The Bouygues vs Orange & SFR case

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1. Introduction of the case

Brief introduction of the case

10th October 2006

Bouygues Télécom referred to the Competition Council a **complaint about anti competitive practises** on the French Mobile Telecommunications Market **from SFR and Orange France** – the two historically biggest players of the market.

The two operators were accused of offering to users **a tariff advantage for subscribing to packages including calls towards clients of the same operators only** since 2004.

13th March 2008

SFR and Orange France received a notification of grievance for **practises leading to margin squeeze of competitors**, susceptible of breaching some articles of commercial code.

« Is prohibited (...) abuse of dominant position by a company or a group of company on an internal market or on a substantial part of this one (...) as soon as they are susceptible of altering the business structure or operation of the market competitors (...). »

Article L. 420-2 of the Commercial Code

15th May 2009

After a session led by the Competition Authority, the judgement was reported to a second session. They stated that they needed to conduct further analysis to determine if the pricing differentiation was linked to a **potential margin squeeze**.

25th July 2012

Final decision following second and final session led by the Competition Authority, with the **following penalties**:

- ***117 419 000 euros*** for Orange France & France Télécom,
- ***65 708 000 euros*** for SFR.

2. The French Mobile Telecommunications Market

The French Mobile Telecommunications Market

- A mobile operator is a **telecommunications company**, offering both mobile telephony and mobile internet access services.
- The operator offers these services by providing a SIM card to the customer who inserts it into his mobile phone to access the network (GSM, 3G, 4G,..).
- The industry can be divided into two separate market: **the call termination rate** (gross market of telecommunication) and the **mobile services** (retail market).

Key characteristics

- **Call termination rate** corresponds to the **service offered** from operator A to operator B **that consists in terminating the call** of operator B's client towards client of operator A.
- The call termination rate is fixed by the operator of the user that is called.
- Each operator owns a network (*traditional player*) or purchase the right to connect on a tier network (*virtual mobile players*).
- **Relatively high retail prices**
    - Highest EU prices after Switzerland
    - About 70% higher than the EU average

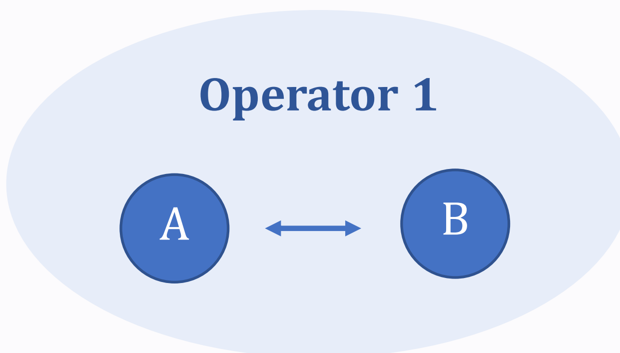
A static retail market

- A market considered as not really dynamic, with the **lowest penetration rate in the EU**.
- Market shares have been stable since 2005.
- Between 2002 and 2009, **there was no new entry into the market**, except for a number of entries and exits of MVNOS (virtual mobile operators).
- Barriers to entry in the market are consistent as requiring antennas and access to a network.

Within or outside an operator network: the two types of calls

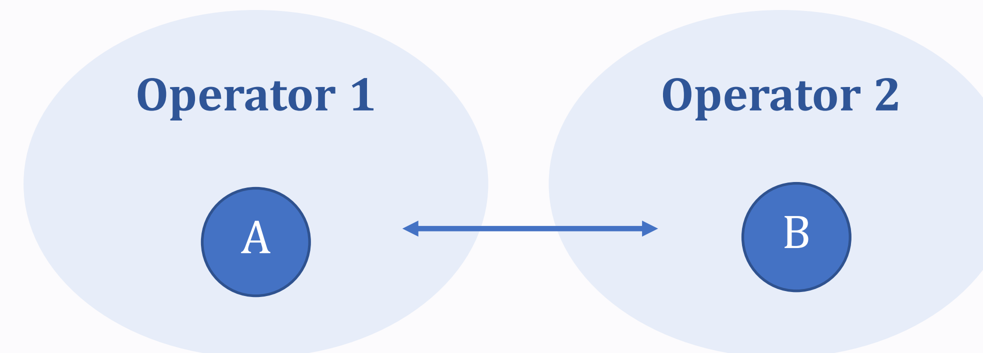
On net communication

If the communication is operated end-to-end by the same operator, it is called an "*on net*" communication and only requires the use of the operator own public network.



