Telecommunications Market in Hong Kong:
Cultivating an Environment Conducive to Investment

Keynote Address by Mr M H Au,
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Distinguished guests, ladies and gentlemen,

Introduction

There is no doubt that Hong Kong is being served by a world class telecommunications infrastructure. Over three thousand overseas companies have set up their regional offices and regional headquarters in Hong Kong. One of the most important factors influencing their decisions was the efficient telecommunications infrastructure here. Five wireline fixed networks and four wireless fixed networks provide broadband coverage to all commercial buildings and 98% of all households. Eleven submarine cable systems and seven overland cable systems ensure that Hong Kong is connected to the rest of the world with plenty of capacity. Eleven digital mobile networks operated by six operators provide near ubiquitous coverage within the territory.

The existence of such a world class telecommunications infrastructure did not happen by accident. This is the result of many years of investment as the telecommunications market is progressively open to competition since the mid-eighties. The Government does not invest in the telecommunications infrastructure, but has worked over these years to cultivate a conducive environment for investment in the telecommunications sector, an environment built upon the policies of open market, pro-competition, pro-consumers, market driven and light-handed regulation.

Too Competitive?

And yet some critics say that the market in Hong Kong is too competitive. Prices stay low and dampen investment incentive.

Corporate telecommunications users and consumers have benefited tremendously from the competition in the market. Mobile phone services are affordable to everyone, leading to the penetration of 87%. Prices for broadband Internet connections are very competitive, leading to a household broadband penetration of 40%.

Since the liberalization of the external telephone services market in 1999, the consumers have saved HK$ 17.5 billion in IDD call expenditures. Such saving would have been put back into the economy and generated an even larger benefit to the economy through the multiplying effect.

It is true that the Hong Kong market is one of the most competitive markets in the world, but there is no reason why competitiveness should dampen investment incentive.

What do Investors Look For?

Let us look at what the investors are looking for before deciding to invest in a market.

First - Are there any barriers for entry into a market?

Obviously if an investor wishes to come in and it is barred from doing so, it will turn to other markets.

In Hong Kong, as of today, the market is already very open, as witnessed by the large number of facilities-based and service-based operators here.

In another month's time, the final regulatory barrier to entry into the Hong Kong telecommunications market will be removed, and this is the end of the moratorium period restricting the issue of further licences for local (or domestic) wireline-based fixed networks.

There is also no foreign ownership restriction in the telecommunications market in Hong Kong.

From 1 January 2003, the number of players will be determined by the market only unless there are physical constraints such as spectrum availability that limits the number of licences.

Second - once the investors have entered a market, are they able to compete in a fair environment?

In this regard, Hong Kong has a regulatory framework that conforms to the best practices in the world. It adheres in every aspect to the regulatory principles set out in the Reference Paper in the basic telecommunications agreement under the auspices of the World Trade Organization.

The regulatory framework is transparent and based on law, administered by an independent regulator. All the essential building blocks for a fair regulatory system have been implemented –

- dominant operator regulation to ensure that any dominant operator in the market will not stifle the development of competition;
- interconnection regime under which interconnection charges are to be cost-based;
- sharing of "bottleneck" facilities;
- Type II interconnection to local loops (or unbundling of local loops in other countries) to facilitate early network rollout;
- access to limited resources such as telecommunications numbering;
- statutory right of access to land for network rollout;
- number portability to remove customer switching barriers;
- transparent and competitively neutral scheme for universal service obligation and contribution;
- fair competition provisions in the telecommunications legislation, including the prohibition of anti-competitive conduct, abuse of dominant position, misleading and deceptive conduct in the market.

Third – can the investors identify the revenue stream that enables them to recoup their investment with the expected return?

Despite the temporary stagnation in the economy, Hong Kong remains a relatively affluent city with a GDP per capita of over US $24,000. Consumers and users have the capability to pay for the services provided that the services meet their needs.

On the corporate side, Hong Kong continues to the capital for regional headquarters and regional offices for multinationals in the Asia Pacific. Our goals to be a regional centre for financial services, logistics, tourism and professional services all require the critical support a world class telecommunications infrastructure. Our geographic location, our infrastructure, rule of law, clean government, simple and low tax regime, free flow of information, our talents, our entrepreneurship, etc. will ensure that Hong Kong will stay as a thriving business city in the years to come. This is a guarantee for increasing underlying demand for telecommunications services as Hong Kong moves to a knowledge-based and high value-added economy that depends on the exchange of huge volume of information over the telecommunications infrastructure.

On the consumer side, our population is prepared to embrace new technologies. Our younger generation is computer savvy. With a mobile customer base of 87% of the population, with 40% of households connected to the broadband infrastructure and the potential of growing in a couple of years' time to 70 - 80%, the percentage of households equipped with personal computers, the platforms are in place ready to deliver high value-added services, content and applications to the consumers. What is required is the innovation and creativity of the service, content and application providers to deliver the services that the consumers need and are willing to pay for.

Prices may be competitive in Hong Kong, but this needs not be a deterrent for investment. The basic objective of doing business is to earn a return commensurate with risk. Monopoly rent is not required to induce investment. And there is also no reason that prices should stay below cost. When the market functions properly, market forces will bring prices to a level that covers cost. We have in place fair competition provisions in the Telecommunications Ordinance to guard against predatory pricing. Effective competition is to lead to prices that cover costs including the cost of capital. As in all other market sectors, effective competition only prevents excessive prices. Effective competition will not deter investment.

No Entry or Exit Barrier

In Hong Kong, the ingredients for an environment conducive to investment are already in existence. We do not need to re-erect entry barriers to protect existing players.

We believe that, without physical constraints such as spectrum availability, the market is the best position to decide how many operators should there be in the market. If the Government simply sets a number of operators, how can the Government judge that this is the right number of operators? How can the Government judge that the existing operators supply the products and services that meet the users' demand?

Investors will make their own judgement as to whether or not to enter a market. Investors do not come into the market simply because the regulator opens the doors to them.

Some suggest that the regulator should license only operators who are prepared to commit to a minimum level of capital expenditures and a minimum level of coverage when we fully liberalize the local fixed network market next year.

We disagreed. Any such requirement will be arbitrary. Investors should be given the freedom to adjust their investment plan in the light of operational experience and actual market environment. The minimum commitments are effectively regulatory entry barriers.

What is also important is that, besides no regulatory entry barrier, there will also be no regulatory exit barrier, so that the market will adjust itself to the optimum number of operators.

Market exit is facilitated by mergers and acquisitions. The proposed legislation regulating mergers and acquisitions in the telecommunications industry now before our legislature is aimed at providing a clear framework for the regulator to consider entry and exit. Only the mergers and acquisitions that would substantially lessen competition in the market would the regulator consider intervention. Hong Kong is also not unique in having such mergers and acquisitions regulation as part of the legislation to protect fair competition in the market. We do not expect to intervene in the vast majority of mergers and acquisitions in the market that do not substantially lessen competition.

Conclusion

Ladies and gentlemen, Hong Kong's policies of open market, pro-competition, pro-consumers, market driven and light-handed regulation have attracted investors that built the world class telecommunications infrastructure that has been serving us so well. All the ingredients to promote investment are already there. Our strengths guarantee that Hong Kong will continue to have a booming demand for telecommunications services. We are just waiting for the economy to turn around. We do not need take a backward step to managed competition in order to promote investment.

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