

AT&T/T-Mobile Merger: More Market Concentration, Less Choice, Higher Prices



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The Bottom Line

From a spectrum perspective, the merger of AT&T and T-Mobile appears to expand network coverage and improve performance for AT&T customers. From a market perspective, Yankee Group believes the merger will increase market concentration, reduce consumer choice, and open the door for price increases in the most heavily populated U.S. wireless markets.

Today's US Wireless Market: Verizon, AT&T and Everyone Else

Will the merger of AT&T and T-Mobile be good for mobile users?

At the time the merger was announced, Yankee Group thought the combined spectrum made possible by such a merger could bring better coverage and higher performance to customers (see the March 2011 Yankee Group Report "AT&T/T-Mobile to Verizon: Can You Hear ME Now?"). However, while a single company with combined spectrum promises better coverage, that technical solution ignores the market effects created by such a merger. This report is intended to raise our concern about the potential market and competitive implications of this merger on the U.S. wireless marketplace.

Since the March announcement, Yankee Group has analyzed its wireless industry and consumer data to understand the effects such a merger would have on the U.S. market, consumers and businesses. These results dash cold water on the merger's promise of benefiting consumers and competition; instead, we see this merger resulting in less choice and higher prices for T-Mobile's consumer and business customers.

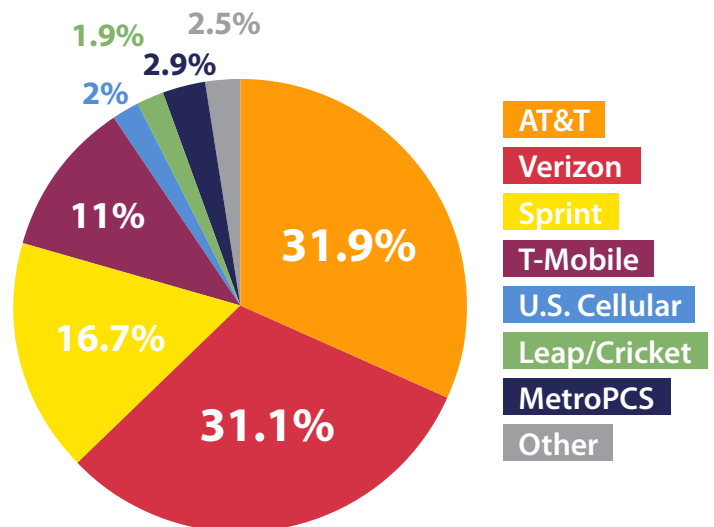
According to Yankee Group's [North America Mobile Carrier Monitor, June 2011](#), AT&T and Verizon each reported having almost a third of all U.S. subscribers at the end of March 2011 (see Exhibit I). AT&T reported having 97.5 million or nearly 32 percent, while Verizon reported 95 million or just over 31 percent. Other mobile operators, including Sprint (about 51 million subscribers), T-Mobile (33.6 million) and other smaller carriers, offer alternative wireless services that serve 105.4 million, or roughly the other third of the U.S.' 298 million subscribers. This market share picture at the national level appears to provide consumers with a wealth of choices.

But Market Share in Local Markets Varies Significantly

However, what Exhibit I ignores is the local competitive landscape. When the U.S. FCC created the licensing rules for the cellular market in 1982, it divided the U.S. into 734 cellular market areas (CMAs) to ensure no one carrier dominated in each of those local markets. Yankee Group analyzed more than 15,000 responses from its [US Consumer Survey - Wave I-12, 2010](#) to understand how those market shares changed at the local level.

Exhibit I: Wireless Service Provider Market Share in the Top U.S. Cellular Market Areas

Source: Yankee Group's North America Mobile Carrier Monitor, June 2011



Note: Data includes Q1 2011 reports from all U.S. mobile operators.

