

Why change? Benefits of allowing market participation & regulation

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Learning Initiatives on Reforms for Network Economies

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Agenda

- Telecom sector in the overall economy
- What is good performance in telecom
- Pre-conditions of good performance
 - Investment
 - What enables investment
- Why reforms, even in international, are win-win
- Regulation



What is expected from the sector?

- Telecom is an increasingly important link in all value chains
 - Tourism, banking, apparel, etc. depend on availability of high-quality and low-cost telecom
 - Exports, jobs, wealth will increasingly depend on performance of telecom sector
- Telecom is a major driver of economic growth in countries where reforms have occurred
 - Major contributor of tax revenues
- People, especially those with family and friends abroad need to keep in touch: international communication is a basic need
 - Everywhere telecom has been reformed, pent-up demand has exceeded expectations



ICT use helps all enterprises

Table 1.1 Effect of ICT Use on Enterprise Performance in Developing Countries			
Indicator	Enterprises that do not use ICT	Enterprises that use ICT	Difference
Sales growth (percent)	0.4	3.8	3.4
Employment growth (percent)	4.5	5.6	1.2
Profitability (percent)	4.2	9.3	5.1
Investment rate (percent) ^a	n.a.	n.a.	2.5
Re-investment rate (percent) ^a	n.a.	n.a.	6.0
Labor productivity (value added per worker, dollars)	5,288	8,712	3,423
Total factor productivity (percent)	78.2	79.2	1.0

Note: n.a. Not applicable.

