Non-Confidential

Helping consumers to get better deals in communications markets: mobile handsets

Our response to this consultation is in two parts. First, we make a number of observations on the consultation and then answer Ofcom's questions. In short, we are concerned that more information will confuse rather than enlighten customers, and that regulating subscription prices could dampen competition by reducing engagement and switching. Ofcom has already proposed regulation to prompt customers to re-evaluate their purchase decisions when the end of their minimum term is imminent; it should at least understand its effectiveness before contemplating other actions. In the meantime, providers – as Virgin Media has already done – may introduce offers to give customers more flexibility about how they pay for their mobile services.

Missing details

1. The consultation lacks the usual depth and breadth of analysis that we see in Ofcom's work, and the proposals are missing detail. These are important gaps because one of the options is the regulation (capping) of mobile subscription prices. This type of intervention has not been a feature of the mobile industry for over 30 years and, to our knowledge, has not been contemplated by either Ofcom or its predecessor. Importantly, Ofcom signals a future consultation once it has received responses to this one.[1]

Context

2. There are important and relevant market features and trends that are not adequately covered in the consultation, but well documented in Ofcom's 'Pricing Trends for communications services in the UK' published in May 2018[2] (and other publications). In summary:

    a. Between 2006 and 2016, average household spend on 'mobile voice & data' has fallen by just over 15% in real terms.
    b. Average monthly data use per mobile handset increased from 1.4GB in 2016 to 1.9GB in 2017, a 36% increase. Despite the significant increase in data use, the weighted average price was relatively flat, at £18.36 per month (using a defined basket of mobile services and excluding the cost of a handset).
    c. Since 2013 the average amount of mobile data consumption has increased five-fold, while the weighted average cost of the average basket has *fallen* by 11.5% in real terms.
    d. Using six baskets of mobile services designed to represent *"a wide spectrum of mobile usage",* Ofcom finds that, in real terms, prices decreased by 14.2% in 2017 across *all* baskets.

[1] Paragraph 2.16
[2] https://www.ofcom.org.uk/__data/assets/pdf_file/0030/113898/pricing-report-2018.pdf

e. Consumers purchasing voice-focused baskets are also benefiting from lower prices, particularly for smaller baskets that may appeal to customers with basic or low-use needs. Between 2016 and 2017, the price of the two lowest-use baskets, each of which requires 50 minutes of voice calls, fell by at least 30%, and the average prices of these baskets were lower in 2017 than in 2014.
f. PAYG services can represent excellent value for those with lower usage needs. Consumers in lower income brackets may prefer using PAYG services to control costs and avoid 'bill shock', or they may take PAYG services if they cannot pass a credit check for a pay-monthly contract. Older consumers tend not to be heavy users of mobile services, which may be why they are more likely to opt for PAYG services.

3. Ofcom has also carried out an econometric analysis of pay monthly mobile tariffs including handsets with data allowances of less than or equal to 20GB[3]:

> *"our findings support the proposition that the general trend of available prices available in the market over the period in question is falling over time (with the exception of between 2014 and 2015). This suggests that consumers are either able to receive improved services without having to pay proportionally more or can consume the same services for less money over time. We therefore consider that given prices are continuing to fall overall over the period, and* ***consumers are not forcibly being migrated****, the mobile sector is continuing to work in favour of consumers."* (our emphasis).

4. Ofcom is careful to state that *"[o]ur analysis does not speak to broader consumer welfare questions (for example, consumers continuing to pay handset repayments although they are out-of-contract)"*. We note Ofcom's qualification, but surely the path of prices over time for active customers (and recall that these are not unit data prices) is a relevant consideration when Ofcom is contemplating such intrusive intervention? The analysis shows that, even with no change in data consumption, customers on packages with fewer than 20GB of inclusive data have seen a real reduction in prices.[4] Those that use more data (we know that average monthly data consumption per active connection has increased nearly five-fold over the same period[5]) will have seen a drastic reduction in unit prices.

5. Ofcom's Communications Market Report (2018) gives some context to the many-fold increase in the consumption of data. It explains that this has been fuelled by a 'virtuous circle': better connectivity (through investment is 3G and 4G networks), new devices with significantly greater processing power ("*[s]martphones have become the most popular internet-connected device (78% of adults use one")* and new services supplied by Apple, Google, Airbnb, Amazon, Netflix etc).