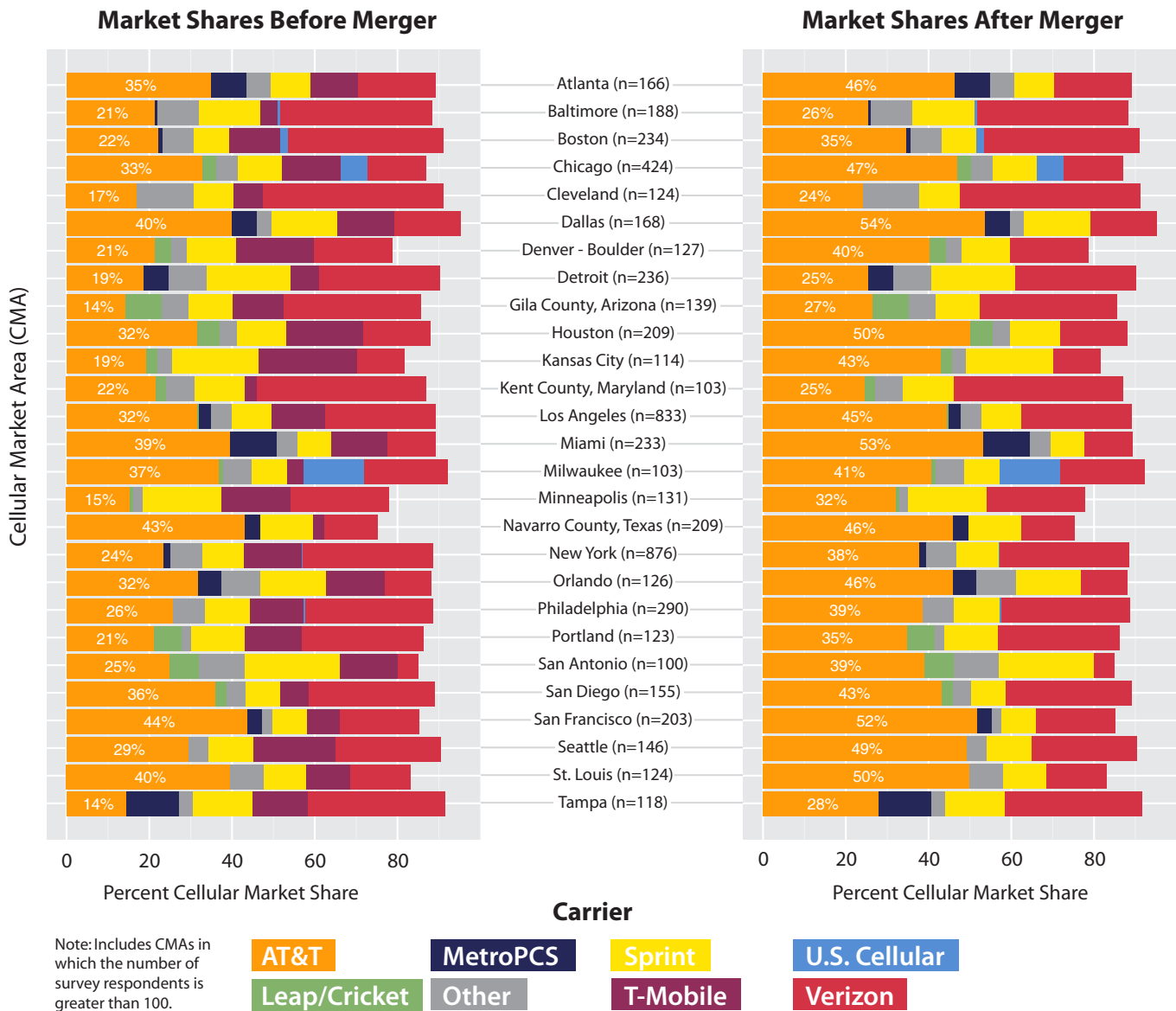
Exhibit 2 shows the results of that analysis for 27 of the most populous CMAs. Today, AT&T has 33 percent or more of the subscribers in nine of those CMAs. The proposed merger would give AT&T more than 33 percent of the market in 20 of those 27 markets. In fact, the merger with T-Mobile would give AT&T a full 50 percent market share or more in five of the most populous CMAs.

Department of Justice Metrics Imply This Merger Would Concentrate Market Power

Market share numbers don't provide the complete picture of how concentrated a market is. The U.S. Department of Justice (DoJ) uses a more sophisticated metric, the Herfindahl-Hirschman Index (HHI), to assess market concentration. (Details on calculating and interpreting the HHI are available in the DOJ's 2010 guidelines for mergers, which can be found at <http://www.justice.gov/atr/public/guidelines/hmg-2010.html>).

