

# Opening Canada's Doors to Foreign Investments in Telecommunications: Options for Reform

Submission from Deloitte Canada

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**Who we are:**

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As such we are ideally positioned to contribute to a discussion on the future of our country's digital economy.

Our approach to this consultation process has been to engage our senior and experienced business and technology professionals in Canada, representing a broad selection of industries and viewpoints. Rather than advocate a single interest or outcome, our goal with this submission is to provide a Deloitte opinion on issues that affect all stakeholders in Canadian business and society.

**General overview**

As the world becomes more and more global, does it make sense for Canadians to be restricted in their choice of wireline, wireless and internet providers to only those who are Canadian-owned? Cell phone subscribers from Australia, UK and US, for example, can choose from services offered by some foreign companies.

Canada's absence of foreign-controlled alternative providers might cause some to argue that a lack of choice has resulted in a lower level of competition, lack of innovation, poorer quality of service and higher prices.

There are arguments supporting both greater competitiveness in the telecommunications market and the need to keep existing Canadian ownership regulations. It appears the time has come when Canadians may be forced to finally choose between the options. In the following pages we will present our arguments and our supporting rationale for our conclusions.

One of the ostensible main purposes in lifting foreign ownership restrictions is to reduce prices. Today, although Canada has one of the lowest rates for wireline we have one of the highest for wireless. Canada also trails most developed countries in terms of wireless subscription penetration.

At the same time, Canada has one of the most restrictive foreign ownership regulatory environments in the OECD.

Based on a study done by the OECD in 2006 and focusing on measuring the regulatory restrictions on inward foreign direct investment (FDI), Canada's global telecom score was 0.525 where 1 represented closed and 0 was open. The only countries who had a higher (more restrictive) score in the OECD were Australia (0.575), China (0.525) and South Africa at 0.638.

The USA has more than 285 million wireless customers, and Verizon is the largest US wireless carrier with 91.2 million wireless subscribers as of the end of 2009. Just for 2010, AT&T plans to invest about US\$18B in capex. On this side of the border, there are approximately 1M new wireless customers per year in Canada. At the end of last December there were about 22.8M subscribers for the whole country.

Telecommunications carriers have been able to keep their market share as customers continued to migrate to wireless and IP-based platforms. There are almost 5B text messages sent per day and more than 6B minutes-of-use a day in the US wireless industry. Based on CRTC statistics, the Canadian wireline revenues for 2008 were \$24.3B and \$16.0B for wireless.

Based on the increasing popularity of smartphones, spending for wireless data is expected to increase in the US from US\$43B in 2009 to US\$93B over the next four years. Today wireless data represents more than 28% of all wireless revenues. The

new trends in mobile phones are related to: mobile gaming, mobile TV, mobile banking and mobile advertising.

The migration from wireline to wireless is well under way. According to a recent survey by Statistics Canada, 8% of Canadian (22% in the US) households reported having only cell phones, up from 6.4% just one year earlier. And this number is even higher for under-35 year olds.

### **Review of the options**

In their consultation paper, the Government offers Canadians three options:

1. Increase direct limit for broadcasting and telecommunication to 49 percent;
2. Lift ownership restrictions on smaller players in the telecom sector so that those with less than 10 percent of the total telecommunications market can be foreign-owned;
3. Remove telecommunications ownership restrictions completely.

Canada has the world's second-largest territory and with a very low population density (4 people per sq. km. compared to 30 people per sq. km. in the US and 70 for Europe). To recognize this, the CRTC has adopted a subsidy regime targeting the high-cost serving area. In 2008, Local Exchanges Carriers (LEC) received approximately \$214M in subsidies and the final revenue-percent charge was 0.87% of contribution-eligible revenues. Moreover the incumbents must also assume the obligation to serve. In such a situation, can we afford to overbuild our networks? This would almost certainly take place as new entrants rapidly build their networks to match the incumbent providers' service.

BCE is the largest Canadian telecom company and as at the end of July has a market value of about US\$23 billion, compared to AT&T which has a market value of about US\$155 billion. Are we too small to compete efficiently on a global level? The answer should be no, and now might be the time for our companies to become global players – which probably will require Canada to loosen our own ownership rules.