[3] An econometric analysis of pricing trends in the UK (October 2018).
[4] *"We estimate that the monthly prices of available post-pay plans with handsets (and data allowances less than or equal to 20GB) fell by £6 between 2013 and 2017. "* p.26
[5] Ofcom CMR Figure 4.1

6. In summary, the data show that mobile customers are getting more for less. Despite the many-fold growth in consumption of data, real expenditure on mobile voice and data has fallen. This means that unit prices (quality adjusted prices) for data are falling exponentially.[6] Furthermore, those using predominantly voice are well served by either pay-monthly or PAYG plans.

7. The evidence above jars with Ofcom's assertion in paragraph 1.2 *("we are concerned that the market is not working well for everyone")*, the data show that the market is working well for the vast majority of customers; even if they do not take advantage of the *"good deals on offer".* The fact some customers could do even better by being more engaged does not undermine this evidence. Ofcom could also helpfully acknowledge that its own survey[7] shows that some customers know when their contract ends *and* that they have options to reduce their outlay, but choose not to; this is not a 'market failure'.[8] Addressing those customers who are ignorant of both their contract status and the options available is what Ofcom's end-of-contract and out-of-contract notifications are intended to achieve.

Options available to customers

8. Ofcom recognises that some providers (O2, giffgaff, Tesco Mobile, Virgin Mobile and Sky) have separate contracts for the handset and airtime elements. This means that the customer pays only for airtime once he or she has paid off the handset loan. This choice ensures that the cost of the handset is paid off over a specific period of time. Customers who are concerned that they might fail to convert to a SIM-only tariff (SIMO) after their minimum contract period can avail themselves of this option from five providers (and potentially more in the future).

9. As Ofcom notes, Virgin Media has its own Freestyle product where customers take a loan of 24 or 36 months for the handset as well as a separate, rolling SIMO (30 day) airtime agreement. When the customer finishes paying the loan he or she will remain on the SIMO tariff and the monthly payment will drop automatically.

10. In May 2018, Virgin Media launched new combined airtime and handset deals. Customers are given a handset as part of a 24 month contract. At the end of the contract term, the monthly price is automatically reduced by moving the customer

[6] Ofcom will recognise this effect because it participated in the Office for National Statistics working group that looked at different approaches to deflating telecoms services output: see https://www.escoe.ac.uk/wp-content/uploads/2017/02/ESCoE-DP-2017-04.pdf

[7] See https://www.ofcom.org.uk/__data/assets/pdf_file/0022/117076/Consumer-engagement-quantitative-research-2018-slide-pack.pdf e.g., only 6% of mobile subscribers are unsure of their contract status.

[8] Neither is it necessarily 'irrational'. Dr Deller, Professors Hviid and Waddams point out in their response to Ofcom's Call for Inputs on consumer engagement that: *"Consumer engagement should be treated as an intermediate objective rather than a final objective, in other words consumer engagement is only valuable to the extent that it delivers net benefits to consumers, for example, in terms of lower prices or high quality. Also, it is essential to recognise that consumer engagement involves an opportunity cost for consumers: by spending time engaging with a communications market they are unable to spend time pursuing other activities which might deliver greater benefits."*

to the nearest equivalent SIMO tariff. Customers on legacy combined deals [Confidential].

11. In summary, customers are already well served by a variety of ways of managing spend.

Analysis of consequences

12. The consultation contains insufficient consideration of the risks from an intervention which sets prices after the minimum contract period.[9] We expand on these potential risks below:

    a. There may be a misconception about how combined handset/airtime contract prices are set. There is no formula which is used to ensure that the unit cost of each handset is recovered precisely over the minimum commitment term. Ofcom's calculations appear to assume this to be the case: the handset cost £18.52 per month is subtracted from the monthly fee to yield the amount of 'overpayment'[10]. However, in practice, mobile providers know that, on average, customers remain for longer than the minimum term[11]. This means that providers may choose to 'risk' recouping the handset cost (and other acquisition costs) over a period longer than the minimum term, and the monthly charge in that first period is correspondingly lower. Mandating a migration to a SIMO after the minimum term could motivate providers to recover more of the cost of the handset over the minimum term. There is therefore a risk of a 'waterbed effect' where revenue 'lost' to providers in the post minimum term period is recovered through higher subscription prices during the minimum term. On average, the profile of payments from customers changes but the amount recovered is unchanged (ignoring the time value of money).