Exhibit 2: AT&T/T-Mobile Merger Would Give AT&T More Than a 50 Percent Share in Five Major Markets

Source: Yankee Group's US Consumer Survey - Wave 1-12, 2010



Those guidelines identify numeric HHI breakpoints for analyzing mergers:

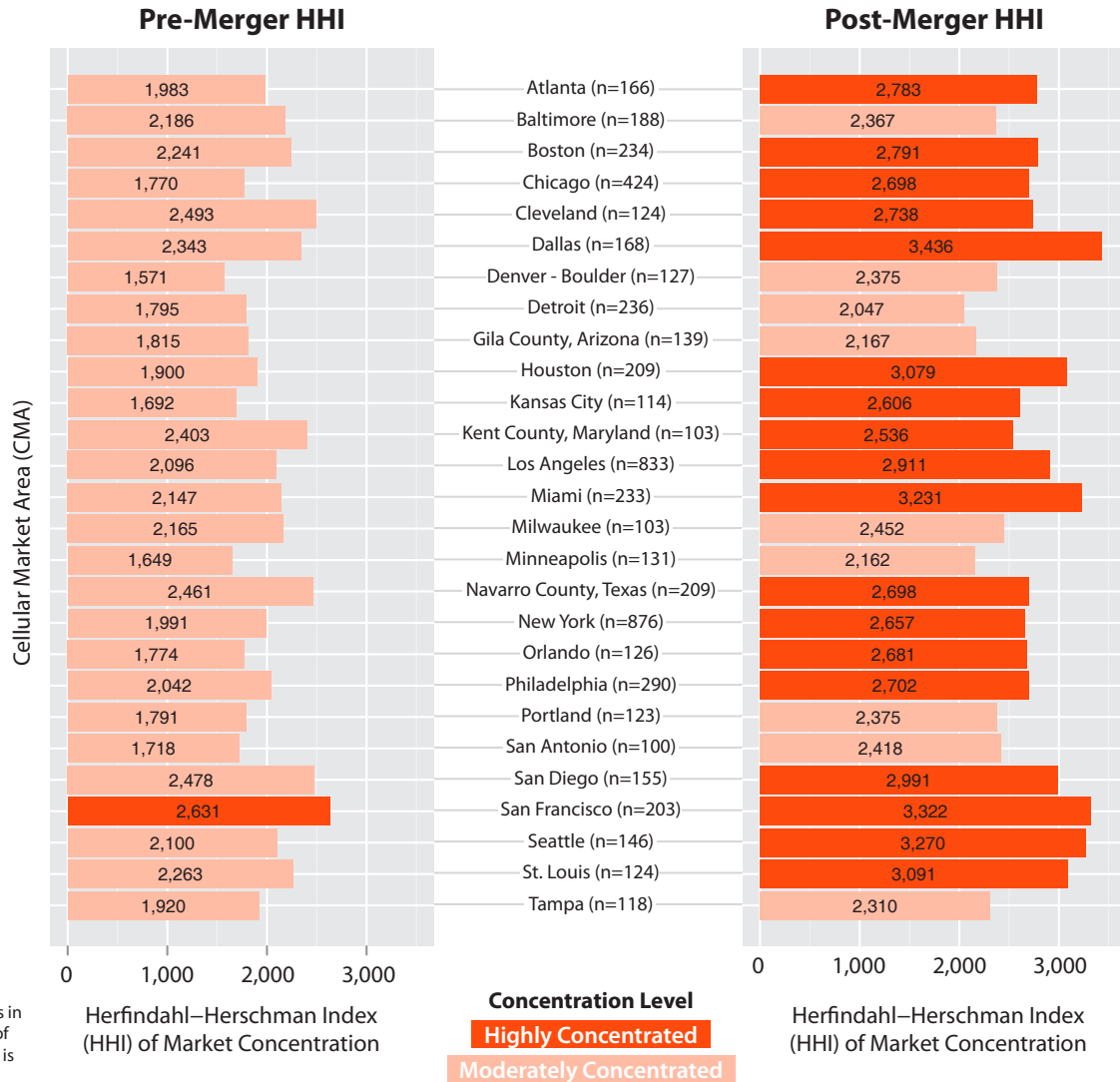
- **Post-merger HHI below 1,500.** The DoJ regards markets in this category to be unconcentrated. Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- **Post-merger HHI between 1,500 and 2,500.** The agency regards markets in this category to be moderately concentrated. Mergers producing an increase in the HHI of more than 100 points in moderately concentrated markets post-merger potentially raise significant competitive concerns depending on the factors set forth in Sections 2-5 of the guidelines.