Source: World Bank (2006), ICT4D: Global trends and policies

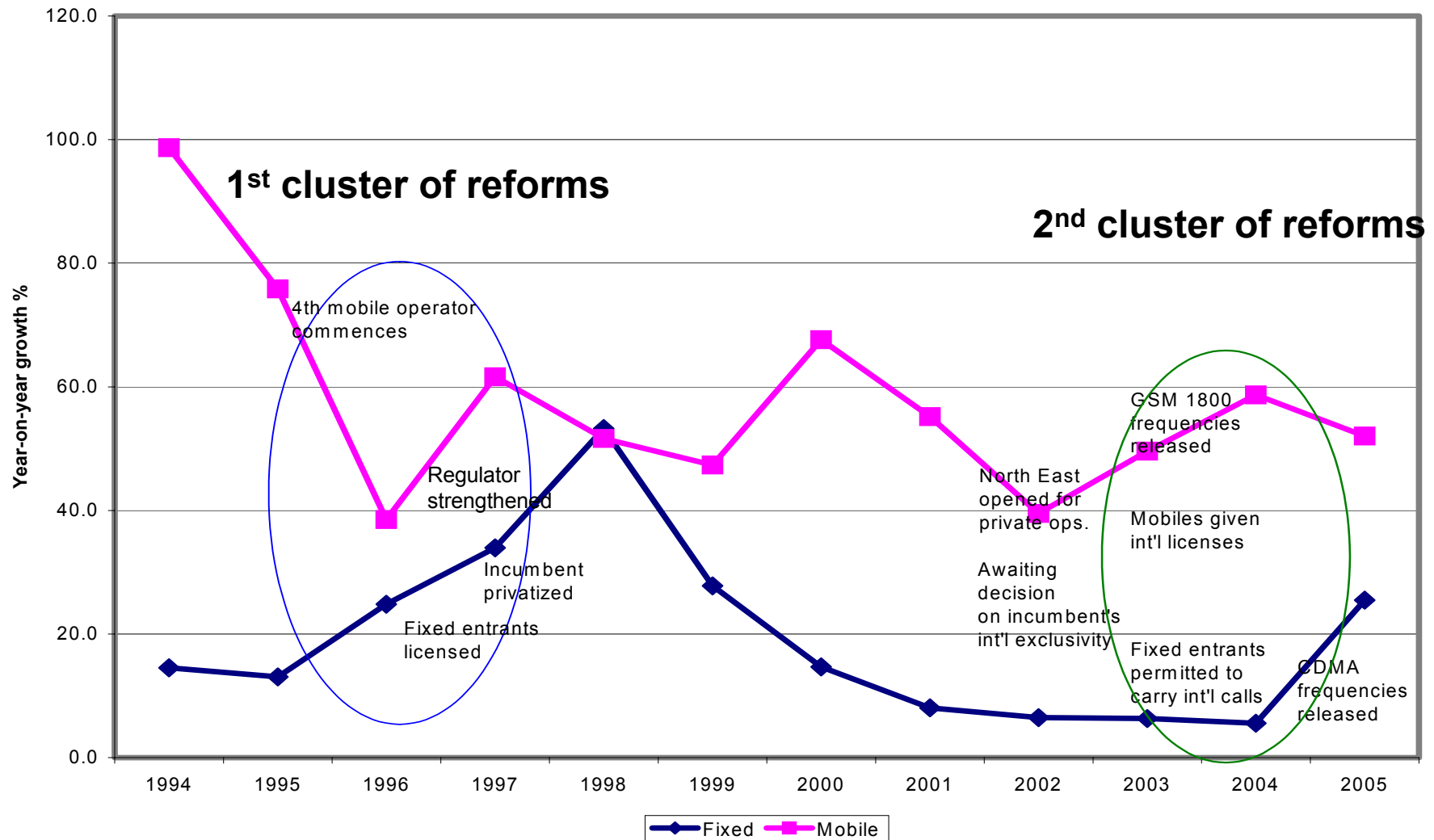


What do we, as sector professionals, want from the sector?

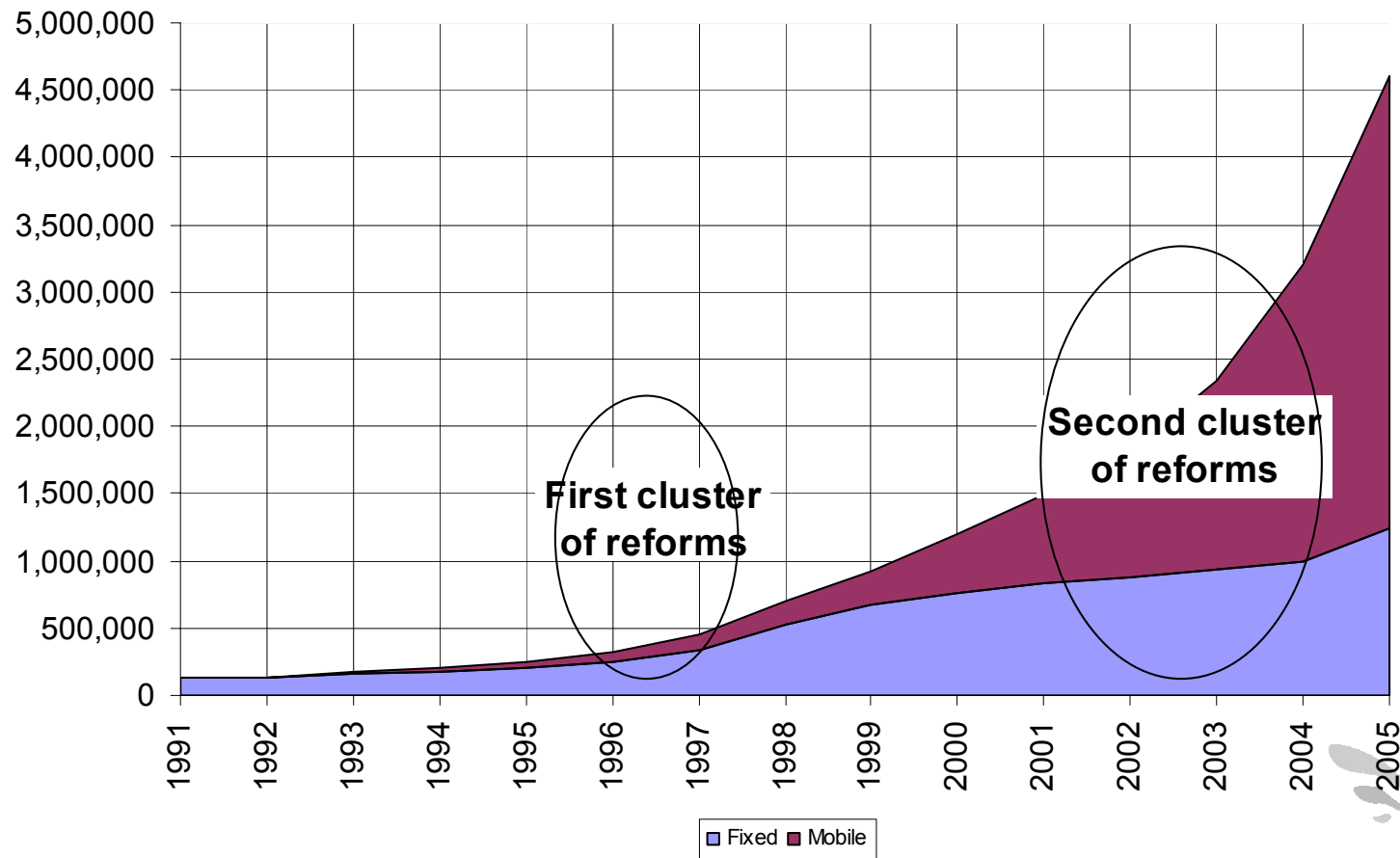
- Good performance, a sector we can be proud of
 - Network build-out → greater connectivity
 - No waiting lists; supply adequate to meet demand
 - More value for money
 - Lower prices
 - Improved quality of service
 - Greater choice and more functionalities
 - Broadband, mobile, etc.



