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The importance of differential pricing for good consumer outcomes in telecoms

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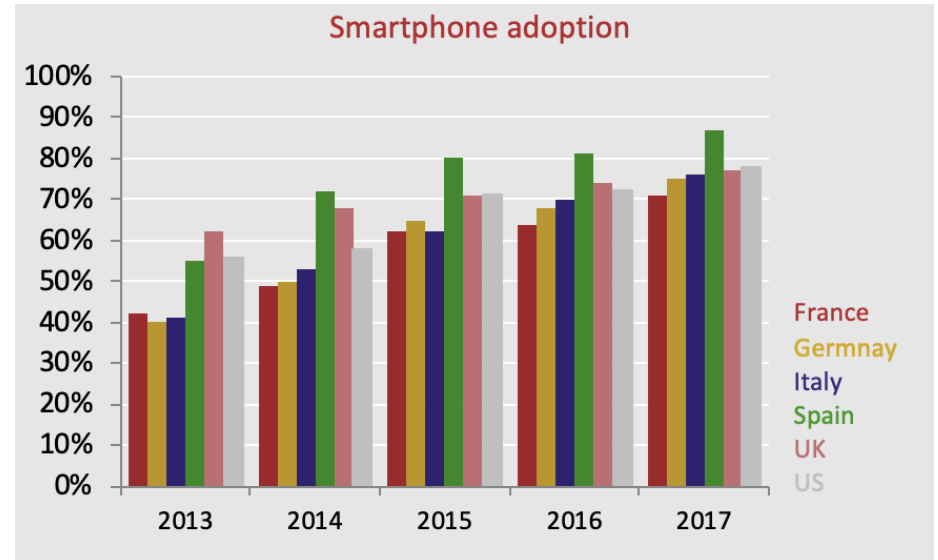
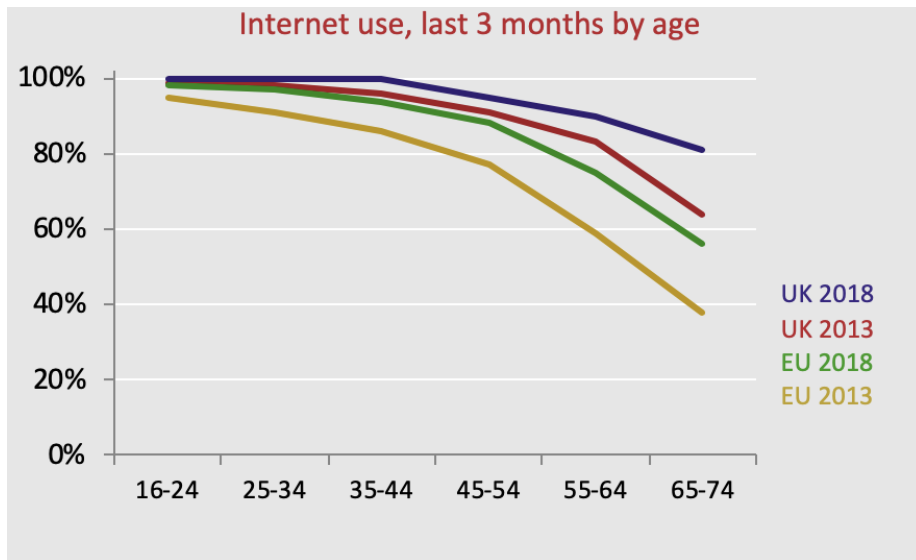
Agenda