- **Post-merger HHI above 2,500.** The agency regards markets in this category to be highly concentrated. Where the post-merger HHI exceeds 1,800, it presumes that mergers producing an increase in the HHI of more than 200 points are likely to create or enhance market power or facilitate its exercise.

Using data from our 2010 US Consumer Survey, we computed HHIs for the same largest CMAs listed in Exhibit 2. We find that before the AT&T/T-Mobile merger, only one of the top 27 CMAs is highly concentrated. If the merger proceeds, however, 17—or 63 percent—of the top 27 markets would be considered highly concentrated (see Exhibit 3).

Exhibit 3: AT&T/T-Mobile Merger Results in the Number of Highly Concentrated Top 27 CMAs Growing From 1 to 17

Source: DoJ HHI 2010 Guidelines and Yankee Group's US Consumer Survey - Wave 1-12, 2010



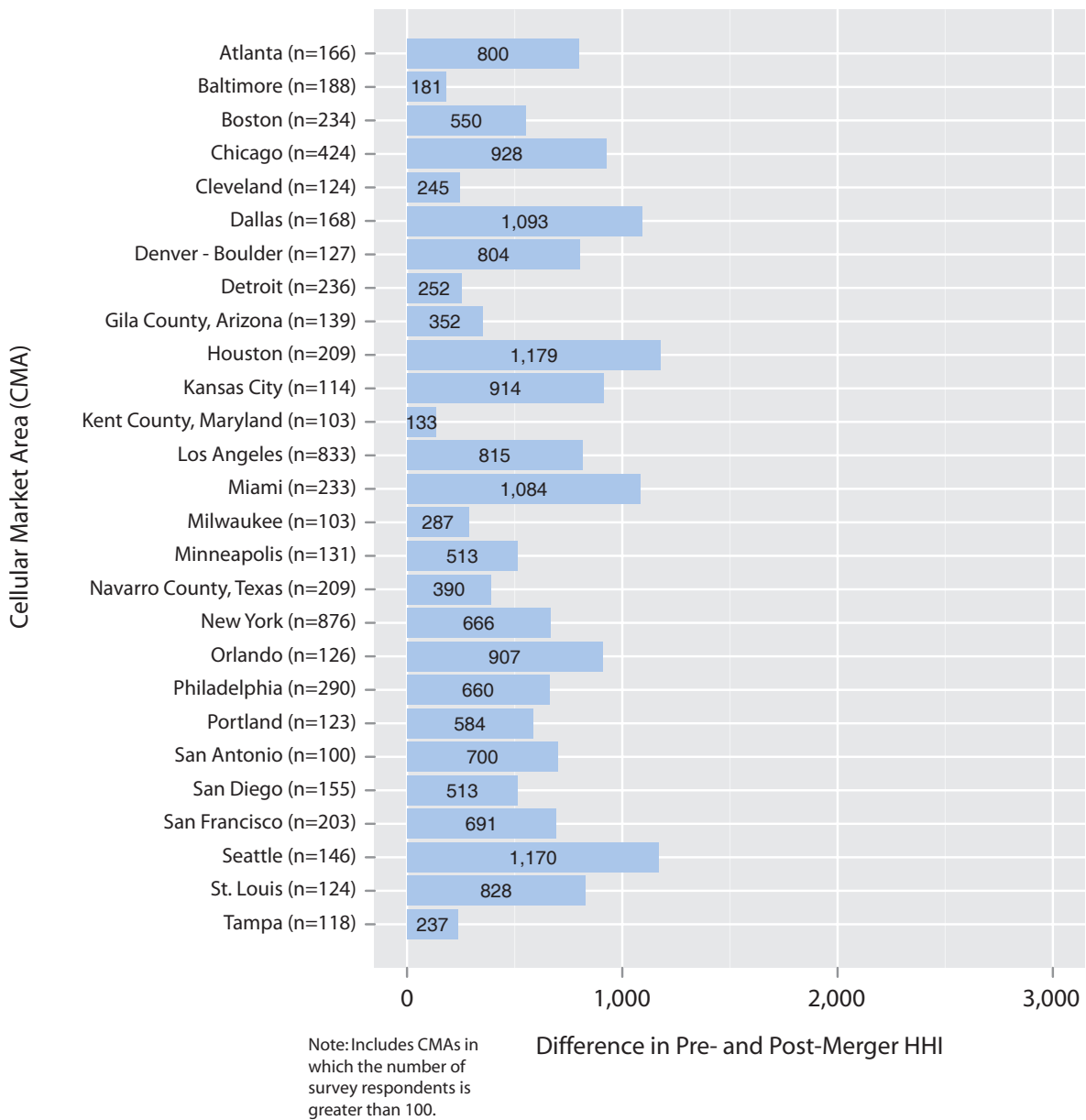
The shift in market concentration among the top CMA is striking. Not only would 17 of the top 27 CMAs become highly concentrated, but the HHIs would jump dramatically. The DoJ's 2010 guidelines state that any HHI increase of 200 points or more is considered significant. In our analysis, not only did 25 of the 27 CMAs see HHI increases over 200, but four of the CMAs had HHI increases of over 1,000 (see Exhibit 4). There is no question the merger would result in significantly more concentrated markets.