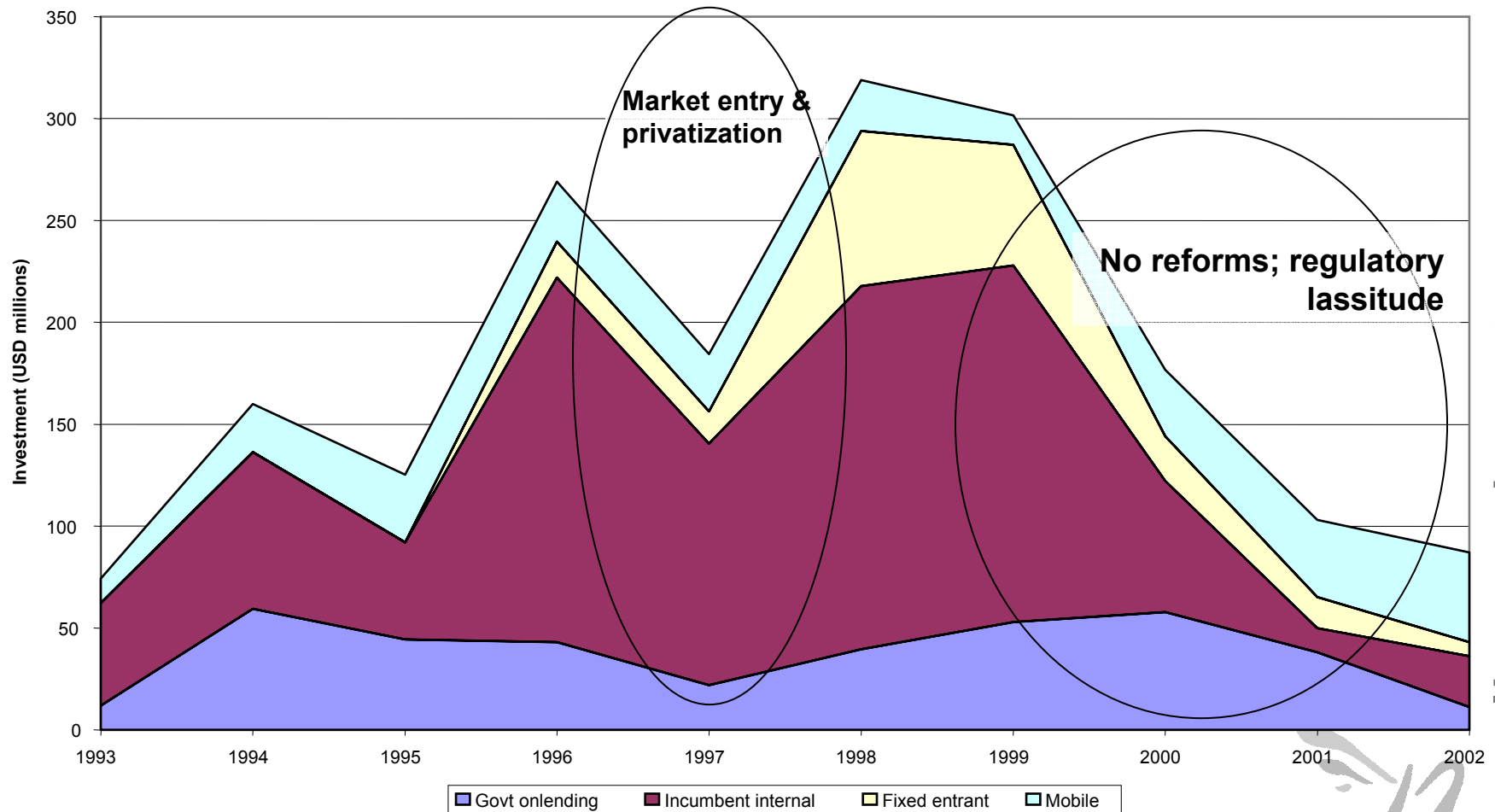
Year-on-year growth & reform actions, Sri Lanka 1994-2005



