TELECOM PRIVATIZATION AND LIBERALIZATION

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Introduction

First liberalization of telecom services and privatization of a state telecom operator took place in the United Kingdom approximately 20 years ago.

While numerous countries since have undertaken this transformation, industry is still learning how to make these changes successfully.

There are no prescribed methods or models; this is particularly true for liberalization which is more complex than privatization.

Enough experience has been gained to identify the basic issues and to understand alternative ways to address those issues.

Introduction (Continued)

Privatization and liberalization are often linked.

In fact, they are related but distinctly are different in regard to certain basic policies and fundamental issues.

At its core, privatization is the conversion of a state enterprise to private-sector ownership. The state enterprise may be privatized as either a monopolistic or competitive entity.

Liberalization, in contrast, is the opening of a monopolistic market to competitive provision of facilities and services. Whether the former monopoly operator is a state enterprise or a private enterprise is not the primary consideration.

Introduction (Continued)

The single most important factor to successful privatization or liberalization is clear government goals for the telecom sector and adoption of policies to achieve those goals.

A key factor for investors in the telecom sector is regulatory risk and its potential effects on future revenue streams.

Governments are tempted to view privatization as a source of income to the general treasury and fail to accompany a telecom privatization with policies necessary to stimulate sector growth.

As a result, a telecom privatization may be driven largely by factors that will affect the share price at flotation – most frequently resulting in an extension of the former state operator's monopoly to the detriment of competitive entry and sector expansion.

“Privatization is the Enemy of Liberalization”
- Prof Michael Beesley, CBE

Prof. Beesley was principal consultant to the UK government on telecom liberalization during the 1980s.

Experience there and in other countries led him to make the above-quoted observation concerning the policy tension that often results from the advice of investment bankers in favor of continued market protection of the privatized operator in order to increase share value at flotation.

After years of related work and study, I have modified his adage –

“The Real Enemy of Liberalization is the Ministry of Finance”

Driving Factors

In addition to governments' desire to obtain substantial one-time revenue infusion from the sale of the telecom operator, other factors may motivate a government to privatize.

Some overlap exists between the factors driving a privatization and those driving liberalization. However, differences in the driving factors may be fundamental and may affect the ability of the country to reap benefits from information and communications services and technologies (ICT).

Therefore, distinctions between the driving factors may be crucial to policy decisions affecting the development of this important sector.

Drivers for Privatization

Political Ideology

(This was a particularly important factor in the UK privatization where diminution of the public sector's role in the economy was a priority goal of the government.)

Reduction in Public Debt and/or Employment

(The proceeds from the sale of a state operator are often applied to reduction of the public debt. Public sector budget obligations are further reduced by removal of the former state operator's employees from the public payroll.)

Generally Poor Performance of State Operators

(State operators frequently under-perform private operators; as the economic importance of the ICT sector increases, demands for improved operator performance also increase.)

Drivers for Privatization (Continued)

Financial/Investment Requirements of State Operator

(In order to address customer dissatisfaction with performance, state operators often require capital investment beyond limits set on public spending and indebtedness. Access to private capital becomes a critical requirement of the state operator.)

Role of ICT Sector in Economic Competitiveness

(Telecom liberalization is now seen as fundamental to successful development of the ICT sector and to broader stimulation of economic growth in other key sectors.)

Drivers for Liberalization

Generally Poor Performance of Incumbent Operators

(An overlapping driver, but one that tends to have stronger impact in context of liberalization.)

Technological Innovation

(Desire on part of government, often led by business and industry, to capture economic benefits of ICT innovation through rapid deployment of new technologies.)

Role of ICT Sector in Economic Competitiveness

(Another overlapping driver)

Drivers for Liberalization (Continued)

Business Demand for Advanced Services at Lower Rates

(Expansion of international business communications requirements, particularly Internet-based services, has dramatically increased the importance of this driver in favor of telecom competition.)

Consumer Demand for Internet Services

(Increasing Internet penetration/usage by consumers creates pressure for low-cost, high-speed Internet access over IP networks.)

WTO Pressures – "Join in or be left behind"

(The combined effects of WTO agreements on basic telecom services and information technologies have set a global benchmark favoring liberalization; nations now risk falling behind economically if this benchmark is not met.)

Evolution in Liberalization

Services initially opened to competition were limited
in early days of liberalization.
Over past two decades, full liberalization has become the standard.

1980s – VANS, CPE, Closed User Groups, and Private Networks

Early 1990s – Interconnection of Private Networks to PSTN, Cellular Mobile, All Services other than Basic Voice, and limited liberalization of International Services

1996 – WTO Agreement on Basic Services.

Liberalization, not Privatization, is the Benchmark;
Key WTO requirement is Independent, Transparent Regulation

Past Model

In the early stages of industry restructuring,
the pattern was:
Privatization First; Liberalization Later (if Ever)

This was largely due to the pressure to
increase flotation price through continuation of monopoly.

Current Model

As experience has been gained and ICT has become more important to economic growth, the model is frequently:
Liberalization First; Privatization Soon After

Liberalizing allows competitive market conditions to be settled before flotation; this enables more accurate assessment of regulatory risk and potential market opportunities.

Primary Considerations in a Successful Privatization

Factors Affecting Share Value:

- Investment in Plant
- Debt Levels and Structure
- Penetration Level; Lines in Service
- Recognized and Latent Demand
- Employment Issues

Factors in Preparing Privatization:

- Corporatization - Shareholding Structure
- Future Treatment of Existing Debt
- Service/Buildout Requirements
- Investment Forecast - New Plant Requirement
- Full or Partial Competition - Duration of Exclusivity
- Rationalization of Workforce; Treatment of Pensions

Transition to Full Liberalization

When liberalization is undertaken, a transition is often used to permit the regulator time to establish the rules and conditions for competition.
Transitions are usually in three phases:

First Phase: Customer Premise Equipment,
Resale (domestic and international), Cellular Mobile,
Private Networks, VANS/ISPs

Second Phase: Domestic Fixed Networks including
Fixed Wireless and Interactive CATV, Inside Wiring,VSATs

Third Phase: International Facilities

Critical Issues for Successful Liberalization

Open and Transparent Regulation

(WTO agreement requires that regulator be independent of state operator. In privatized environments, open and transparent regulatory processes may be most important requirement.)

Economically Efficient Interconnection

(Interconnection between operators, primarily with incumbent, must be transparent and cost-oriented; any subsidies must be explicit.)

Equitable Access to ROW & Sites

(New entrants must be given access to public rights of way, utility poles & conduits, towers and necessary facilities.)

Critical Issues for Successful Liberalization (Continued)

Pricing Flexibility for New Entrants;
Protection against Cross-subsidization by Incumbent
(If some services are not competitive, then regulator must be able to prevent cross-subsidization of competitive services from monopoly service revenues.)

Efficient Equipment Certification
(Rapid technological innovation has created pressure for rapid sale and deployment of new ICT equipment. Process for testing and certification of ICT equipment must be flexible and streamlined to meet this market demand.)

Effective Control over Abuse of Market Power
(Regulator must have authority to police market behavior of industry; most often required relative to abuse of market power by incumbent operator.)