

# Vertical separation and value

Dr. Chris Doyle

Economic Consultant and  
Associate, Warwick Business School

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[chris.doyle@cdoyle.com](mailto:chris.doyle@cdoyle.com)



# Telecommunications and value...the received wisdom

- ⌘ Network industry with strong synergies between network management (supply) and retail operations (demand)
- ⌘ Integration enables easier coordination of investment activities
- ⌘ Boundaries
  - ⌘ Upstream – equipment manufacturing
  - ⌘ Downstream – installation of customer premises equipment

# What does theory say about value and separation?

- ❖ Key question: Why would a company separate allowing rivals to access wholesale inputs? (The opposite of vertical foreclosure!)
- ❖ Two hypotheses in the literature on financial restructuring (see Krishnaswami and Subramaniam, *Jnl Fin Econ* 1999)
- ❖ Core-operation hypothesis – remove unrelated businesses allowing managers to focus on core business. *Unlikely reason in telecoms*
- ❖ Information hypothesis – help provide financial clarity about best performing units. *May be a reason in telecoms.*

# Strategic reasons for separation

- ⌘ An alternative position is the Strategic hypothesis (see Lin, *Eur Econ Rev* 2006)
- ⌘ Idea simple:
  - ⌘ Spin off of wholesale operations allows upstream firm to expand production (even where this benefits the parent company's downstream rivals)
  - ⌘ Joint profits of spin off plus downstream operation may be higher vis-à-vis case where firm remains integrated
- ⌘ This proposition is probably closest to separations currently being considered by some integrated operators – rests on idea of *commitment value*

# What's happening in practice?

- ❑ Eircom – strategic hypothesis
- ❑ Orange in Switzerland – Core operation hypothesis
- ❑ Telstra, Australia?
- ❑ Regulation complicates setting – and may be an important driver for separation

# Concluding remarks

☐☐☐ Unlocking value through spin offs in telecoms more likely to occur given:

☐☐☐ Increased downstream competition

☐☐☐ Regulation affecting upstream wholesale activities