Positive outcomes for consumers

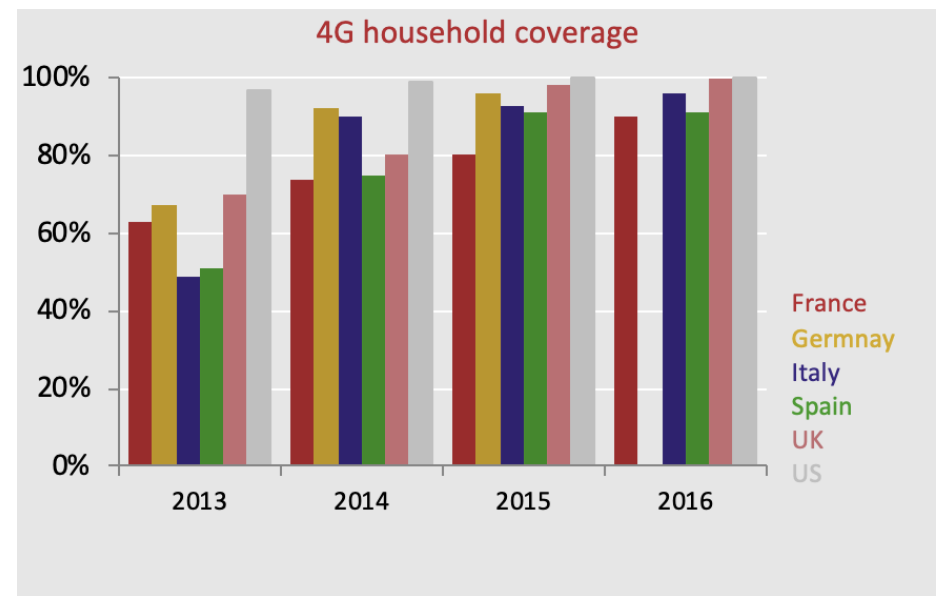
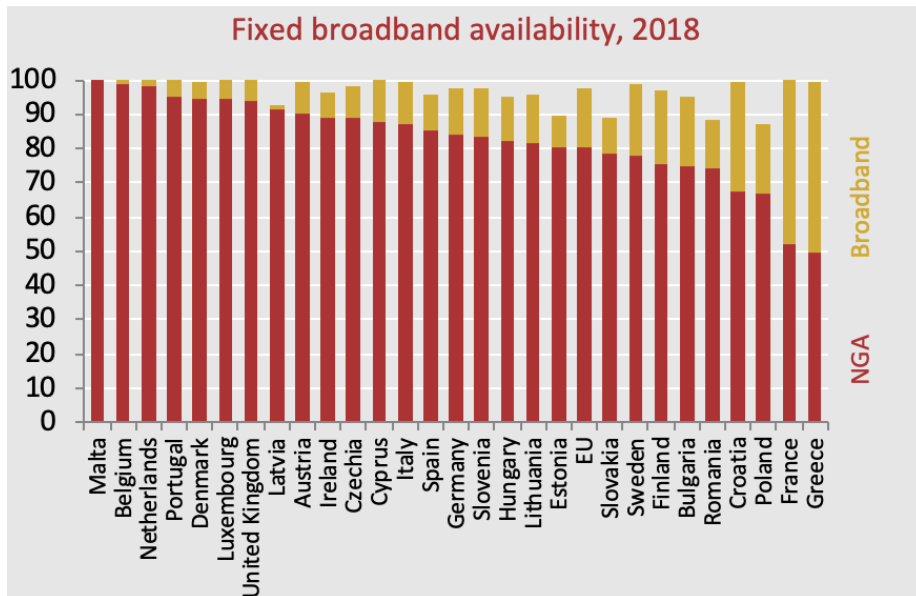
Telecoms vs utilities