Deloitte is not aware of any legitimate threats to national security or privacy issues that would justify keeping current Canadian ownership regulations.

Any new regulatory regime should not attempt to pick winners or losers but treat everyone equally. An asymmetric approach would create an artificial bias in favour of the new carriers at the expenses of the incumbent carriers. The goal should be to stimulate competition on a neutral basis and minimize market disorder.

For broadband, Canada ranks 10<sup>th</sup> out of the 30 OECD countries with 29.7 subscribers per 100 inhabitants. Unfortunately, we rank 25<sup>th</sup> in the OECD for high-speed internet services. The average Canadian monthly subscription cost is \$46.31 but in Sweden the average is only \$29.64. Moreover, our average advertised download speed is only 6.24Mbps compared to 92.85Mbps in Japan. When we compare speed for price, Canada falls to 28<sup>th</sup> out of 30 OECD countries, only ahead of Mexico and Poland. On this level, there is clearly room for improvement since high-speed internet access has become an essential dimension for innovation, our economy and the development of rural areas.

In the case of wireless, Canada had 66 wireless subscribers for every 100 people in 2008, compared with 93 in Algeria and 87 in the U.S. However, we have to be careful with those numbers because in many European countries, the subscribers have multiple subscriptions (SIM cards) to reduce roaming fees. In Canada, smartphones rose to 25% ( 31% in the US) of all mobile users and this is before the launch of the new iPhone 4. In the US, it is forecasted that there will be more smartphones than feature phones by the end of 2011. This initial smartphone adoption will likely lead to increased data usage which should in turn stimulate a decrease in rates and therefore continued migration toward smartphones.

In the light of the above mentioned elements, it is obvious that the carriers will have to make large investments either to catch up with other OECD countries or cope with new technologies as they arise. Fortunately, up until now, Canadian telecommunication companies have been able to raise their required capital, further

we have not seen much (or any) evidence that the cost of capital has been increased due to the existing ownership restrictions.

Even under proposed new foreign ownership rules, many of the large telecommunication companies would likely have to change their corporate structure to be able to access foreign capital. As an example, Rogers, a Canadian diversified telecom and media company, owns both a cable-distribution network and television stations in addition to telecom assets. The need to reorganise could complicate their corporate structure and reduce beneficial synergies.

One challenge of more relaxed ownership rules will be to avoid our telecommunication carriers being bought by foreign companies and becoming branch offices. This scenario could lead to rural areas becoming further disadvantaged and lacking essential choices between carriers and services. Significant Canadian job losses are another possible consequence of foreign control as jobs could be moved offshore.

On the other hand, foreign ownership restrictions can act as a barrier to entry that provides the incumbents with a material cost advantage. We have to remember that incumbents were able to build their network over time whereas the new carriers have to do it rapidly before having a strong customer base. But this head start for the incumbents was not free, as they have an obligation to serve. Perhaps in the near future we will see even more network sharing, as is often done elsewhere and we are starting to see in Canada.

After all these points, the ownership restrictions dilemma now centres on Canada's ability to attract innovation and new technology. If innovative foreign firms are not allowed to invest in our carriers or in our communications infrastructure, then Canada might not meet the primary objectives of the Minister of Industry Canada in terms of innovation and growth. Since our major wireline and wireless providers represent only a very small share of the global communications industry, and we already have very few large high-tech companies located in Canada, such as RIM,

allowing foreign ownership could certainly give Canadians and Canadian companies a better chance of being a real player in this changing environment.

Thus, we think that neither option 1 or 2 represents the best solution as they would not enable us to reach the Government's primary objectives. The remaining option, the removal of the telecommunication restrictions completely, would be the best choice but would still need a fairly high level of intervention from our government. Even if it will not be an easy task, we would recommend that Industry Canada approve foreign investment on a case by case basis so it would be able to monitor the situation and balance many competing factors such as the QoS, the obligation to serve, the need for subsidy in HCSA, employment, security and public safety, the emergence of innovation and new technologies and the need to have an orderly market.

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