Growth in connectivity, 1991-2005



What drives expansion in connectivity: Investment, 1993-2002

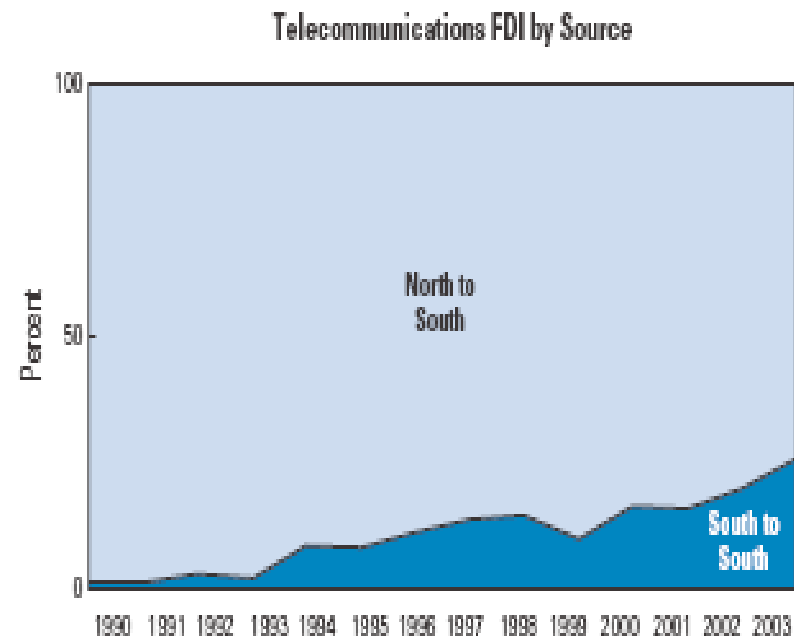
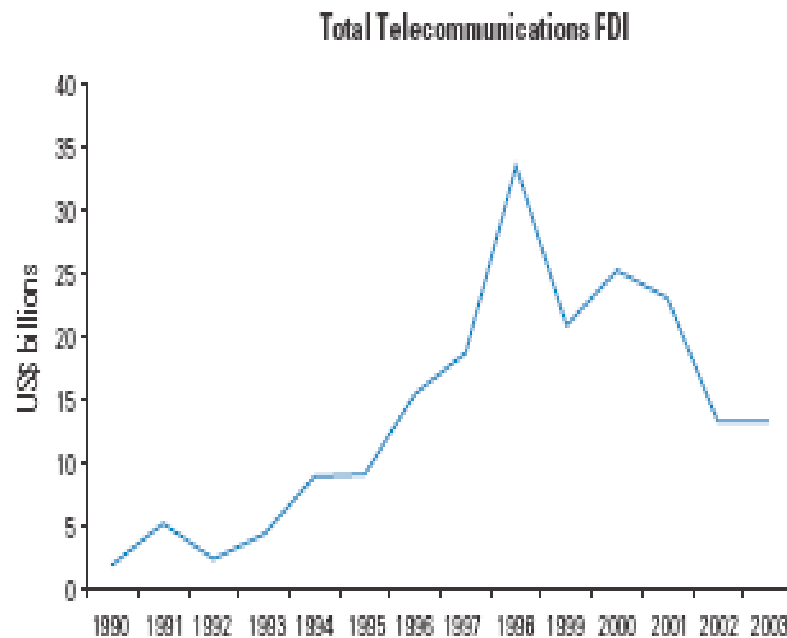


