

Per-minute calling based on technology two decades old

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Latin Americans love their mobile phones, but if you sit down and ask about how much they pay in monthly bills in the case of postpaid users, or how much they spend on topping up the device for prepay users, it is common to hear them complain about how costly it is to maintain their devices. In fact there have been commercials that make fun of mobile users' tendency to try and have a friend or family call them, rather than having to shell out the money to make the call themselves.

The culprit behind these perceived high charges is the mobile termination rate (MTR), or how much the receiving mobile company charges you to connect a call to their network. And Latinos' gripes aren't unfounded complaints, it turns out. US telecoms consultancy TMG found that at US\$0.106 a minute, the Latin American/Caribbean region has the highest average MTR in the world, even surpassing developed areas like Europe.

BNamericas spoke with TMG senior analyst Michael Mingos to find out more information behind Latin America's high priced MTRs.

BNamericas: To what would you attribute Latin America's high rates?

Mingos: Just a lack of regulatory oversight of the rate, and the fact that you have two big operating groups there - América Móvil and Telefónica - that have been resistant to the lowering of any termination rates whenever it comes up for discussion in any country.

Also, in the Caribbean, Digicel is against lowering termination rates. There have been all kinds of battles between them and Cable & Wireless.

BNamericas: The other developing regions - Asia Pacific, Middle East, North Africa - had some of the lowest MTRs at about US\$0.05 a minute. Is this because they have more regulations?

Mingos: It's partly regulatory oversight, but also just a different model in terms of the different mobile networks where the operators go for volume and high minutes of use with lower tariffs.

You look at the minutes of use [MOU] in India, it's something like 496 minutes a month, compared to most Latin American countries where it's around 100 minutes a month. In Brazil it's 93 minutes - five times higher in India.

So India can have less than a US\$0.01 a minute termination rate because they have so much volume.

BNamericas: Do they both have the same systems? Calling party pays?

Minges: Yes. There are a few Asian countries that have receiving party pays but they're not the norm. The average is for calling party pays.

BNamericas: Do you think it possible for Latin America to get to that low of a termination rate, or that level of MOU, in the future?

Minges: Sure, studies have shown that there's an elasticity of more than one. The lower the tariffs go, the higher the usage is going to be. In general, the reduction in the MTR gets passed through to the end user.

BNamericas: Were there any countries in the region that stood out in terms of highs or lows, or any other specific cases of interest?

Minges: Brazil has among the highest termination rates in the world at about US\$0.20 a minute. The operators are really dependent on that interconnection revenue, [as] it forms a high proportion of their revenues. But it just exasperates the lack of competition in the market.

On the one hand it seems that they have a lot of retail competition, and the regulator will always say that, but the prices are really high, MOU is low and existing operators offer really low on-net rates, making it hard for any new competitor to enter the market. A new player could offer low on-net rates, but the problem is that they're so small they don't have enough subscribers.

This shows the absurdity of the termination rate. It makes no difference where the call originates, it costs the same figure to terminate, no matter if it's on your own network or if it's coming from outside the network. So if the on-net rates are below the average MTR in Brazil, which they are, then something's wrong, it shows that the rate is not cost based.

The regulator Anatel is looking into it. They're going to have an MTR proceeding, but it has so far to drop and the operators are so large, so entrenched and so dependent on this that it's hard to say how long this will take. In the meantime, Brazilian consumers are suffering from this because apart from high MTR, they also pay really high taxes on telecoms services.

BNamericas: Were there any countries that stood out due to its low termination rates?

Minges: Colombia is actually interesting; the MTR is US\$0.0549, one of the lowest in the region. But it's interesting because there is also the option for capacity-based interconnection. I'm not sure how many operators take advantage of it, but it's something that the regulator has called for.

This means you don't pay a per-minute termination rate; you just put a high capacity IP line between the two networks and pay a monthly rate for the line. In a lot of the more advanced countries, they're moving to the capacity-based interconnection. It's a wholesale agreement and recognizes the transformation of the networks.

Charging per minute is based on the situation 20 years ago, when it was switch telephone networks and the accounting systems were set up that way and everyone thought in pulses and minutes. But now, at least on the telephone network, they're switching over to all-IP, and the concept of "minute" really doesn't make sense anymore.

BNamericas: What are some of the conclusions or recommendations you can make, for governments on one hand and operators on the other?

Minges: It's a question of perspective. Some of the operators view the termination rate as a source of revenue, but for other operators it's a cost, especially fixed-line operators. For consumers, the MTR filters into the retail price.

