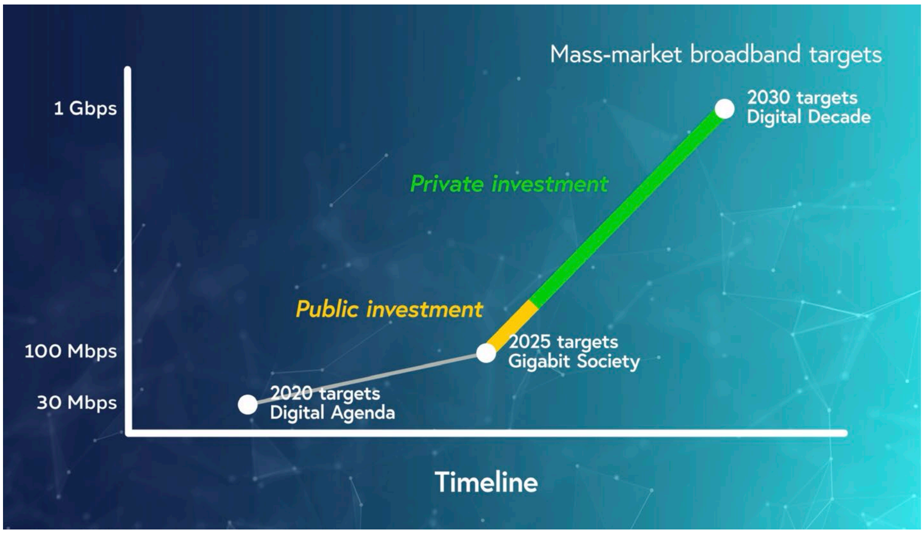
GIGAEurope response to the draft revised Merger Implementing Regulation

3 June 2022

GIGAEurope would like to take the opportunity of giving feedback on the draft revised Merger Implementing Regulation and the draft revised Notice on Simplified Procedure, and provide a more high-level perspective on a future approach to consolidation in the European connectivity sector.

1. Digital Decade ambitions require a paradigm shift in the thinking about consolidation in the connectivity sector



The Commission's Digital Decade target of connecting all European households to a gigabit network and of 5G coverage in all populated areas by 2030 is ambitious. Reaching the connectivity targets is key to allowing connectivity to play its enabling role in support of the strategic and socio-economic objectives of the EU Digital Strategy. By providing secure, resilient and high-quality connectivity for all economic sectors at scale, network operators facilitate the digital transformation of European businesses and society and increase the global competitiveness of European industry. In the same way, connectivity enables accelerating the green transition by providing access to sustainable, innovative digital solutions.

Addressing the obstacles to attract private investment into the roll-out of European digital infrastructure is a matter of great urgency. At present, the pace of private investment in European connectivity is a point of concern, particularly regarding the 5G roll-out. The infrastructure investment case for reaching the Digital Decade targets is impacted by the high

industry fragmentation nationally and across the EU, as well as by consistently falling revenues for operators because of regulation and hyper-competition in local markets.

2. The highly fragmented European connectivity market prevents recovering the cost of capital of infrastructure investments for the Digital Decade

The level of fragmentation of the European connectivity sector can best be illustrated in comparison with global peers. Europe accounts for 38 operating telecom groups with over 500k subscribers, compared to 7 in the US, 4 in Japan and 3 in South Korea[1].

This fragmentation prevents connectivity providers to fully benefit from the Single Market and to gain the necessary scale. The prospect of suboptimal business models because of high network costs that cannot be sufficiently amortized due to a lack of scale, negatively impacts incentives to accelerate gigabit infrastructure and 5G roll-out.

E.g. while we have approximately 10% transformational 5G coverage, China stands already at 60% population coverage, the US at 45% (by T-Mobile), Switzerland, UAE at 50%. If Europe remains on its current trajectory, we will reach 60% transformational 5G coverage by 2035, 12 years after China[2].

The root of the European 5G investment challenge is the lack of sufficient scale to support the very significant capital requirements (and national scale is the pre-requisite for being able to build pan-EU scale).

In fact:

- Deploying 5G requires 5 times more CAPEX than 4G (in urban areas)
- There are key markets where the current main mobile network operators are below minimum efficient scale for 5G deployment. The Commission has set that 20% market share is the minimum efficient scale of a mobile operator in 2G/3G[3]. As real 5G requires multiples of 2G/3G CAPEX, the minimum efficient scale for 5G is likely to be significantly higher than 20%, probably around 30-40% market share.

