry could deliver in driving take up of new technology by Australians through innovation, service and pricing.

But when I became responsible for all of Optus’ operating businesses in 2001, I saw that competition had not come anywhere near as far on the fixed line side of our industry.

I think that is a really important factor as we look at the issues now facing Australian telecommunications – including, of course, the privatisation of Telstra.

Today I want to argue that there is a lot at stake for Australia in getting the right approach in telecommunications. Next, I will look at how we are positioned today – with a highly competitive mobile sector, but with a lot more yet to do in fixed.

And in the balance of my remarks, I want to offer some suggestions about what the focus should be now – to seize the unique window of opportunity - so that our sector can deliver on its potential for Australia.

### What is at stake for Australia

Let me start by talking about what is at stake.

There is plenty of talk about infrastructure at the moment.

To take one example, there are increasing calls for a national water strategy.

I would suggest to you that the state of our telecommunications infrastructure is every bit as serious an issue. The resource we are transporting is information – and just as you can't live without water, you can't do business without information.

Telecommunications networks are the trade routes of the twenty first century.

Now at Optus we believe that our industry can make a very substantial contribution to Australia's future. We are moving to a world in which every home, business, school and hospital will be able to receive massive and growing amounts of data.

This technology will change the way we live and the way we do business.

Many Australians today still have to use dial up internet and receive data speeds of 56 kilobits per second. But as we build data networks over copper and over fibre, we can easily offer speeds of ten times that and one hundred times that.

Technologies like ADSL 2+ will offer speeds of up to 20 megabits per second to people within 1.5 kilometres of the exchange – and in time the prospects for fibre and wireless are even greater.

But it is one thing to run through the gee whiz possibilities – of video over phone lines; of health applications like remote diagnostics; of giving distance education students wherever they are the chance to see their teachers in real time video.

It is another thing to deliver the vigorous, competitive market structure which we need to ensure this information is available and affordable to most Australians.

We will not get it without competition. Independent studies show that in markets dominated by an incumbent telco, the available technology tends to stagnate.

In Australia today, for example, Telstra is the dominant provider of broadband, nearly 80% of services running over its network. It is no coincidence that Australia's per capita broadband penetration ranks twenty first out of thirty OECD countries.

We are down at 7.7% - compared to the US at 12.8%, and the world leader South Korea at 24.9%.

Yet in areas where Australia does have infrastructure competition in broadband – the 1.4 million households which can be served via the Optus HFC network – broadband penetration is much higher, at 30%.

At Optus, we believe there are several things that have to happen if Australia is to enjoy the full benefits that this communications revolution can deliver.

We need near ubiquitous penetration of broadband services to homes. That in turn is going to mean competitive broadband networks and world competitive prices.

Secondly, we need a rapid availability and take up of IP based applications for corporates and governments. This will give them cost efficiencies to make them internationally competitive. It will allow them to provide many types of services they cannot provide today.

Thirdly, we need a high take up of the most advanced mobile broadband services.

If our industry lives up to its potential, Australians will receive integrated communications services, both voice and data, across both fixed and mobile networks.

When you are at home or at the office, you will take advantage of the high bandwidth capabilities of fixed line. On the move, you will use your mobile and get a portable version of the same applications.

And we will make it easy for you to manage these applications by giving you a single account with a uniform set of tools – such as address book, calendar and email inbox – across the different platforms.

In the future, a country that does not have these kinds of services available on a near universal basis to homes and businesses will simply not be competitive.

So this is a critical policy area for Australia – and we will not get the right outcomes unless we have the right market structure in the telecommunications sector.

### Telecommunications: a tale of two sectors

How, then, does the market structure we have compare to the one we need?

If you were the proverbial visitor from Mars, wishing to compare the Australian telecoms sector to what happened back home, what would you see?

The first thing you would probably notice, once you mentioned your many years of experience in Martian telecommunications, would be press speculation nominating you as a potential new Chief Executive for Telstra.

Next, though, you would notice that Telstra is massively dominant. With annual revenues of \$21 billion, Telstra is three times the size of its next biggest competitor and has around two thirds of all industry revenues.

Telstra is also much more profitable than its competitors. If you take the commonly used measure of EBITDA margins, Telstra stands at around 48% - almost 19 percentage points higher than the next most profitable company, Optus.

In fact, even today, 13 years after Optus entered the market, Telstra receives around 90% of total industry profits.

If you dig a little deeper, though, you notice a marked difference between mobile telephony and fixed line telephony.

In mobile, there are four separate companies owning mobile networks: Telstra, Optus, Vodafone and Hutchison. Telstra is the largest – but not by a massive amount. It has 45% market share; Optus has around 35%; with 20% split between the other two players.

As this market structure would suggest, the mobile industry is highly competitive. There is aggressive price competition, with mobile capped plans offering customers remarkable bargains. Optus will give you, for example, up to \$230 worth of calls – for a price to you capped at \$49 a month.

And this is matched by plenty of other evidence of competition, including relentless innovation in marketing and in services; expanding customer numbers; and continued introduction of new technology, such as the 3G networks that the major operators are now building.

By contrast, competition in the fixed sector is fragmented.

Well over 90% of all fixed line telecommunications customers in Australia are connected via the Telstra network.

With that kind of market share you get strong pricing power. Telstra has been able to increase its monthly line rental charge from \$11.65 in 1999 to \$26.95 in 2004 – at a time when prices in our industry generally have been falling.

Telstra also has a strong position in all the so called ‘preselect’ services delivered over the fixed network. As the ACCC observed in a recent report, these markets ‘are dominated by Telstra which has market shares of 65% in national long distance, 52% in international and approximately 65% in fixed to mobile.’

### The way forward

I think our Martian visitor would conclude that we have a gap as a nation between where we are and where we want to be.

