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Competition in Korean mobile telecommunications market: business strategy and regulatory environment☆

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Abstract

After the launch of PCS in 1997, the Korean mobile telephony market achieved a remarkable subscriber base growth. The market is composed of a differentiation advantage seeker, SK Telecom; a cost advantage seeker, LG Telecom; and three other carriers: Hansol PCS, Korea Telecom Freetel, and Shunsegi Telecom that do not show clear adherence to any type of advantage. Despite large growth in subscribers, price competition has not occurred after the competition except in handset subsidies. New restrictions on handset subsidies, closing the only door for price competition, favored a differentiation seeker at the expense of a cost advantage seeker. The Ministry of Information and Communication's provisional plan for quality evaluation without price deregulation runs the risk of quality over-provision that is sub-optimal, and may further distort the business performance of carriers. Overall complete deregulation is necessary, in order to enhance the competitiveness of the Korean mobile telephony industry and to increase consumer welfare.

Keywords: Mobile telephony; Business strategy; Cost advantage; Differentiation advantage

1. Introduction

During the past two years the Korean mobile telephony market has seen a major increase in the number of subscribers. Subscribership doubled each year during 1996–1998. The growth rate of the subscriber base was 114% from 1996 to 1997, and 105% from 1997 to 1998. Such high growth

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along with the penetration rate of 44.8% in 1999 obviously indicates that the mobile telephony service in Korea has achieved more popular use by the public. Now, the mobile telephony subscriber base is well over 20 million, surpassing the wire-line subscriber base.

Such an increase is both surprising and dramatic, since Korea has experienced serious setbacks in aggregate consumer demand during the period due to the foreign exchange crisis. Despite unfavorable external circumstances, the high growth was possible mainly due to efforts made by highly motivated service providers. After the launch of personal communications service (PCS) in October 1997, the five mobile telephony carriers exerted energetic efforts to capture as many customers as possible. Carriers have offered a large amount of handset subsidies, which apparently encouraged potential consumers to easily subscribe with a little initial cost. New PCS entrants have also completed nationwide service coverage in less than a year after the start-up of service by making huge up-front investment.

Even though the market has witnessed a substantial growth in total subscribers, criticism has been raised in terms of market performance. Critics argued that excessive competition in handset subsidy hampered the financial viability of carriers, and the duplicate investment of five carriers' nationwide network facilities caused social inefficiency. For example, in the 'Korean National Parliamentary Hearing on the Economic Crisis' held in February 1999, the Ministry of Information and Communication's (MIC) policy, which allowed five mobile telephony service providers to compete in a rather confined domestic market came under fire. Politicians and newspaper reports argued that excessive competition might hurt both carriers and consumers. They argued that excessive competition might put some marginal carriers into bankruptcy which would result in undesirable termination of services for consumers. They called for appropriate policy measures to establish soundness of the mobile markets. In response to these critical views, the MIC, in the early half of 1999, issued regulatory interventions such as continued rates regulation, restriction on handset subsidy, and the quality evaluation system.

Competition in mobile market has been analyzed in many instances. Fullerton (1998) showed that duopoly cellular competition in the US facilitated price competition, although there is a wide variation in performance from market to market that indicates that factors other than market structure strongly influence the behavior of the firm. Gruber (1999) found that although the increasingly competitive market structure in European mobile telecommunications delivered lower prices, the sector risk for firms is increasing. He warned that financial investors, used to high profits in the industry, may react to these trends by potentially reducing the resources to the sector. He concluded, however, that from the point of view of social welfare, it may be well worth the increased risk given the huge benefits consumers receive as a result of competition.

In this paper, we identify the business strategy and assess the impacts of regulatory intervention on the Korean mobile telephony market. A brief history of competition in the Korean mobile telephony market is presented in the next section. In the following section, we use factor analysis to identify that an incumbent carrier (SK Telecom) uses predominantly product differentiation strategy (product differentiator); one entrant carrier (LG Telecom) is seeking cost advantage (price competitor); and three other carriers (Shinsegi Telecom, Hansol PCS, KT Freetel) do not show clear adherence to any type of business strategy. We assess the impacts of current regulatory policy on mobile markets; price regulation, restriction on handset subsidy payment, and quality evaluation. Even though there has been a large increase in subscribers, cross-sectional evidence shows