Market Concentration Leads to Reduced Price Competition, Higher Prices Over Time

In these more concentrated markets, consumers and businesses will have fewer choices for wireless carriers. This in turn reduces price competition among wireless carriers, which over time leaves every consumer in these markets with higher prices. This basic dynamic is present in other markets, such as the airlines, where cities served by multiple national carriers offer lower fares than cities served by a single national carrier.

Exhibit 4: Post-Merger Market Concentration Increases Markedly in Top 27 CMAs

Source: DoJ HHI 2010 Guidelines and Yankee Group's US Consumer Survey - Wave 1-12, 2010

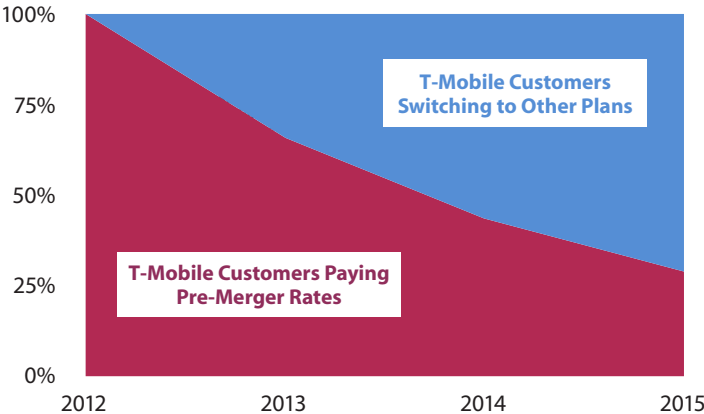


The open question is what effect this market concentration will have on wireless service prices for consumers and businesses. To understand the consumer impact, we return to Yankee Group’s 2010 US Consumer Survey to examine the prices consumers say they pay for mobile phone service. These are not unit prices, nor are they actual customer bills. While we know these prices provided by consumers are not completely accurate compared with actual carrier bills, we don’t believe the errors in consumer responses differ significantly from carrier to carrier. Therefore, we believe these consumer-reported mobile prices can provide us with some guidance of how prices may change, even if the absolute prices aren’t completely accurate.

The first step in our calculation is to estimate how much of the T-Mobile subscriber base is made up of current T-Mobile customers versus new customers (consumers moving from another carrier to AT&T/T-Mobile). This distinction is important, as AT&T has publicly stated that it will allow these existing customers to keep their lower T-Mobile rates. In our analysis, we applied T-Mobile’s published churn rate to determine the mix of existing customers who will be grandfathered in with current T-Mobile pricing and new customers who switch to AT&T/T-Mobile from other carriers. Exhibit 5 shows that over half of T-Mobile’s existing subscriber base will churn in the next three years.

Exhibit 5: T-Mobile’s 34 Million Subscribers Will Decline to Fewer Than 10 Million by 2015

Source: Yankee Group estimates based on T-Mobile published churn rate, August 2011