Off net communication

If the communication is from a client A to a client B, using different operator, it will be an "*off net*" communication based on an interconnexion on two public networks, agreed by the two operators.



Wholesale hosting market

- Since 2004, Mobile-to-mobile (M2M) termination rates are determined by ARCEP **to avoid abusive behaviour**.
- The price caps are set on the basis of long-run incremental costs which takes into account network design, traffic and cost.
- Before 2005, mobile operators did not charge each other for terminating calls when interconnecting : **"bill and keep" regime**.
- From then, **operators could charge other operators for call terminations on their own network**.

The retail market: selling mobile services to clients

- Originally, market consisted of pre-paid mobile services.
- The end of the bill-and-keep regime in 2005 led to the development of "**unlimited *on net* offers**", **packages offering unlimited communication with other clients of the same operator** for a given number of hours per month.
- Operators can offer *on net*, *off net* or *cross net* subscription offers.
- "Unlimited *on net*" bundles can include all clients or a restricted number of clients of the same operator. It can also be restrained to certain pre-defined time period, like after 6pm or during week-ends.

Key competitors on the market

- 1992: France Télécom Mobiles and SFR acquire licenses for digital mobile services
- 1996: Bouygues Télécom entered the market
- 2001: France Télécom and SFR acquire 3G licenses
- 2002: Bouygues Télécom receives its 3G licence
- 2004: Introduction of MVNOs on the market

1. Traditional mobile operators (MNOs) – Network Operators

Orange

- Subsidiary of France Télécom group created in 1991.
- Biggest player with 47% of the market share in 2007.

Society Française de Radiotelephonie – SFR

- Created in 1991, owned at 56% by Vivendi group and at 44% by Vodafone group.
- Owns 36% of the market share in 2007.

Bouygues Télécom

- Created in 1994, it is the third and last traditional mobile operator that entered the market.
- Owns 19% of market share in 2007.
- Benefits from a pricing asymmetry with higher threshold for call termination rate.

2. Virtual mobile operators (MVNOs)

- These operators **have not purchased any licence allowing them to use frequency bands**.
- Sell mobile telephony offers by **purchasing the services necessary to acces to mobile network.**
- Usually **diversification strategy** from traditional players.
- In 2008, **less than 5% of mobile telephony subscribers** are MVNO customers.
- **Exert poor competitive pressure** due to **restrictive conditions of network access** by MNOs.
- Target consumers with **low budget**.

The tribe effect

- **Natural decisions following recommendations from one's immediate environment** (friends, family, co–workers).

- Research[1] shows that "tribes" of clients (same social circle), for the vast majority, congregate around the same mobile operator company, with:

75% Of children have the same mobile operator than their parents in 2004

57% Of spouse/husband have the same mobile operator than their partner in 2004

- Moreover, data analysis show that communication dynamic among users is concentrated around their close relatives and friends:

52% Of a client's communications come from 5% of their total connections according to SFR in 2006

76% Of a client's communications come from their 5 first connections[2]

- These studies highlight the tendency of clients to communicate with their close social circle, and combined to the "tribe effect", this shows that traffic distribution is in favour of *on net* communication.

1) SFR study, Cote 13190, « Potentiel de l'option appels famille gratuits ».
2) Orange Study, cote 39464

3. How Orange and SFR used their pricing strategy to influence switching cost

Orange, SFR & Bouygues offers in 2005

After the end of the bill-and-keep system, the three operators changed their offers & pricing strategy

➢ Offers allowing unlimited communication **only got largely developed by operators in 2005** because it created a **new financial interest** for them: they can now charge calls entering their network.

	SFR	Orange	M6 mobile by Orange	Bouygues
Type of communication	**On net packages** : *"SFR Essentiel"*	**On net packages**: *"Orange Intense"* & *"Orange Classique"*	**On net package**	**Cross-net packages** : *"Neo"*
Package description	24/7 unlimited calls for a given number of hours	24/7 unlimited calls for a given number of hours + free text/media messages for the Intense package	Unlimited calls to all Orange numbers between 10 pm and 8 am on a blocked package basis.	Unlimited calls every day from 20:00 to midnight to any phone operator
Price for 2h of unlimited call for 12 month subscription	**36 euros/month**	**37,5 euros/month** for the Classique line **39,5 euros/month** for the Intense line	**32,90 euros/month**	**42,90 euros/month**
Price for 2h of unlimited call for 24 month subscription	**32 euros/month**	**33 euros/month** for the Classique line **35 euros/month** for the Intense line	**29,90 euros/month**	**42,90 euros/month**

➢ While Bouygues Télécom opted to offer ***cross net* packages**, allowing clients to have unlimited communication with users regardless of their operator, SFR & Orange decided to **develop their *on net* offering**: **price advantageous packages** for only *on net* communication, with **lower prices for longer subscription**.