Benefits of differentiated pricing

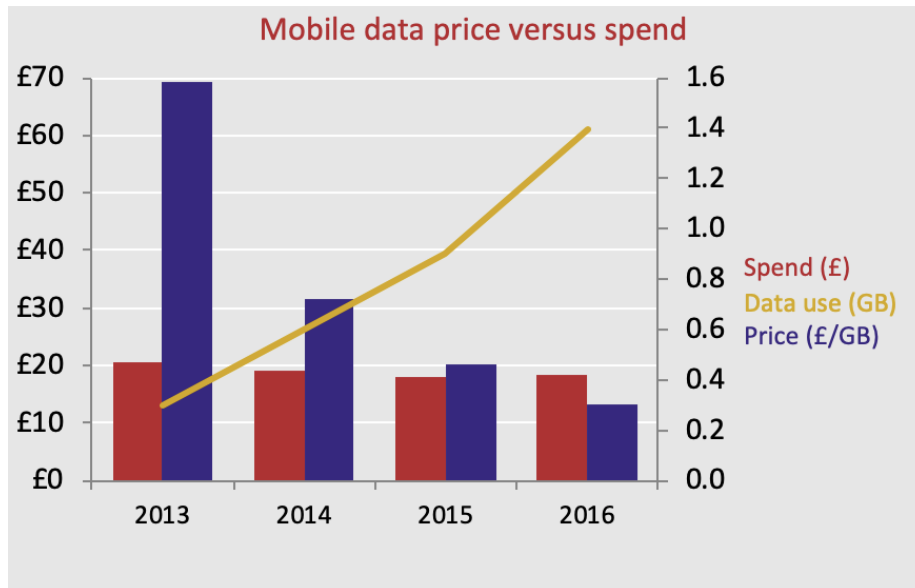
The UK ranks well in terms of internet and smartphone adoption



The UK ranks well in terms of broadband coverage (lags on 'full fibre', has picked up pace)



Value for money has improved enormously, driven by investment



- Mobile & fixed
 - Capacity/speed increases
 - Rapid data growth
 - Bundled content & services
- 4G coverage increase
- Spend \neq unit price

Customer service – there are problem areas, comparisons are difficult

- Consumer Green Paper - utilities & telecoms rate poorly
- However, EC scorecard
 - Telecoms scored 77.3 vs 78.7 for services & 82.7 for goods
 - Narrow range: 73.1 real estate agents to 85.3 spectacles & lenses
- Telecoms differs from utilities
- Telecoms paradox - rapid improvement & grievance
 - Haves & have-nots as networks upgraded
 - 'Disruption' associated with service transition

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Telecoms differs fundamentally from utilities such as water and electricity distribution

- Heterogenous
 - Consumers have a choice of different services & service levels
 - Telecoms services do not enjoy universal adoption
- Differentiated
 - Service-differentiation supports price-differentiation (benefits investment, transition, adoption & switching)
- Transition
 - Telecoms networks & services in ongoing consumer facing transition
- Competition
 - There are competing telecoms networks & competition is growing

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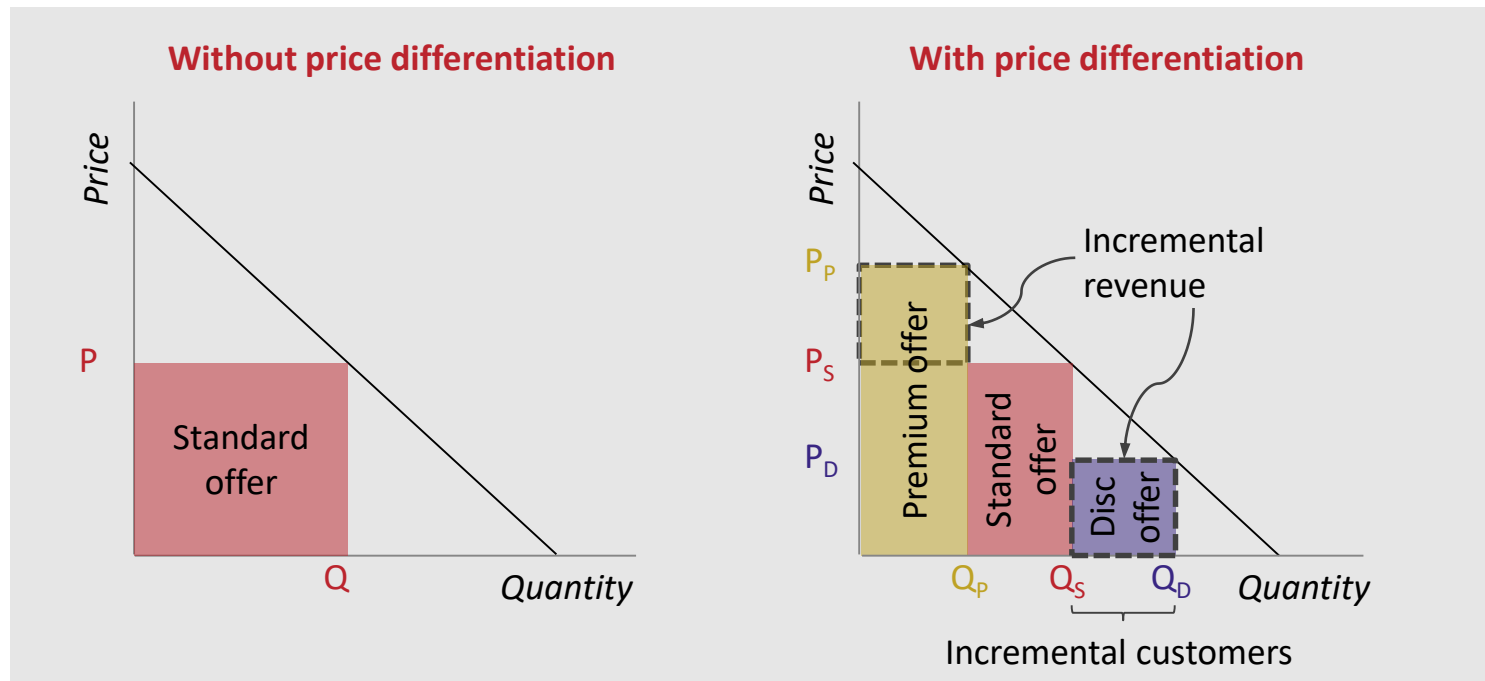
Positive outcomes for consumers