    b. There is a risk that customers become less engaged and less inclined to switch provider because they believe that: a) they will be put automatically onto the best deal available by their current provider[12] or b) the differential in prices between providers is insufficient to prompt customers to re-evaluate their purchase decision. This contradicts policy objectives that Ofcom has recently espoused.[13] The recent consultation on the introduction

[9] See paragraph 4.6: *"We are also aware that some could have an impact on the pricing of deals that are currently available, for example if they were to lead to a substantial increase in the number of people on SIM-only deals. In that situation, it is possible this could lead to higher SIM-only prices. We also recognise that particular solutions could lead to a reduction in engagement amongst consumers who are currently engaged, who might have less incentive to shop around, leading to lower levels of engagement and switching, and less competition or higher prices across the mobile market more generally."*

[10] The gross overpayment figure pf £330m per annum appears to assume that all customers 'overpay' for 12 months; we connect find in Ofcom's publications evidence to support this assumption.

[11] O2's contract churn of 12% implies that the average life of the customer is over eight years.

[12] This is a problematic assumption because SIMO deals have got better over time.

[13] For laudable reasons. Wadhams and Zhu (see: Empirical Evidence of Consumer Response in Regulated Markets, Journal of Competition Law & Economics 12(1) 2016) find that in order to encourage consumer

of contract notifications for mobile and broadband customers approaching the end of their minimum period together, with a one-off notification to customers who have already passed the end of their minimum contract period, is intended to encourage customers to 'engage'. Furthermore, from July 2019 customers will be able to switch mobile providers without speaking to the losing provider or having a notice period; a regulation designed to make switching easier between mobile providers. If the net effect of mandating lower tariffs in the post minimum term is to lower engagement and switching, the consequent reduction in competition could result in higher prices compared with the status quo.[14]

c. There is only one mention of investment in the consultation: *"consumers benefit most from competitive markets, where providers invest in networks and services and compete to make innovative offers to consumers who make informed choices about the services which suit them best."* If the waterbed described above is not 100% effective, providers will see a reduction in the lifetime value of their customers. This will reduce the return achieved on incremental investment. Ofcom should evaluate the possible magnitude of this effect given its regular encouragements to the mobile network operators to improve 4G coverage and the desire of government to *"be a world leader in the next generation of mobile technology, 5G, with deployment to the majority of the country by 2027 so that UK consumers and businesses can take early advantage of the benefits"*.[15]

d. We are beginning to see the convergence of fixed and mobile services. Ofcom should consider how its proposals would work if customers buy fixed and mobile services as a bundle with a minimum term commitment.

13. Ofcom should weigh the risk that its proposals for price regulation provide little savings for customers in the short-term, and in the medium to long-term result in higher prices through their deleterious effect on competition.

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action (i.e., switching) sector regulators and agencies need strategies: "*to **emphasize potential gains** and reduce anticipated switching time are the most likely to increase consumer activity, but programs need to be tailored to particular markets and target groups if they are to be effective in stimulating consumer activity."* (our emphasis). Put another way, potential gains (alongside an easy process) are what encourage switching between providers.

[14] See *Consumer Protection and the incentive to become informed* (Armstrong, Vickers, and Zhou, 2009). The authors note that *"imposing price controls on an oligopoly market could act to raise equilibrium prices…price controls soften competition by blunting consumers' incentives to search for good deals. Although the direct effect of a price cap is to reduce prices, the indirect effect of reduced search lessens each firm's demand elasticity so much that prices on average go up."*

[15] See the Ministerial Foreword to the Future Telecoms Infrastructure Review (page 1).

Questions

Question 1: Do you agree with the concerns that we have identified in relation to bundled mobile airtime and handset contracts?

These observations lack context. Ofcom's own data shows that customers are paying less for more and they are typically aware when their contract ends and that there are options to reduce expenditure. Customers can legitimately choose not to shop around. Ofcom's proposed regulation on end-of-contract notifications is intended to prompt more customers into action; time should be given to determine whether this objective comes to pass.

Question 2: Do you agree with the options we have outlined as potential remedies for the concerns outlined?

The regulation of subscription prices could have unintended consequences: customers could end up being no better off or in a worse position because intervention undermines Ofcom's other recent policy objectives: to increase engagement and make switching easier.