Analysing the pricing of Orange & SFR packages

To analyse whether Orange & SFR strategies were pricing fairly *off net* communications, hence not preventing their clients to communicate with clients from other operators, an analysis was conducted, consisting in calculating:

1 Difference in price of an *on net & off net* call

SFR Essentiel and Orange Intense & Classique packages considered, **an average price difference of 12,4 cents** per minute was found between *on & off net* calls.

	Price per minute (c euros/min)	Average price on net (c euros/min)	Price difference (c euros/min)
Orange packages	15,96	2,56	13,42
SFR packages	14,48	2,9	11,6

2 Difference in production cost of an *on net & off net* call

Difference in production cost between an *on net* and *off net* call for an operator equals to the call termination rate difference between the two operators.

All years considered, a cost difference of 1,9 cents was found

	2005	2006	2007
Difference of call termination rate (c euros)	2,29	1,74	1,74

3 Difference between price and cost of an *on net & off net* call

Conclusion: price difference exceeded more than 6 times the cost difference *between 2005 & 2007 on SFR Essentiel package and Orange Intense & Classique packages*

With the tribe effect, changing operator implies switching cost for the user and for their tribe members

☺ User A has **an unlimited *on net* subscription** at Orange for a **12-month period** and wishes to switch to Bouygues

User A belongs to a tribe, all having an unlimited mobile subscription to Orange and all benefiting from unlimited calls to other tribe members (relatives, friends,...)

1 **Switching to Bouygues implies losing the price advantage of *on net* communication if the other tribe members stay with Orange**.

The client will face the choice of either

1. opting for a *cross net* package offer
2. opting for an *on net* package

➢ ***Increase of switching cost for user***

2 **User A switching operator also leads to an increase in cost for the remaining tribe or a decrease in communication volume**. Indeed, the communication with A for all the members will now be an *off* net communication, that will imply extra cost out of their unlimited contract.

➢ ***Increase of cost for all tribe members***

3 **If the client A is still under contract, they will be charged a sum of money for the remaining months of subscription by Orange**.
The cheapest and long-term contracts tend to have the high termination fees to attract consumers and prevent them from switching.

➢ ***Increase of switching cost due to high exit cost, lock-in effect***

4 **It becomes harder for a small player to acquire "complete tribe" on its network,** due to the disparity of contract end-date and the length of engagement each tribe member subscribed to.

➢ ***Lock-in effect increases difficulty to switch operator as a group***

As a result, SFR & Orange pricing strategy distorted the "tribe effect" on the market

