

## **ATTACHMENT F**

### **Intangible Costs and Benefits**

Intangible benefits and costs are the gains and losses attributable to a universal service provider that are not reportable for formal accounting purposes. In general, financial calculations do not include these costs and benefits because they are non-monetary and/or are difficult to measure.

In 1999, following representations from industry, the then Australian Communications Authority (ACA) commissioned Ovum to review and report on intangible benefits associated with the USO. The Ovum report estimated the value of intangible benefits to the universal service provider as being between \$80 million and \$136 million in 1999–2000<sup>1</sup>. Following its consideration of this report, the ACA concluded that the potential benefits were material, but raised concerns about the estimated value of intangible benefits.

### ***Potential advantages of being a USO provider***

Intangible benefits that were suggested by various parties that submitted to the 2004 *Review of the USO and Customer Service Guarantee* were:

- life cycle effects, i.e. customers in an area may not initially be profitable, but may become so in the future;
- non-USO services, i.e. the benefit that accrues by virtue of having a USO presence and infrastructure and thereby being able to offer non-USO services at marginal cost;
- ubiquity, i.e. the advantages of having a ubiquitous presence as a result of being the universal service provider and thereby potentially having a greater profile with potential customers;
- brand enhancement and corporate reputation, i.e. the enhancement of the brand and image as a result of the national role of the universal service provider and the ability to leverage this into marketing and advertising;
- payphone advertising, i.e. the benefit of being able to advertise on payphones provided under the USO;
- volume discounts, i.e. the cost savings in equipment made as a result of providing the USO (for example, cable, vehicles, switching equipment, terrestrial and tower equipment); and
- the network effect, i.e. the value of adding additional users to the network and the increase in use that results.

### ***Life cycle effects***

The ‘life cycle’ effect involves an assumption that some USO customers who are not currently profitable may become so at a future time, and that a proportion of those customers will choose to stay with the universal service provider even if they become profitable to other carriers.

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<sup>1</sup> Ovum, *Calculation of the intangible potential benefits of being the universal service provider: report to the Australian Communications Authority*, December 1999

The life cycle effect can make it economical to retain customers who are not currently profitable in the expectation that over the long run they will generate a positive net present benefit.

### ***Non-USO services***

This is the benefit that accrues to a universal service provider by virtue of having a presence and infrastructure in the net cost areas and thereby being able to supply non-USO services at marginal cost. The services include value-added services such as messaging, facsimile and Internet access.

### ***Ubiquity***

The benefits of ubiquity are the benefits of having an overall presence through being a universal service provider and, through that presence, the potential dealings with customers. This benefit has been generally accepted. However, a few points regarding this issue need to be raised.

Firstly, many international analyses of the intangible benefits of ubiquity are predicated on the assumption that the USO provider is a monopoly provider in the USO area. However, this is not the case in Australia, where the ACCC has declared the unconditioned local loop service, public switched telephone network originating and terminating access and local call resale under Part XIC of the *Trade Practices Act 1974*.

These access and interconnect declarations enable competing carriers to offer ubiquitous connection to customers in USO net cost areas because they can rent the lines that Telstra, as the universal service provider, is required to provide. Similarly, competing carriers can offer local, long-distance and data services to USO area customers under these declarations. Once connected, a USO customer may have no dealings with the USO provider at all. Indeed, the universal service provider may be providing access but gaining little revenue or benefit from being the universal service provider other than wholesale access revenue.

### ***Payphone advertising***

Telstra is required to provide public payphones as part of its USO. The loss incurred on uneconomic payphones has been included as part of its USO net levy credit claim. However, there may be some benefits of having the corporate logo and insignia on uneconomic pay phones. Telstra, as the universal service provider, may also use available space on payphones for its own advertising.

### ***Volume discounts on telecommunication equipment***

Volume discounts are cost savings that Telstra potentially makes as a result of the USO obligation. Ovum suggested that savings could be made in cable, vehicles, switching equipment and terrestrial and tower equipment. However, other equipment such as radio technologies are not widely used outside NCA areas and are therefore unlikely to get the benefit of volume discounts.

### ***The network effect***

The network effect is the concept that telecommunication users benefit from the addition of more customers. At the most simplistic level, having a phone is of no

value if no-one else has a phone. As additional users join the network a person's telephone service becomes more valuable.

The existence of the network effect is well documented. Determining how much the additional USO customers add to the USO provider's profitability is more complex. In the absence of the USO regime, many USO customers may still choose to pay the cost of connection and join the network anyway. If, in addition, price caps were absent then many customers would opt to pay the true cost for their services, making them economically attractive to the universal service provider. Even in the presence of price caps, these customers may prefer satellite or mobile phones to connect to the network. This part of the network effect would therefore be available whether or not there was the USO.

Network effects are often called network externalities because they represent a market failure. The new user, in choosing to connect, will not directly value the additional utility that their connection will give to all existing users on the network. Therefore it is up to the carrier to attempt to capture it. In monopoly situations it is possible to capture this effect by subsidising the cost of new connections and recovering the amount from existing customers.

In today's integrated phone system, network effects can accrue to all carriers and service providers. For example, even British Telecom and AT&T customers benefit from having additional users in Australian net cost areas. As telecommunications services become more competitive, prices become determined by marginal cost and marginal benefit, meaning that the network effect is lost to carriers and passes directly to telecommunications users.

### ***Conclusions regarding intangible effects***

Intangible benefits to the universal service provider are inherently difficult to value. This is because by definition they are non-monetary in nature and/or are difficult to measure. Also, the effect of Part XIC of the TPA, and the fact that in Australia calculations are based on non-economic areas rather than on individual non-economic services in operation, mean that international comparisons and assumptions based on monopoly provision can be misleading.

Although no clear conclusions can be drawn on the extent of intangibles, there would be value in further examination of this issue if a network costing model approach was pursued in the future.