

APPENDIX 5.5V
(referred to in paragraphs 2.198, 5.77, 5.90 and 5.104)

(This does not form part of the Cellnet report)

The MMC analysis of Vodafone's costs

Introduction

1. This appendix sets out the results of our allocation of Vodafone's costs and return on assets for 1997/98. It also sets out Vodafone's business plan, as summarized in a paper prepared specifically for our inquiry, together with our calculation of the CVE that it implies.

Cost allocations

2. Table 1 summarizes our allocation of Vodafone's costs for 1997/98, showing, for each item, how we allocated it and the percentage of Vodafone's total costs that it represented (including a return of 16.5 per cent on the relevant assets).

TABLE 1 Summary of the MMC's allocation of Vodafone's costs for 1997/98

	Percentage of total costs*
<i>Fixed allocation</i>	
Marketing	⌋
Service provider incentives	
<i>Costs allocated to outgoing calls</i>	
POLOs	⌋
Voicemail	
Customer care	
Billing	
<i>Costs allocated in proportion to call minutes</i>	
General depreciation	⌋
Engineering	
Administration	
Operations	
Other assets return	
<i>Costs allocated in proportion to call minutes (excluding PRS)</i>	
Other leased lines	⌋
Radio depreciation	⌋
Cell site running	
Frequency licence	
Cell site assets return	
<i>Costs allocated in proportion to transit minutes</i>	
Transit lines	⌋
Transit depreciation	
Transit running	
Transit switch assets return	
<i>Costs allocated in proportion to processor time</i>	
MSC/BSC depreciation	⌋
MSC/BSC running	
MSC/BSC assets return	
Total	⌋

Source: MMC.

*Including a notional return of 16.5 per cent on relevant fixed assets.

[⌋]

Note: Figures may not add to 100 because of rounding.

3. The remainder of this section sets out the detailed allocations.

POLOs

4. We allocated POLOs to outgoing calls. The total cost allocated was £144 million.

Marketing and service provider incentives

5. We allocated 0.5 ppm of marketing and service provider incentives to incoming calls in recognition of externality factors. The total cost in these categories was £[~~2~~] million, of which £[~~2~~] million was allocated to incoming calls.

Network costs, overheads and depreciation

6. Table 2 summarizes our allocation of Vodafone's network costs (including depreciation) for 1997/98. The total cost in these categories was £411 million, of which £145 million was allocated to incoming calls, equivalent to 7.92 ppm.

TABLE 2 Allocation of Vodafone's network costs, overheads and depreciation, 1997/98

	Total costs £m	Incoming calls		Outgoing calls		PRS	
		£m	%	£m	%	£m	%
<i>Outgoing calls allocation</i>							
Voicemail							
Customer care							
Charge rate order							
Billing							
<i>Call minutes allocation</i>							
General depreciation							
Engineering							
Administration							
Operations							
<i>Call minutes (excluding PRS) allocation</i>							
Other leased lines							
Radio depreciation							
Cell site running							
Frequency licence							
<i>Transit minutes allocation</i>							
Transit lines							
Transit depreciation							
Transit running							
<i>Processor time allocation</i>							
MSC/BSC depreciation							
MSC/BSC running							
Total	411	145	35.0	265	64	3	1.0

Figures omitted.
See note
on page iv.

Source: MMC.

Note: Figures may not sum because of rounding.

Return on assets

7. We allocated Vodafone's return on assets in the same way as the operating expenditure to which the assets related, using a cost of capital of 16.5 per cent as shown in Table 3. The total return was £121 million, of which £56 million was allocated to incoming calls, equivalent to 3.06 ppm.

TABLE 3 The MMC's allocation of Vodafone's return on assets, 1997/98

	Total asset value £m	Allocation of return						
		Incoming calls		Outgoing calls		PRS		
	£m	£m	%	£m	%	£m	%	
Call minutes allocation	[Figures omitted. See note on page iv.]
Cell sites								
Other assets								
Processor time allocation	[Figures omitted. See note on page iv.]
MSC/BSC assets								
Transit minutes allocation	[Figures omitted. See note on page iv.]
Transit switch assets								
Total	733	56	46.0	64	53.0	1	0.5	

Source: MMC.

Vodafone's future costs

8. Vodafone's business plan was summarized in a paper prepared specifically for our inquiry. A summary of the traffic and operating cost assumptions is given in Table 4. Costs are given at out-turn prices, assuming RPI inflation of 3 per cent a year. The traffic figures for 1997/98 in Vodafone's paper were different from those supplied to us by the DGT and used in Chapter 5, partly because they excluded calls made by overseas visitors roaming on Vodafone's network.

TABLE 4 Vodafone's business plan, 1997/98 to 2001/02

	out-turn prices					
	1997/98	1998/99	1999/2000	2000/01	2001/02	
Traffic (bn mins)						
Incoming	1.82	[Figures omitted. See note on page iv.]				
Outgoing	3.03					
Total	4.85					
Operating expenditure						
Operating costs and overheads	[Figures omitted. See note on page iv.]
Depreciation						
Subtotal						
Cost of sales						
Marketing etc						
Total						

Source: Vodafone.

9. The average annual volume growth, average annual cost growth and CVE for operating costs, overheads and depreciation over the period derived from Table 4 are shown in Table 5.

TABLE 5 Vodafone's projected volume growth, cost growth and CVE, 1997/98 to 2001/02

	%
Volume growth	25.5
Nominal cost growth*	15.7
Real cost growth	12.4
	<i>Ratio</i>
CVE	0.48

Source: MMC analysis of Vodafone data.

*Assuming RPI inflation of 3 per cent a year.