CHAPTER 7

CONCLUSION

The technological developments in the communications industry as a whole have changed the nature and landscape of the local loop market and expand the opportunity for new entrants to enter the local market. In accordance, the regulatory framework under the auspices of MCMC has also evolved somewhat but still short of creating effective competition in the local loop market.

Although the number of operators who provide Internet related service and infrastructure has dramatically increased, it is also true that the incumbent still controls essential facilities in most market segments and also has a dominant position in the local loop market. In particular, in residential markets, the level of competition is very limited due to high up-front costs to build infrastructure and low profit in the local residential market.

As mentioned earlier, there have been many impediments for new entrants to compete with the incumbent in the local market. It is important to emphasise once again that the key issue to consider regarding entry barriers in the Internet access market is interconnection. As the market concentrates, particularly with the impending merger of TMNet and JARING, smaller IBPs and ISPs would have little choice but to agree to the terms of interconnection set by the incumbent since refusal meant that their customers could not reach the incumbent's customers. As a result, until there is effective competition in the local loop, regulatory measures such as the requirement for cost-orientation of interconnection charges are critical to ensure effective competition in the local market.

Current regulatory practices have seen the adoption of a "rate of return" regulation of which Malaysia follow and improvise, and a "price-cap" regulation undertaken by the British authorities. Rate of return regulation can potentially result in cost minimising production but to deliver this outcome the regulator must know at least as much as the regulated firm knows about its cost structure and the impacts of alternative technologies. In practice, there is likely to be a significant gap between what the regulator knows, and what they need to know in order to set efficient rates of return. This asymmetry of information can have the effect of offering the regulated firm a perverse incentive to over-invest in assets, a tendency which regulators need to be aware of in determining applications for increases in the rate base.

Under the price-cap regulation, the firm is the residual claimant on its profits and has a strong incentive to minimise costs since cost savings impact directly on overall profitability. Price-cap regulation still requires detailed knowledge and active oversight of the productive process as pointed out above, since the regulator must avoid setting prices so low that the firm closes down, or compromising consumer welfare by setting prices too high. Price-caps, which are in any case ultimately based on some view of a reasonable rate of return at the time they are set, are additionally vulnerable to gaming over the course of the regulatory cycle.

Although efficiency can be obtained through the application of detailed regulation, where the incumbent is instructed to behave in a particular way, in practice most regulatory regimes allow dominant firms considerable discretion over prices and investment decisions. There may be very good reasons for this, not least the fact that the managers in dominant firms are likely to be better informed about supply and demand conditions in the industry.

Furthermore, if regulation can be designed without unduly compromising business activities and operate alongside profit maximising incentives, it is likely to perform more successfully than intrusive regulation which often undermines the incentives for profit maximisation and efficiency. If an incumbent can react to the threat of entry by becoming more efficient and more responsive to consumer needs, there might very well be enhancement in welfare as prices are restrained by competition for the market.

To be sure, there is no tailored made solution. Selecting and assessing the most appropriate regulatory model may be developed from case studies of countries that have successfully introduced effective competition in their Internet industries. Yet the particular regulatory mix in each segments of the market would differ. In Malaysia, the choice of a technologically neutral regulatory regime under the anticipation of a convergent communications industry is commendable but its success would very much hinged on the effective implementation.