Executive Summary of
Report on the Effectiveness of Competition in Hong Kong's Telecommunications Market in 2005: An International Comparison

Introduction

In August 2002, OFTA commissioned an international benchmarking study to assess the competitiveness of Hong Kong's telecommunications industry relative to seven other comparable and "best practice" markets -- Australia, Japan, Sweden, Singapore, South Korea, the UK and the US. That study ("2003 Study") was completed in June 2003 and the results of the study showed that at the end of 2002, the Hong Kong telecommunications market was one of the most competitive amongst the review markets.

As part of its efforts to regularly monitor the level of market competition and the associated consumer benefits, OFTA commissioned a second study in early 2005 ("2005 Study"). This study reassesses the level of competition in Hong Kong and in particular how the level of competition has changed in Hong Kong relative to the other seven markets over the two years of 2003 and 2004.

The 2005 Study focuses on the same four key competition issues that were examined in the 2003 Study. These issues are (I) regulatory framework, (II) development and effectiveness of competition, (III) consumer benefits, and (IV) industry investment. These issues are considered for four important sectors within the telecommunications industry, including the local fixed voice, mobile, data access and international services sectors. These sectors constitute the majority of the telecommunications industry and trends within these sectors have profound impacts on end-users and the general industry structure.

Key Findings

(I) Regulatory Framework

The report has reviewed the regulatory framework of Hong Kong and the review markets, with specific reference to the extent to which regulators can be viewed as pro-competitive and consumer focused. Such an environment is important if market competition is to be created and sustained.

The analysis presented in the report finds that the Hong Kong regulator's competition focus has remained strong after the 2003 Study and that in contrast to many other regulators, the Hong Kong regulator's intent has been consistently implemented in practice. Regulators in some of the other review markets appear to be struggling to define and to implement pro-competition policies and their focus has been occasionally diluted as they simultaneously grapple with issues of competition and industry development.

Specific conclusions for Hong Kong include:

- The Hong Kong regulator continues to significantly focus on the development of competition and the promotion of consumer benefits than the regulator of any other review markets
- In addition, the Hong Kong regulator is also comparatively more balanced in its approach to promoting market competition than other review markets. Apart from implementing asymmetric regulations to ensure market competition, the regulator also ensures that the level of regulation is commensurate with

the effectiveness of market competition. This is reflected in OFTA's initiative in implementing *ex-post* regulation of tariffs of the fixed incumbent operator

- Although Hong Kong does not have any general competition laws, the Telecommunications Ordinance appears to cover all the key anti-competitive practices covered by general competition laws in other review markets
- The Hong Kong government continues to have no direct or indirect involvement in the telecommunications industry beyond its regulatory duties. In contrast to many other markets, it has had no ownership in the incumbent or any other operator and has no foreign ownership restrictions for any operator. This has allowed the regulator to adopt policies which it considers most beneficial for Hong Kong and for end-users, rather than being constrained by a relationship with a particular operator in the market. Governments in some of the other markets have only recently relaxed foreign ownership restrictions
- The local loop unbundling (LLU or Type II interconnection in Hong Kong) is more advanced in Hong Kong than in most other markets and Hong Kong has made significant progress in furthering the LLU process in recent years. LLU facilitated market entry and helped to increase the level of competition in the local fixed market in Hong Kong. Given that the policy objectives of increasing market competition have been met, mandatory type II interconnection at telephone exchange level will be fully withdrawn by 30 June 2008 to promote investment and consumer choice in high bandwidth customer access networks

(II) Development and effectiveness of competition

The report has undertaken an assessment of the state of competition development in Hong Kong and the review markets.

Hong Kong is still considered to be one of the leading markets in terms of effectiveness of competition reflecting the regulator's strong and continued emphasis on the promotion of competition. It scores consistently high on all the involved variables reflecting the sustained competitiveness in all the telecommunications sectors in Hong Kong, and the fragmented nature of some of them.

Specific conclusions relating to the development and effectiveness of competition in Hong Kong include:

- The effectiveness and intensity of competition in Hong Kong's local fixed voice sector is significant as evidenced by the rapid erosion in the market share of the incumbent in the last two years. The deployment of six additional local wireline-based fixed networks after January 2003 has increased the level of competition
- Hong Kong's continued emphasis on the promotion of competition in the mobile sector has resulted in very effective competition in the sector. Hong Kong continues to record the lowest mobile market concentration in the sample
- The impact of competition may have been less significant in the data access sector, with the incumbent's share of the broadband access market decreasing only slightly from 2002 to 2004
- Competitive pressure has been maintained in Hong Kong's international services sector. IDD market concentration had remained stable between 2002 and 2004. Hong Kong recorded one of the largest increase in international bandwidth (from 13,712Mbps to 53,058Mbps) and bandwidth per capita (from 2.0kbps/capita to 7.6kbps/capita) in the sample from 2002 to 2004. International bandwidth per capita in Hong Kong was also significantly higher than in most other review markets in 2004

(III) Consumer benefits

The analysis of consumer benefits focuses on service innovation and development, take-up of services and the associated costs of consumption. The analysis indicates that Hong Kong has performed well relative to comparable markets.

Specific conclusions for Hong Kong include:

- In terms of service innovation and development, Hong Kong is one of the leading markets amongst the eight review markets, as is evident in the fact that Hong Kong has the largest number of IPTV (i.e. television services over broadband telecommunications network) subscribers in the world
- Hong Kong remains one of the most affordable markets for local fixed voice calls
- Hong Kong had by far the highest mobile penetration rate at the end of 2004. The decline in mobile prices between 1997 and 2002 was the highest in Hong Kong, compared to the other review markets. Hong Kong was also the most affordable market in the sample for mobile calls in 2004
- The broadband penetration rate in Hong Kong in 2004 was second only to South Korea
- The use of IDD services in Hong Kong has continued to grow rapidly. On a per capita basis, Hong Kong generated the largest amount of IDD traffic in the world in 2004 and experienced the largest increase in IDD traffic from 1998 to 2004

(IV) Industry investment

Generally, the capital expenditure to revenue ratio of individual operators in the review markets has decreased in recent years. This is likely to be a function of more cautious investment strategies, particularly after the burst of the IT bubble post-2000. Another possible reason is that most operators are now focusing on upgrading and enhancing their existing networks, instead of deploying entire new infrastructures.

Recent network investments by operators in Hong Kong and in other review markets have been to enhance coverage and capacity of their existing networks as well as to upgrade their networks so as to keep abreast of new technological developments.

Conclusions

In summary, the Hong Kong telecommunications sector has largely maintained its competitiveness in the past two years. This was achieved through a strong pro-competitive framework adopted by the regulator and the consequent market trends and dynamics. In particular, Hong Kong consumers and businesses have benefited significantly from the high levels of competition in the reviewed telecommunications sectors with consequent benefits to the wider economy.

The analysis has, however, also highlighted two areas in which Hong Kong has performed relatively weaker as benchmarked against the other review markets. Firstly, Hong Kong has one of the lowest mobile data revenues amongst the review markets. Secondly, the emergence of new technologies, the fixed-mobile convergence as well as and the convergence between telecommunications and broadcasting, will continue to pose challenges to existing regulatory frameworks. In view of these challenges, the Hong Kong regulator should continue to examine and update the existing regulatory regimes in order to facilitate technological applications, infrastructure investment, market development and enhancement of consumer benefits.