

Voice over Internet Protocol (VoIP): A Unique Opportunity for Genuine Competition in Local Telephone Service

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After holding hearings on the issue in the fall of 2004, the Canadian Radio-television and Telecommunications Commission (CRTC) issued an important decision on May 12, 2005 on the regulatory framework for voice over Internet Protocol (VoIP) services, which some telecommunications service providers — including Vidéotron in Québec — started rolling out in 2004.

In its decision, the CRTC recognized the potential of VoIP technology to finally bring meaningful entry into the local telephone market, eight years after this market was formally opened to competition. At the same time, the CRTC purposefully refrained from a premature deregulation of VoIP services offered by the former telephone monopolies. This approach aims to ensure conditions for VoIP roll-out that are optimally advantageous for users while affording long-term prospects for businesses that take the risk of investing in the industry.

The long-distance experience

When competition was introduced in the long-distance market in 1992, the former monopoly incumbents, such as Bell and Telus, were required to charge a floor price for long-distance calls and to submit any new rate structure to the CRTC. This system continued until 1998, when the Commission decided to let the market set prices.

Nevertheless, the new competitors never managed to become truly profitable and in fact most incurred huge losses.

Indeed, the incumbents continue to dominate the Canadian telecom market today, led by Bell with 50% and Telus a distant second with 20%. Due to their presence in all market segments and their financial capacities, the incumbents are able to implement various strategies to maintain their position.

VoIP technology: a window of opportunity

Despite being open to competition since 1997, the local telephone market remains dominated by the former monopoly incumbents, who still hold 92.1% of the business segment and 98.2% of the residential segment according to the most recent statistics.

Therefore, the goal of establishing a competitive market in local telephone service and bringing in new players that have their own facilities has not been achieved thus far. It must be said that given the existing technology, this was an ambitious objective, if only because of the economics of networks.

However, VoIP technology has changed the equation and is now making this objective attainable, particularly since it can support the merging of local telephone service, long distance, Internet access and management of services such as messaging and other data transfers on a single platform.

At the dawn of the roll-out of VoIP services, therefore, a unique window of opportunity has opened and it can be expected to lead to genuine competition in local telephone service.

Advantageous position of the incumbents

However, it would be wrong to conclude that VoIP services will automatically carve out a share of the market.

A recent U.S. survey¹ shows that residential users are only moderately interested in VoIP services and it would take a considerable decrease in their bill for local and long-distance service to induce them to switch suppliers. Furthermore, nearly 40% of survey respondents said they would rather get this service from their local telephone service provider.

This again demonstrates the natural power the incumbents in the local market enjoy over customers. Because of their preferential access to both residential and business customers due to their presence in the local market, which they dominate almost completely, the former monopoly incumbents are able to manage the migration of their customers to VoIP technology. Indeed, they have already begun doing so. Taking advantage of customers' normal inertia, they can offer bundled packages on prices and terms that would make it very difficult for competitors to enter the market and be profitable.

If VoIP services were deregulated, the incumbents would have powerful means by which to thwart competition and would enjoy free rein with a full suite of

¹ See Forrester Survey, "Consumers Are Cool to VoIP: Survey," *Networkingpipeline*, February 2, 2005.

deregulated services, including wireless, long-distance, video, Internet access and VoIP.

By letting the incumbents consolidate their already dominant position, the regulator would be denying consumers a real choice. Customers might see a substantial reduction in prices in the short term. Once the competition had been eliminated, the incumbents could raise their prices again. In the long term, lack of competition would not promote productivity gains by suppliers or lower prices. Without genuine competition, users could be forced to pay more for VoIP services. The CRTC's May 12, 2005 decision, taken from a medium-term perspective, is justly aimed at averting this scenario.

Conditions for real competition

As the CRTC has recognized, to promote competition, market conditions that create a level playing field for all parties are needed. Hasty deregulation of VoIP services would create a competitive asymmetry that would not allow all players to make the required investments to offer these services in the marketplace. Our analysis shows that the incumbents' dominant position in the local market and their presence in all market segments would lead to an imbalance that must be temporarily corrected until real competition develops.

The regulatory safeguards currently in place to support the development of competition remain a necessary provisional framework that could be abandoned once true, sustainable competition has taken root in the local market.

Canada must take this approach if it is to remain one of the world's most competitive countries in telecommunication services.

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