The lack of recovery of the cost of capital impacts operators' capacity to invest in network deployment. This is specifically recognized in a recent GSMA study by Kearney[4] which states that:

"*The medium to long-term incentive of telecom operators to keep investing capex at rates of up to 20% of revenue given the sub-10% returns on capital is a particular concern, and the performance of their share prices illustrates this starkly. There needs to be a balanced*

[1] ETNO 'State of Digital Communications' 2022
[2] ETNO/GSMA data
[3] Position enshrined in the 2009 Commission Recommendation on the Regulatory Treatment of Fixed and Mobile Termination Rates in the EU.
[4] The Internet Value Chain, May 2022, by Kearney for GSMA (p. 36), available at [Internet-Value-Chain-2022.pdf (gsma.com)](Internet-Value-Chain-2022.pdf)

approach to the ability to earn fair returns on investment across the internet value chain if it is going to continue to grow." (p. 36)

"(…) *when operators are expected to invest in expanding and upgrading the access networks, the revenues and margins they earn from these networks are declining. This has a detrimental impact on their ROCE on both sides — more capital investment is needed to upgrade the networks, but the returns are lower as revenues for core services decline*" (p.39)

"*Despite the growth across the overall value chain since 2015, the ROCEs of the telecom operators, which were already below 10%, have declined further. The returns to their shareholders have been equally low, raising questions about the ongoing robustness of investment in capacity, coverage and speed of the networks that connect internet users with services."* (p. 40)

3. Rational competition and greater consolidation can coexist

The Commission's view on consolidation within the connectivity sector has often been dominated by a focus on the potential impact on consumer pricing – with lower focus on the efficiencies which lead to higher investment per operator. Competition remedies have also led to financially unsustainable competition by creating artificial new entrants, particularly in the mobile space. Whilst we support a high level of consumer protection and rational competition, the reality is that local connectivity markets are characterized by regulation and hyper-competition leading to operator revenues that are far below those in markets that the EU wants to compete with in the digital economy. For example, in mobile, European average revenue per user (ARPU) was €14.4 in 2020, compared to €37.9 in USA and €25 in South Korea[5].

We believe that the main imperative for greater sector consolidation in the digital decade is not price effects. It is the strategic prerogative for operators to reach industrial scale that allows faster roll-out of gigabit and 5G networks and deployment of new business models around network innovations that support high growth applications in the field of IoT and AI across all sectors of the economy.

As mentioned in a 2015 CERRE study[6], competition and regulatory authorities have typically focused on the pricing implications of mergers, as they are concerned that increased concentration leads to higher retail prices. Less attention has been paid however to the impact that such mergers could have on efficiencies and notably on investments.

4. The Commission's substantive approach to merger review needs rethinking

At a time when great levels of investment in network deployment are required, the Commission must re-evaluate its substantive approach to merger review. The Commission must in particular consider the impact that mergers could have on efficiency, innovation and

[5] ETNO 'State of Digital Communications' 2022

[6] Genakos, C, T Valletti and F Verboven (2015), *Evaluating Market Consolidation in Mobile Communications*, CERRE, available at 150915_CERRE_Mobile_Consolidation_Report_Final.

investment – and also dynamic benefits for consumers, because investments enhance their demand for services.

The Commission has been almost exclusively focused on short-term pricing effects of mergers. Yet depending on the precise structure of the markets/industry in question, the effects of consolidation on investment incentives and efficiencies – and therefore consumer welfare - can far outweigh short-term pricing effects. This is particularly true in markets with large, fixed costs, where players need to be able to recover costs from a large enough customer base in order to justify the significant levels of up-front investment required.

The Commission's assessment should therefore:

- Acknowledge the role of minimum viable scale in markets with high fixed costs. Artificially persisting on sub-optimal market structures is likely to constrain the ability of smaller players to invest and therefore compete effectively against larger players.
- Focus less on short-term pricing effects and more on non-price consumer and efficiency benefits stemming from mergers, which can be achieved through increased rivalry in investment (with rivalry not being just a factor of the total number of players).
- Consider the competitive effects of a merger over a number of years in order to capture its anticipated impact on investment that may not occur in the immediate short term. In fact, today the Commission does not consider a long enough timeline when considering efficiencies that will arise from a merger. Merger review must be sufficiently forward-looking.

5. Forward-looking perspective on consolidation aligned with the shift in political focus on attracting private investment in European gigabit infrastructure & 5G

In conclusion, GIGAEurope calls on the Commission to adequately consider the inputs and proposals detailed *supra* and also to adopt a forward-looking approach to substantive merger review, aligned with the EU Digital Strategy objective to create European digital champions. As the Digital Decade connectivity targets set steep ambitions at national level, realizing the potential investment incentives associated with greater scale should play a prominent role in the assessment of future sector consolidation at national and cross-border level.

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