But I am an optimistic Irish-Australian rather than a gloomy Martian.

So I want to point out that there is a tremendous opportunity to use T3 to reinvigorate telecommunications policy in Australia.

It can be the catalyst to create for the first time a truly competitive market structure in fixed line telecommunications – and in turn that market structure will help Australia achieve the vision I talked about at the beginning of my speech.

There is a growing consensus that now is the time for change and for new ideas. For example, the National Party has released its Page Research Centre report, which suggested a range of measures to stimulate competition in rural telecommunications.

The Minister, Helen Coonan, has proposed the operational separation of Telstra.

And even from the investor community, there seems to be a recognition that new rules are coming. The key issue will be getting those rules in place before the float, so there is certainty for investors.

At Optus, we would like to see a clear statement from the Government of the specific telecommunications market outcomes that we are looking for as a nation.

In our view, the number one priority is to establish a competitive market structure in fixed line telecommunications.

Let me propose a specific statement of this general outcome which we believe that the Government should commit to: 'By 2008, there will be at least three operators in Australia with national broadband networks extending to more than 500 exchanges around the country, with no player having a market share exceeding 50%.'

How would this objective be achieved?

Optus has suggested an approach. We call it 'bridge to broadband.' The Government would sign up competitive carriers, such as Optus, to Network Development Deeds. These would be legally binding commitments for those carriers to roll out competitive broadband infrastructure to a specified number of exchanges.

Carriers would use the regulated service called 'unconditioned local loop copper', and by renting that copper from the incumbent and putting our equipment into the incumbent's exchanges, they would build their own DSL network.

In exchange for such a commitment, the carrier would receive significant reductions in the wholesale price it paid Telstra for local call resale.

This would be a bold intervention in the market – following the precedent of a similar bold intervention used by the Government in 1992 to establish a long term competitive structure in the mobile sector.

We think four factors have come together to create a unique window of opportunity and justify such an intervention.

The first factor is that Telstra privatisation has created an opportunity and an appetite for new regulatory approaches.

Secondly, we are at the right stage in the growth of the broadband market. Today broadband penetration is around 20%; in a few years time it will be much higher.

It is much easier for new entrants to come in and build a substantial customer base in a rapidly growing market than it is in a mature market – as the comparison between the mobile and fixed sectors starkly demonstrates.

The third factor is the availability of the right technology in DSL - which can deliver broadband over the existing copper wires to the great majority of people who today receive voice telephony.

And fourthly and most importantly, there is a regulatory framework which lets new entrants like Optus build out our own broadband networks.

Let me briefly explain this framework – especially as many outside of our industry may wonder why competitors like Optus get a ‘free ride’ on Telstra’s network rather than having to build our own network from the ground up.

In Australia – as in the UK, France and many other countries – the regulator has imposed a requirement on the incumbent telco to lease its local loop network to its competitors. This is the ‘unconditioned local loop’ which I referred to earlier.

Regulators see it, correctly, as a capital efficient way to drive towards a competitive market structure in the local loop. In turn, of course, lower capital costs for new entrants feeds through to lower consumer pricing.

Because we put our equipment into the incumbent’s exchanges, and lease the copper lines, we are effectively creating our own end to end network – giving us an economic structure which lets us put genuine competitive pressure on the incumbent.

Yet it does not require us to duplicate the most expensive and at the same time least ‘smart’ part of the network, namely the last mile of copper wire.

As the ACCC has said,

“Declaration of the ULLS enables service providers to connect their own networks to existing infrastructure to deliver new and innovative services to end-users more efficiently. This reduces the need for full duplication of communications networks, while encouraging service providers to establish their own infrastructure where this is efficient.”

I have talked about one aspect of regulation, namely measures to stimulate competitive entry of new networks in the fixed line market.

A second key role for the regulation is imposing tougher controls on Telstra – to make it harder for Telstra to drive the market away from a competitive structure.

As the vertically integrated owner of monopoly infrastructure, Telstra can impede competition in many ways.

And sometimes it refuses to offer the same grade of service to its wholesale customers as to its retail customers.

To prevent this, Optus has been calling for a non discrimination rule. Telstra should be compelled to treat its wholesale customers such as Optus in the same way that it treats its own retail business.

The Government's proposal for operational separation would be a powerful framework to give effect to this principle of non discrimination.

But while in some areas there is a pressing need for increased regulation, in other areas, we think regulation can be stripped away.

The most pressing area to wind back regulation is the ACCC's proposed controls on the prices charged by Optus and other mobile operators to terminate calls to our network.

Telstra will now get a substantial reduction in the price it pays to Optus and Vodafone to terminate fixed to mobile calls. But given Telstra's dominance of the fixed market, it is very unlikely Telstra will pass this reduction to consumers.

So Telstra's margins will rise and it will receive a value transfer from its smaller competitors.

We think this may well weaken competition in the mobile market – and strengthen Telstra's dominant position in the fixed market.

A strange policy approach indeed – and why we at Optus say, let's roll back unnecessary regulation of the mobile market.

### Conclusion

The privatisation of Telstra comes at a critical time.

It could do lasting damage to fixed line competition; or it could be the catalyst for regulatory changes which drive us towards a healthy, competitive fixed line market – for the first time since federation.

Which path we go down is important not just for our industry, but for our nation.

Let's use the opportunity of T3 to:

- give certainty to regulators over the inevitable evolution of regulation in our sector;
- to leverage new broadband technology to bring true competition to the fixed line market for the first time;
- to set a national policy to drive infrastructure build through outcomes based regulation;
- and to get rid of misguided and burdensome regulation.

At Optus we are optimistic about the future – and we look forward to playing our part as our industry delivers on its promise for Australia.