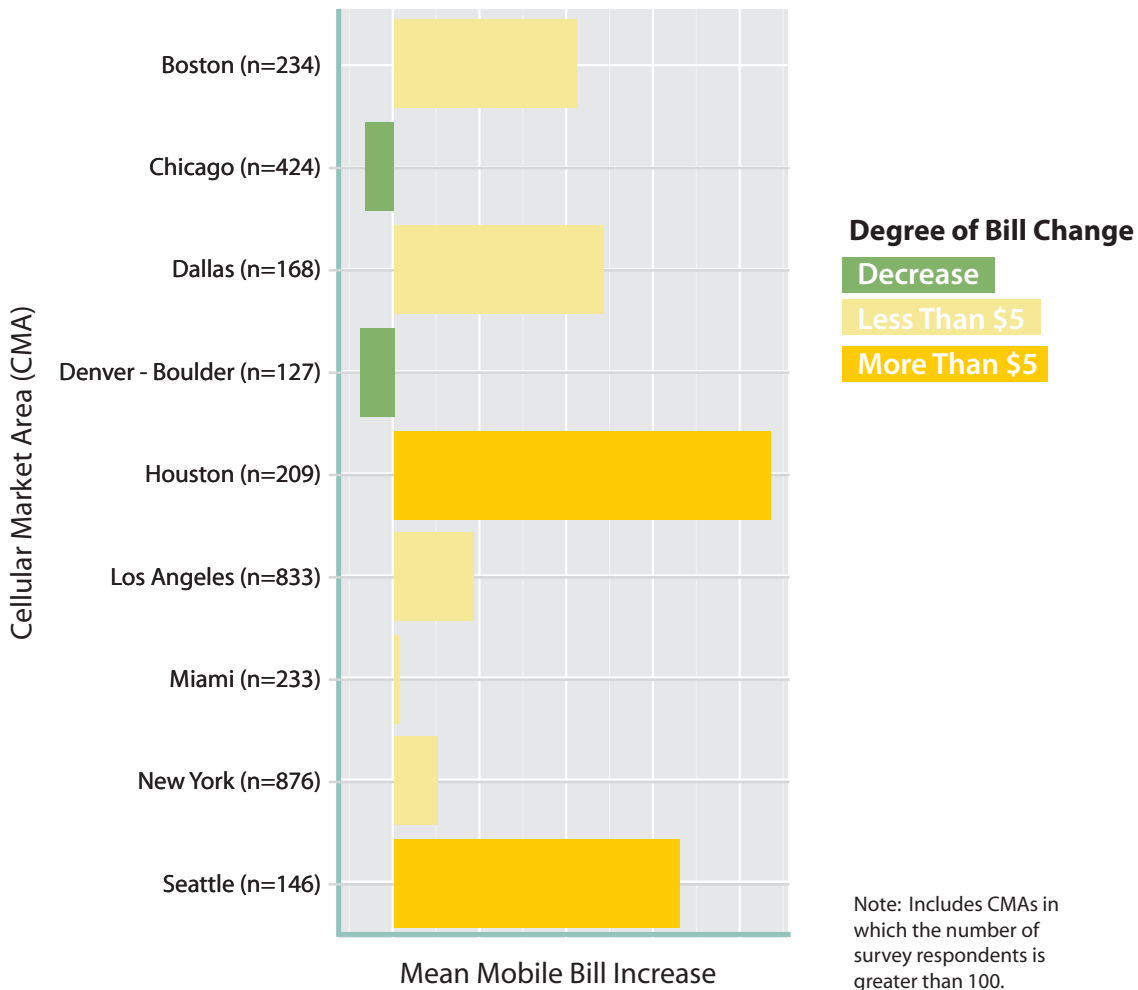
Although it is not possible to know what pricing AT&T will offer T-Mobile subscribers if the merger takes place, it can reasonably be assumed that pricing for T-Mobile’s 33.6 million subscribers will approach the higher rates paid by AT&T’s existing 97.5 million customers over time. Based on a January 2012 completion date for the merger, T-Mobile’s nearly 34 million subscribers will decline to fewer than 10 million by January 2015. We believe that new customers acquired by the merged AT&T/T-Mobile after January 2012 will be paying AT&T rates.

To estimate the pricing effect this changing mix of old and new subscribers would have, we applied these churn figures to nine of the largest CMAs and estimated how the migration of subscribers to AT&T rate plans would change prices in January 2015 (see Exhibit 6 on the next page). Assuming that both AT&T’s and T-Mobile’s average payments stayed constant over the intervening three years, we find that:

- **Two CMAs would see small declines in prices.** Consumers in Chicago and Denver/Boulder today spend less with AT&T on average than consumers who subscribe to T-Mobile. As a result, when T-Mobile subscribers begin paying AT&T average prices, the overall bill average in these two markets declines slightly.
- **Other large markets would see increases.** Customers in Boston, Dallas, Los Angeles, Miami and New York would see mean increases in mobile phone bills of less than \$5 a month. Customers in Houston and Seattle would see increases of more than \$5.

