

**VATM and DIALOG CONSULT publish 2005 study of telecommunications market
Continuation of positive trend from previous year: Competition spurs growth in total
market and investments – Broadband connections increase to 10 million – Further
increase in mobile phone usage**

The total market for telecommunications services in Germany is expected to grow this year by around 4% to € 66.9 billion. Market growth in both fixed and cellular networks stems mainly from the competitors, who can increase their share of the market from € 29.5 billion to € 32.6 billion. This disproportionate revenue growth on the part of the competitors is attributable – even more so than in previous years – to the successful marketing of broadband applications based on the fixed-network, and is also reflected in the number of broadband connections, which now exceeds 10 million.

Gerd Eickers, President of the VATM, commenting on these latest figures in the DIALOG CONSULT market study commissioned by the German Association of Telecommunications and Value-Added Service Providers (VATM), says that “With revenue growth in the market of around 4%, the telecommunications industry is continuing the positive growth trend established last year after years of consolidation. It is now evident, at a time of weak economic growth in general, that the communications sector is maintaining its importance as a driving force for the entire economy. The new federal government must therefore position ‘technological innovation through competition’ at the forefront of its agenda and focus attention on it more intensively.”

The cellular market is also receiving an added boost from the broader range and marketing of broadband services. While data services are gaining increasingly in share, voice communications from person to person – totalling 118 million minutes per day - will remain a central field for innovative applications in the telecommunications field. Accounting for € 20.5 billion in revenue and more than € 1.5 billion in investment, cellular services continue to comprise almost two thirds of the total revenue generated by the competitors in the telecommunications market, as well as main driving force behind the € 2.5 billion in total investments by the competitors.

“The telecommunications industry is showing once again that competition releases billions in investment and creates new jobs. Since liberalisation began, more than 50,000 new jobs have arisen without any form of subsidies, more than offsetting the job cuts necessitated at Deutsche Telekom AG to improve its efficiency. Half the total investment volume is accounted for by the competitors. Thanks to superior growth rates, the industry will continue to

make important contributions to future jobs growth. However, this is contingent on a rigorous regulatory and competition policies,” Gerd Eickers emphasises.

Prof. Dr. Torsten J. Gerpott explains the precise findings of the study:

I. Total market for telecommunications services in Germany

Telecommunications services in Germany generated approximately €67 billion in 2005 – about half of that total still goes to Deutsche Telekom, which continues to be the dominant player in the fixed network segment.

The total market for telecommunications services in Germany – revenue including broadband cable TV but excluding TV signal transport – is projected to grow in 2005 by 3.6% from €64.6 billion to €66.9 billion (Figs. 1+2). The competitors are the principal drivers of market growth, increasing their share of market by 10.5% to €32.6 billion (48.7%) compared to €29.5 billion (45.7%) the year before. The above-average growth of the competitors in 2005 stems to a greater extent than in previous years from successes achieved in the fixed network segment, and less from increases in the mobile telephony sector (Fig. 3).

Investments in fixed assets increased again in 2005 for the first time in four years – with the competitors and Deutsche Telekom each accounting for one half of the total.

In 2005, investments in material assets in the telecommunications market totalled €5.3 billion, and signified a substantial increase on the previous year (€4.4 billion, or 20.5%) for the first time since 2001 (Fig. 4) – mainly in the form of intensified investment in the fixed network for diversified broadband services, as well as progressive expansion of UMTS coverage for cellular services. The competitors invested €2.5 billion, or about half the total volume of investment in the telecommunications market.

Business growth and investments in 2005 are having a positive impact on employment.

The number of jobs provided by the competitors is growing apace and has now reached 50,500, thus maintaining the positive trend signalled by a slight recovery last year. The interim decline in total workforce size has thus been reversed and stabilised. The net increase in jobs as a result of new entrants to the market is therefore significantly greater than the absolute number of jobs created in the first years of liberalisation (Fig. 5).

II. The fixed network market, in sales revenue and minutes

The growth of the competitors is slowing while the market share held by Deutsche Telekom is stabilising – Slight decline in total connection minutes due to increasing use of DSL for data transfer.

Total connection volume is retreating from 922 million to 897 million minutes per day as a result of an escalating shift of Internet minutes towards DSL (Fig. 6). The competitors are able to boost their fixed line connection minutes to 442 million minutes per day (49.3%), whereas the share held by Deutsche Telekom is receding further from 455 million minutes per day (50.7%). As anticipated, however, the gradually increasing gains in market share on the part of the

competitors, expressed in daily connection minutes, is not reflected one-to-one in revenues, because DTAG earns a good profit through its inter-carrier sales for every minute sold by a competitor. The competitors' dependency on up-stream products from Deutsche Telekom is thus helping to stabilise DTAG's sales revenues of € 25 billion, which are declining only marginally in total (Fig. 7).

Competition for local exchange calls is leading to a definite increase in competitors' market share and in local call traffic in general.

Of all local exchange minutes, the competitors meanwhile sell 93 million minutes (42.1%) of the 221 million minutes generated each day. In contrast to the number of voice connections beyond the local network, which at 388 million minutes a day is growing only slightly, lively competition in the local loop is tapping into further growth potential and leading to services being extended to call-by-call, pre-selection and complete lines (Figs. 8+9).