Telecoms vs utilities

Benefits of differentiated pricing

Price differentiation is the practice of charging different prices to different customers for the same (or very similar) product

- Differentiation may be related to purchase volumes, customer segments or many other criteria
- Particularly for segment-based pricing, the price differences are not related to cost differences – rather they relate to willingness-to-pay of different segments
- This enables investors to serve more customers and capture more revenues (supporting investment)



Price differentiation is widespread across the economy – and not seen as inherently unfair

OECD: “price discrimination is used in the vast majority of markets, it is frequently used by firms with little market power, and discrimination often makes markets more competitive”

Market	Pricing strategy
Airlines	Lower prices for round trips originating in lower income countries
Airlines	Discount for weekend stays (to identify non-business travellers)
Railways	Discount for advance purchase (as above)
Text books	Lower price in lower income countries
Consumer books	Expensive hard-backs (a premium for those WTP to read immediately)
Pharmaceuticals	Lower price in lower income countries
Retailers	Student discounts; discount coupons
Restaurants	Early-bird specials
Conferences	Discounts for attendees from non-profits
Theatres	Cheap standby tickets
Cinema	Cheap tickets for children
Satellite TV	Higher prices for bars vs home user
Productivity software	Lower prices for home users
Academic journals	Lower prices for universities, higher for corporates
Various	Armed forces and senior discounts

In markets with high fixed cost, competition or regulation, there is economic consensus that price differentiation is likely to benefit both providers and consumers

[C]onsumers may more often than not benefit from price discrimination in competitive markets

Dr Papandropolous , DG Comp

If there are large fixed costs, and low marginal costs, differential pricing may be required for a producer to be economically viable

Prof Hal Varian, UC Berkeley

Price differentiation often has a welfare-enhancing effect. In particular, the welfare effects are positive overall if demand increases as a consequence

Monopolkommission [Germany]

Price differentiation...[could] allow investments to take place that would, with a single price, not be possible

Ofcom

[We reached] a relatively strong conclusion regarding price discrimination with competition: it is at worst neutral, and at best positive.