Virgin Media continually tries to 'steal a march' over it rivals. As an example, our new 'combi' packages automatically move customers to SIMO after the minimum term. We would prefer not to have this advantage undermined by regulation.

More information for consumers should not be an end in itself; it has to assist customers in making informed decisions. A cursory examination of what information providers might be required to present to potential or actual customers reveals that they a likely to end up bamboozled and in no better position to make an informed choice.

Ofcom says:

"When a customer signs up for a bundled handset and airtime contract, providers are not transparent about how much of the price they pay reflects the cost of the handset and how much for the airtime…….This makes it difficult for them to compare packages…."

Therefore:

"In our view, consumers should be able to clearly identify the goods and services that are offered to them and at what price, in order to evaluate what is on offer and make an informed decision about what to buy."

We make a few observations:

- How much is the cost of the handset in a combined deal? The Apple iPhone XR is available on the Vodafone website with a variety of memory options (https://shop.vodafone.co.uk/shop/contracts-and-deals/mobile-phones?initialFilters=flt_paymonthly).[16] A customer choosing 26GB of data with unlimited text and minutes will pay £49 upfront and £50 per month for the iPhone XR 128GB with a 24-month contract. Suppose the unit cost of this handset is £700. Should the customer be told that he or she is paying £29.16 for the handset per month over the minimum term and £20.83 for the data, text and minutes. If so, how should the upfront cost of £49 be treated? Is this a payment for the handset (in which case the monthly charge for the handset becomes £27.12 per month) or does it, in part, recover other joining costs? More accurately, what heads of cost should be included in the cost of the handset? Should this include: storage, transportation to the retail outlet (presumably this will vary across the country), breakage? The cost of purchasing handsets will change over time as manufacturers introduce new versions and exchange rates alter; how should this be reflected in the price presented to customers? Are handsets selected from the warehouse on a LIFO or FIFO basis? If Ofcom settles on a prescriptive definition of the handset cost, what if the implied cost of data, text and minutes in the minimum term differs from the SIMO tariffs available? Would Ofcom expect the latter to adjust, or should any difference reflect the amortisation of other customer acquisition costs?

- Alternatively, is the cost of the handset a residual item derived from subtracting the closest SIMO price (x24) – assuming there is one[17] – from the amount paid by the customer in the first 24 months? After all, this is the example given for the 'deal' that customers would be moved onto after the minimum period and it is what customers pay if they choose to buy their own handset; hence, conceptually, payment in excess of the equivalent SIMO monthly fee could be thought of as payment for the handset. In the example above, if a 30-day SIMO plan was available at £30 per month for 26GB this would make the amount recovered for the handset between £480 and £529 depending on the treatment of the handset. In this case, the actual unit cost of the handset (plus any allowance for other associated costs) is not recovered over the minimum period. How should the customer be made aware? Should he or she be told that the handset will be paid off in month 33?[18] What happens when SIMO prices vary? Should the customer be updated on the implicit contribution to the recovery of the handset cost that is being made during the minimum term?

- Either of the two options above could muddy the distinction between combination handset and airtime offers and 'Freestyle'[19] contracts where the customer pays separately for the handset and the airtime, potentially confusing rather than helping customers.

[16] We note that Vodafone has 63 pay monthly phones for personal use listed on its website, excluding options to purchase tablets.
[17] In the Vodafone example used the customer buys 26GB of data per month, however the 30-day SIMO plans only offer 20GB for £27 and 30GB for £32.
[18] This is analogous to the example quoted in 10a) where providers do not recover the handset charge over the minimum term.
[19] Virgin Media's branding.

The above should illustrate how complicated the task would be to disentangle the handset cost from usage charges and how potentially confusing it is likely to be for the customer to be presented with the consequential data (especially if the methodologies differ between providers).

We suggest that the customer needs to know: when the minimum period ends (if it hasn't done so already) and the options available after the minimum term. This is the information that will be imparted through Ofcom's proposals on notifications on contract status and end-of-contract prompts.

Question 3: Do you have views on additional solutions we should consider, including on split contracts?

Before contemplating other solutions, Ofcom should first decide what it wants to do about its recent consultation on contact notifications. If Ofcom decides to proceed with notifications, adequate time should be allowed to determine its effectiveness.

Virgin Media
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