For all fixed line access methods, the alternative providers are achieving a substantial increase in absolute customer numbers in 2005 – the strongest relative increase, at 43.5%, is with directly connected customers.

The winners in this year's market study are the complete lines, the number of which has risen by more than 43% from 2.3 million to 3.3 million customers in all – many of them quality-conscious private and business customers. They generate 61 million minutes a day in total, or about 91% more connection minutes than a call-by-call customer, whose intensity of use is only 13% less than that of a pre-selection customer. The total number of customers using services offered by the competitors has risen to 25.9 million, 16.2 million of them being call-by-call users, who account for 157 million minutes and the largest share of use (54.5%) of the new services sold by new providers. The marginal growth in the pre-selection field, from 5.7 to 6.4 million customers, illustrates that users are also tying themselves for the long term to competitor companies. At 70 million minutes, these customers generate just under a quarter (24.3%) of the total connection volume handled by the competitors (Figs. 10-12).

In the service number field, the companies are generating substantial revenue with customer care and call media.

The market for innovative information and service numbers continues to develop well. With 1.7 million numbers on offer, 18.3 million minutes per day are handled by the new providers, generating revenue of € 506.4 million. 0137- numbers, in particular, are a popular instrument that is deployed in many different ways, especially in the transaction TV produced by media enterprises. Other services greatly in demand are 0800- and 0180- numbers, which account for more than 43% of revenue and the major share of the competitors' market volume. There is also considerable demand for information services, which provide 14.1% of revenue generated (Fig. 13).

III. Internet access market

Customer demand for broadband is increasing significantly – by the end of 2005, the number of broadband lines will easily reach 10 million

The lucrative market for broadband Internet connections continues to be dominated by Deutsche Telekom, with 10.2 million broadband connections. Although national and regional local exchange carriers have almost doubled the number of directly subscribing DSL customers, their share of DSL lines remains low, at a mere 16.7%. In Germany, other forms of broadband access that might compete with DSL play a subordinate role, and amount to only 0.3 million connections.

DSL lines sold by Telekom resellers are estimated at 9.1% in 2005, or 900,000 customers. This equates to a market share, based on T-Com's customer relationships, of approx. 74%. The consequence is that, despite the start of reselling in 2004, around three quarters of all DSL customers in Germany will still be billed for their broadband connection by Deutsche Telekom at the end of 2005. Internet access had already been offered by competitors in the past. For 3.1 million T-Com-DSL lines, Internet access is provided by competitors and not by T-Online. The importance of this marketing variant (Variant C in Fig. 16) is expected to decline in future in favour of reselling (Variant B in Fig. 16).

The expected growth in broadband traffic volume to 676 million gigabytes (GB) in 2005 is a clear indication that demand for broadband services remains strong; the volume of traffic on the Deutsche Telekom network is showing a further substantial increase relative to 2004. The competitors are also experiencing a substantial increase from 139 million GB to 191 million GB, and are succeeding – with aggressive price strategies and tailored service packages – in winning over power users (Figs. 14-17).

IV. Cellular market

The latest marketing drives by cellular market operators are resulting in substantial increases in total connection minutes in 2005.

Although data services – predominantly driven by MMS and data transfer – are acquiring a ever larger share of total service revenue in the cellular market, namely 20.2% this year, voice communication continues to dominate, with usage levels increasing: the total number of minutes daily is increasing to 118 million (Figs. 18-19). Substantial growth in the total number of minutes consumed by mobile telephony can also be expected in the future. In 2005, the market has seen the launch of cards with low per-minute prices (no-frills rates) as well as flat-rates. These cards are a suitable way to draw connection minutes away from the fixed network and into the cellular networks. However, there are no signs that the number of voice connection minutes in the fixed network is declining in absolute terms.

Gerd Eickers concludes with what is essentially a positive assessment of the competitive situation, saying “The satisfactory and gradually stabilising situation in the industry must not be jeopardised by premature demands to wind down regulatory activities – especially in the innovative broadband segment. What is now imperative is that the federal government pick up on the advances being made in the communications sector, and take advantage of them in order to revive the economy across all sectors of industry by fostering competition in targeted ways. This also means ensuring that the EU, the ministries and the Federal Network Agency have the requisite expertise. Concentrating on new regulatory fields, such as energy, gas and the railways, must not lead to the regulatory challenges in the telecommunications market being neglected.”

Prof. Dr. Gerpott likewise calls for Germany to boost its role as a centre for the communications industry: “When expanding broadband Internet access, advancing cellular technologies and developing mobile services, we have to re-assert our previous leadership in communication technologies and become a prime market again. We cannot be satisfied any longer with a medium ranking. Achieving these ends requires policy decisions that foster entrepreneurial activity, paving the way, in turn, for innovation and investment. How to deal with the market power exerted by the ex-monopolist Deutsche Telekom is still the greatest challenge we face in this regard.”

Further information and charts presenting the data obtained in the survey can be downloaded from the VATM website or from www.dialog-consult.com.

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