In terms of regulatory best practice, and even when it comes to the World Trade Organization, they all say that interconnection charges should be cost oriented. One of the issues has been deciding what the costs should be. Often, the operators have lumped all these costs in there that you could say are unrelated to pure termination. So a lot of the discussion is centered on whether those costs should be included.

Some of these countries that have high rates, the regulators approved them, based on the cost data provided by the operators. But the problem is that some operators include all kinds of questionable costs - there are some shared costs that are hard to distinguish between whether it's part of their origination and retail services - so they usually assign an arbitrary 10% of those shared costs to termination.

But now the European Union came out with a recommendation last May, that the cost of MTR should be based on an efficient operator. In other words, it's not the actual operating cost that's used in Latin America. Because if you use an inefficient operator's costs, you're not productive and the other mobile operators have to subsidize the least efficient ones, which isn't economically efficient.

The EU also said the rate should be only based on the portion of costs that terminate a call. The way to conceptualize that is to take the total cost of the network as if you had only your subscribers with only on-net calls and figure how much more it would cost to provide a termination service - that's how you isolate the termination charges. So the EU thinks that with the new guidelines on calculating termination rates, the MTRs will fall to US\$0.02-0.04 a minute by 2012.

BNamericas: You said that some operators are looking at MTRs as a source of revenue. What would be the other sources of revenue if they were to eliminate them altogether?

Minges: Their argument is always that if you lower the MTR, then handset prices will go up as subsidies will be taken away, and therefore consumers will suffer. But it doesn't make sense if you look at that argument, because handsets for prepaid users are hardly ever subsidized. The subsidies go to the postpaid users. Most of the subscribers in Latin America are prepaid and most prepaid are poor, so in a sense you have the poor subsidizing handsets for postpaid users through the MTRs.

Operators also claim there will be a waterbed affect - where you lower one side and the other rises - meaning that they'd have to raise prices elsewhere if they lower MTR. But that argument has also been refuted. There's evidence from ongoing MTR reductions over the years and there hasn't been any waterbed effect. That's actually where retail kicks in. If you have a competitive market there would be pressure for them not to raise prices.

So where do they get the extra money if they lower the MTRs? It will be in higher usage, and they have to develop other sources of revenue, like mobile data and internet access over mobile phones.

BNamericas: Do operators want to be encouraging higher use of their networks, or drive more data use? Wouldn't that make their networks collapse?

Minges: That's business; if you can have higher revenues with less effort, you always go for that.

But I don't know of any operators that have gone bankrupt because they've lowered their MTRs. If you look at Ebitda, they're all really high. I was just looking at data for India and comparing it to Brazil, and even on a much smaller retail pricing in India, the operators' Ebitda margin is the same as Brazil. So they're making as much profit as a market with high MTR. So you sacrifice the higher costs for more volume.

BNamericas: What would you say are some of the trends developing since you did the last study in 2005, and the study now?

Minges: Well the MTRs have been going down, perhaps not quick enough. There's also more regulatory attention being paid to this issue.

One of the interesting characteristics too, in the Caribbean, is that the European Union has been very vigilant of termination rates. If they feel the rates aren't cost based, they write a letter to the operator in that country and they can even take them to court over the issue. Latin America lacks that - there's no regional regulator that has these powers. But in the east Caribbean, there's a regional regulator for five countries, called the East Caribbean Telecommunications Authority. They came out with a ruling last year that put the rates out for those five countries, for the next three to four years.

My understanding is that this was only the second time where a regional agency came out and established benchmarks for what the rates should be.

In Latin America, a regional regulator could monitor and track the MTRs like they do in Europe, so that they become more visible.

BIOGRAPHY:

Michael Minges, senior market analyst for TMG, has more than 30 years of international experience. Before joining TMG, he worked as head of the market, economics and finance unit in the Telecommunication Development Bureau at the International Telecommunication Union (ITU), where his functions included the analysis of telecommunications trends in developing nations, market studies of countries and regions, and regulatory and policy advice.

He also worked at the International Monetary Fund as an economist and information technology specialist.

ABOUT THE COMPANY:

Founded in 1992, Arlington, Virginia-based Telecommunications Management Group (TMG) provides strategic, managerial and technical advice to telecommunications entities, governments and international agencies.

The company focuses on helping clients in projects in areas such as telecommunications opportunities and strategic planning, business analysis and evaluation, privatization, regulation and policy development, technology and infrastructure development, wireless strategies, and market research and analysis.

By Christian Molinari

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