OFT

While price differentiation has been common in telecoms (eg broadband speed), there is current concern whether discounts for new users is a fair form of differentiation

- Such discounts are very common across multiple industries:

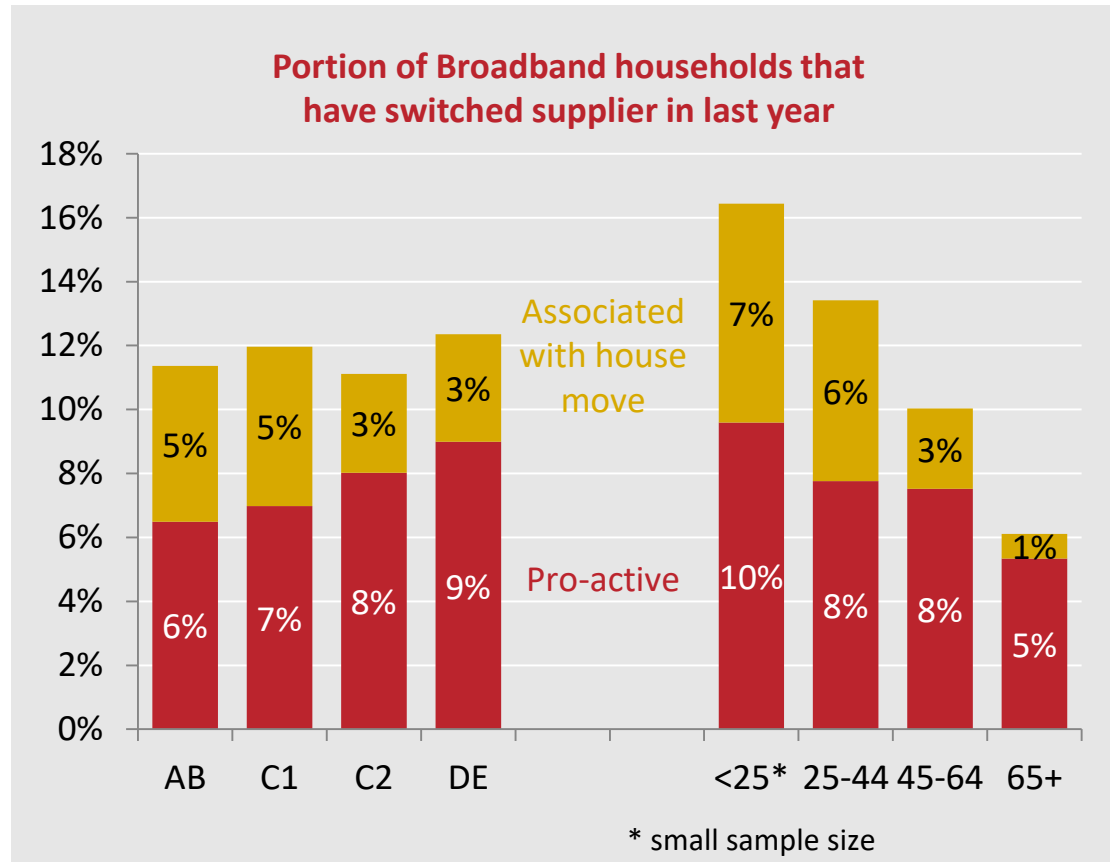
Products and services sold with initial discount			
Alarm monitoring	Electricity	Online dating	Subscription food boxes
Apartment rental	Gyms	Pay TV channels	Subscription software
Banking services	Health insurance	Personal coaching	Subscription vitamins
Bookkeeping	Magazines	Podcast hosting	VPN services
Car leasing	Managed IT services	Pool cleaning	Warranty plans
Child care	Martial arts lessons	Racehorse management	Water cooler services
Coworking space	Music streaming	Restaurant clubs	Website hosting
Dance lessons	Newspapers	Storage units	Weight loss programmes

- Suppliers offer initial discounts to:
 - Offset switching or set up costs for customers currently with another supplier or not using the service at all
 - Persuade customers to try an experiential good (eg ultrafast broadband)
 - Overcome the fact that a consumer with another brand may prefer that brand over the discounting brand