Exhibit 6: Chicago and Denver Would See Average Bills Decline Post-Merger, While Seven Other CMA's Would See Increases

Source: Yankee Group's US Consumer Survey - Wave 1-12, 2010



Summary

In summary, Yankee Group believes that while the combined spectrum of the proposed merger should bring better coverage and performance to customers, we are concerned about the merger's effect on consumer pricing. Our analysis shows the AT&T/T-Mobile merger would solidify AT&T's leading market position in a majority of CMA's. We believe this market concentration by a company already serving a third of U.S. wireless subscribers will reduce choice for consumers and, more importantly, leave little incentive for AT&T to offer competitive pricing for unbundled mobile services. And while our analysis is based on consumer data, we do not expect its effects to be limited to consumers; businesses would also see more concentrated markets and likely higher prices.

Conclusions and Recommendations

The proposed AT&T/T-Mobile merger comes only three years after Verizon's 2008 acquisition of Alltel, and it is only the latest in a long series of consolidating moves in the U.S. wireless market. We do not believe it will be the last. Once this merger goes through and AT&T serves 132 million subscribers, it's only a matter of time before Verizon purchases Sprint and adds Sprint's 51 million subscribers to its 95 million, thereby creating a national duopoly. Yankee Group believes reducing competition in the most heavily populated markets will extend duopoly-style pricing to the national level, resulting in less choice for consumers and limiting competition.

Yankee Group believes the merger of AT&T and T-Mobile will have a negative impact on consumers and competition in the U.S. wireless marketplace. To counteract this negative impact, and to increase competition in moderately and highly concentrated markets, we recommend the FCC not allow this merger to proceed unless it is also prepared to maintain a stronger regulatory stance to avoid domination by the two largest carriers. Such a stance might include actions such as:

- **Thinking creatively about divestiture remedies.**

Regulators typically require merging companies to divest properties to conform with anti-trust regulations. However, remedying the market concentration caused by the AT&T/T-Mobile merger won't be easy because no other national GSM networks exist and few regional GSM service providers are big enough to serve the divested AT&T/T-Mobile subscribers. To reintroduce competition in highly concentrated markets such as Dallas, Miami and Seattle, the DOJ and FCC may have to consider creating a new mobile service provider from smaller competitors or requiring the merged companies to cede a portion of their customers to a mobile virtual network operator (MVNO) such as TracFone or Tru operating on their network.

- **Enforcing mandatory, reasonable data roaming rates to facilitate competition.** National carriers must offer reasonable roaming rates for voice calls. Similar requirements for reasonable roaming rates for data went into effect in June 2011 (see FCC document [WT Docket No. 05-265](#)), and both Verizon and AT&T are protesting the decision. If those dominant carriers are not required to provide reasonable data roaming

services, customers of regional carriers such as U.S. Cellular (CDMA) and Cincinnati Bell (GSM), both in Ohio, have no access to data when they are outside their regional networks. With data-hungry smartphones making up the majority of new phone purchases and national network carriers reluctant to provide access to their networks, the FCC must ensure that smaller regional carriers can compete in concentrated markets by enforcing these mandatory reasonable data roaming fees, just as it did with voice roaming.

- **Regulating unbundled wireless tariffs.** Both Verizon and AT&T have land-line telephony, pay TV and broadband Internet businesses that are struggling to grow, while wireless subscriptions are booming. In highly concentrated markets, it's likely these duopoly carriers will try to extend their market power to those lower growth offerings by making unbundled wireless much less attractive than bundles that pile on these other services. The FCC should regulate the maximum rate carriers can charge for unbundled wireless services; otherwise, the duopoly holders can easily extend their market concentration in wireless to broadband Internet and pay TV.

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Gigi Wang, Chief Research Officer

As Chief Research Officer, Gigi Wang leads Yankee Group's team of analysts in defining the overall direction of research content for the firm. Wang works closely with analysts to track the evolving demands of connected users and the products and services that drive them, and she guides the delivery of data and insights to clients and the broader Yankee Group community.



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Carl's current research agenda includes research on digital applications and media, mobile Web sites and their evolution, and digital advertising.

Headquarters