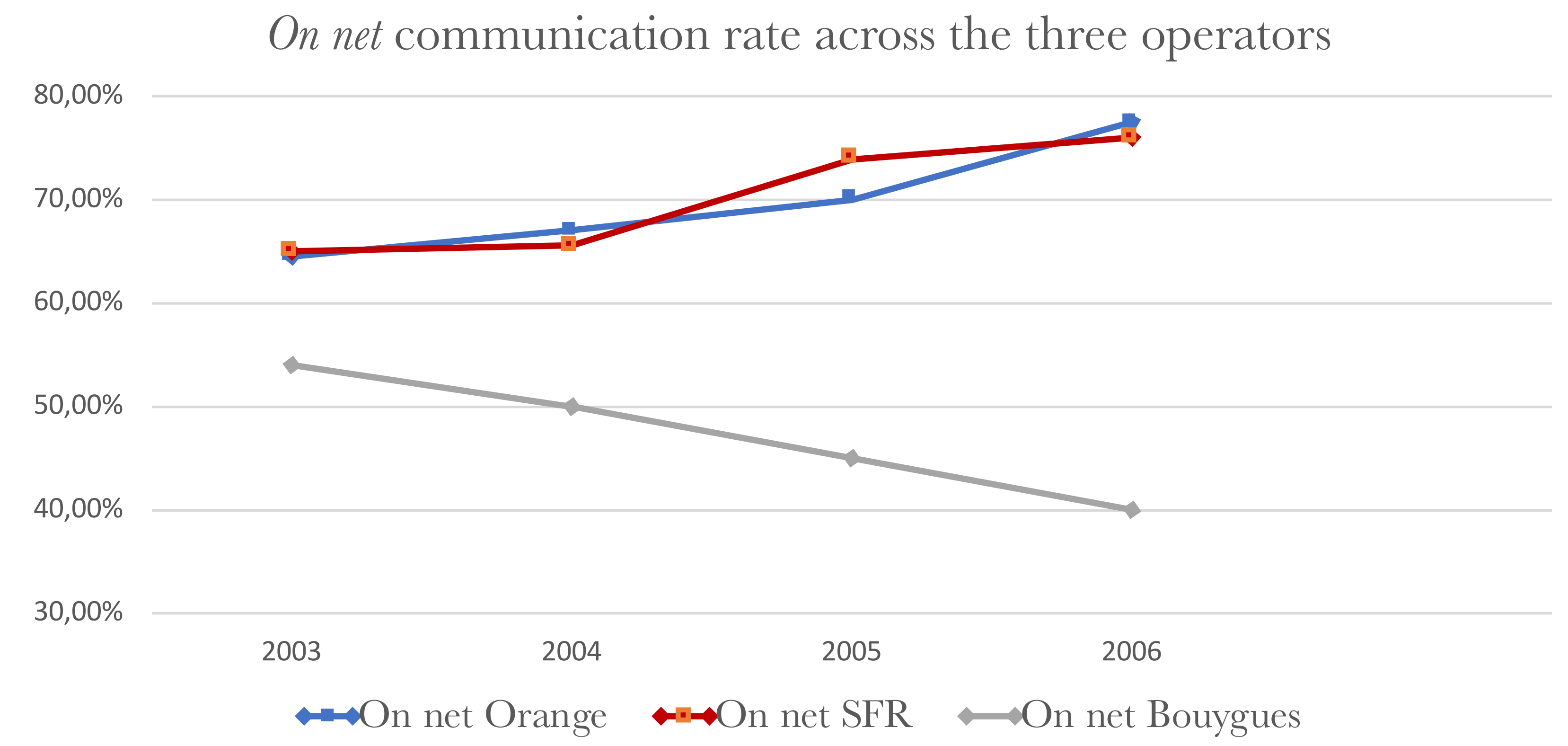
- Orange and SFR *on net* unlimited offers translated **into an intense increase** of *on net* traffic of the 2 operators, to the expense of *off net* traffic.
- This *off net* traffic retention caused an estimate loss of earnings of **140 million euros** from Orange and **42 million euros** from SFR between 2005 and 2009[1)]

➢ Increase of social gathering around one operator

Number of "tribe" members in each operator[2)]

Before 2005	After 2005	
1,8	3,5	Close relatives of the user also subscribed to SFR
2,5	3,7	Close relatives of the user also subscribed to Orange

➢ Increase of *on net* call rate



➢ Increase of communication within tribes

- For SFR, clients subscribed to an *on net* unlimited package call their first favourite number **about 25% more than the average client in 2006**.
- For Orange, **the first number of a client represents 46% of their calls**, compared to 41% for the average client in 2006.

➢ Decrease of churn rate

***Churn rate**: monthly percentage rate of users unsubscribing to an operator service*.

- A churn rate **16 times lower** for clients using fully their Orange Classique 2h compared to the total cohort of clients.
- Evidence for **increased customer loyalty**.

1) Données de l'ARCEP et de SFR, calculs de l'Autorité
2) SFR and Orange study in 2006

Summarizing Orange and SFR's pricing strategies effect on switching cost

➢ The tariff differentiation between *on net* and *off net* offers **artificially intensifies the tribe effect as it increases the incentive users have to choose their operators depending on their relatives' operator** => communautary aspect of an operator.

➢ As soon as **a "club" is formed within the same operator**, switching cost are higher since users value highly their communication with other "tribe members".

➢ SFR and Orange create **a "lock–in" effect by setting higher termination cost**. **"Lock–in" effect is intensified by club effect,** since it raises the switching cost for all members of a social group.

➢ **High exit cost and tariff differentiation prevents the market fluidity and raises barriers to entry** for operators that try to conquer market shares.