By supporting competition, initial discounts benefit all consumers

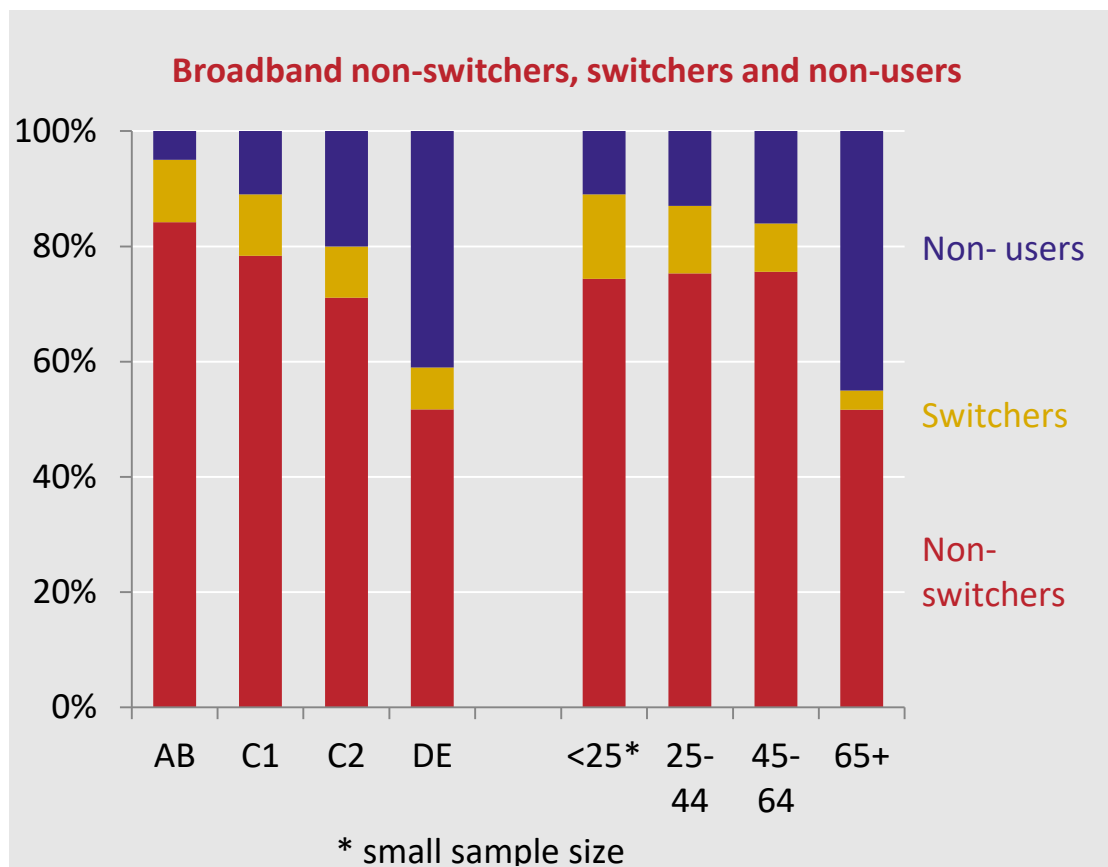
- As Ofcom has said, “unnecessary switching costs tend to dampen competition”, but initial discounts effectively act as a *negative* switching cost
- According to the FCA:
 - “Under price discrimination, the firm could offer a low price to new customers joining from a rival firm – and offer a higher price to its existing customers. However, its rivals will also price discriminate and target the firm’s existing customers with a low price. The firm has to respond to protect its existing customers and the effect can be that when firms price discriminate, prices to both new and existing customers fall compared to competition under uniform prices.”
- An example of this protective response is broadband providers actively offering free speed upgrades to existing customers, even if they have not demonstrated any interest in switching
- When Ofgem blocked initial discounts in 2009 (on the grounds of fairness), competitive intensity in the electricity sector fell and prices rose. Ofgem later reversed its ruling
- In addition to supporting competition, initial discounts support adoption, since entirely new customers benefit from them

Further, the evidence on who pays higher (post discount) prices is mixed



Source: Communications Chambers analysis of data from Ofcom, Core Switching Tracker 2018, 30th August to 30th September 2018, 30 October 2018

In addition, introductory discounts are potentially beneficial for those moving online for the first time – primarily the elderly and DEs



Source: Communications Chambers analysis of data from Ofcom, Core Switching Tracker 2018, 30th August to 30th September 2018, 30 October 2018