What enables investment are market-friendly policies and regulation

- Not realistic to think of public funds (taxpayers or credits) as source of investment in telecom
 - Because private investors are willing to invest in telecom, limited public funds should be used for education, health, etc.
- Days of taxing international calls (actually your own families) for domestic investment are also gone
 - Bypass is endemic



Private investment available for telecom



Source: World Bank (2006), ICT4D: Global trends and policies



Conditions for good performance through private investment

- Policy to open markets
 - Licenses and authorizations
- Stability in overall investment climate
- Regulatory environment to ensure
 - Fair and simple access to spectrum, numbers and rights of way
 - Non-discriminatory and cost-based interconnection and access
 - Safeguards against anti-competitive practices

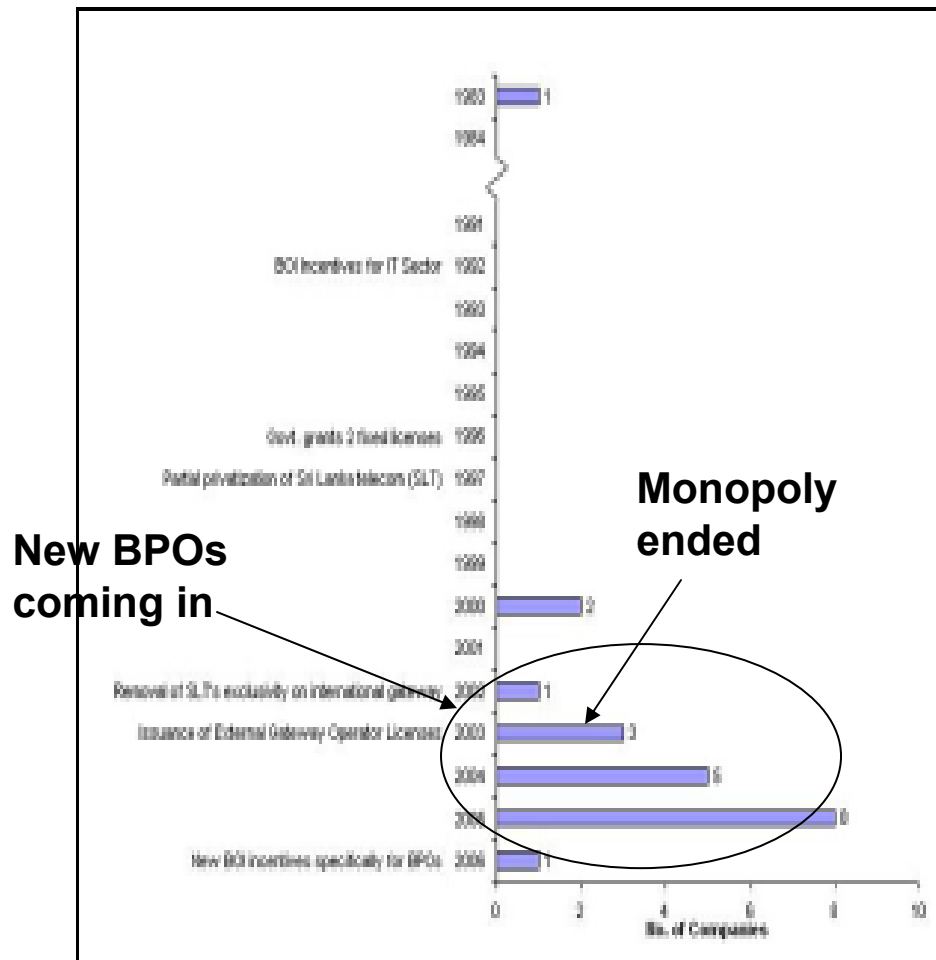


Other benefits of market reforms

- In 2003, Sri Lanka ended its international exclusivity by issuing authorizations for External Gateway Operators
 - Implemented in March 2003
 - Announced prior to the Initial Public Offering of incumbent (62% owned by government) in December 2002
 - IPO succeeded (previous two attempts failed)



BPO boomlet started



- Sri Lanka similar to South India, but missed the BPO wave
- By 2006, 13.2 million USD invested in BPOs
- 3,700 persons employed now with 30% growth projected for 2006*

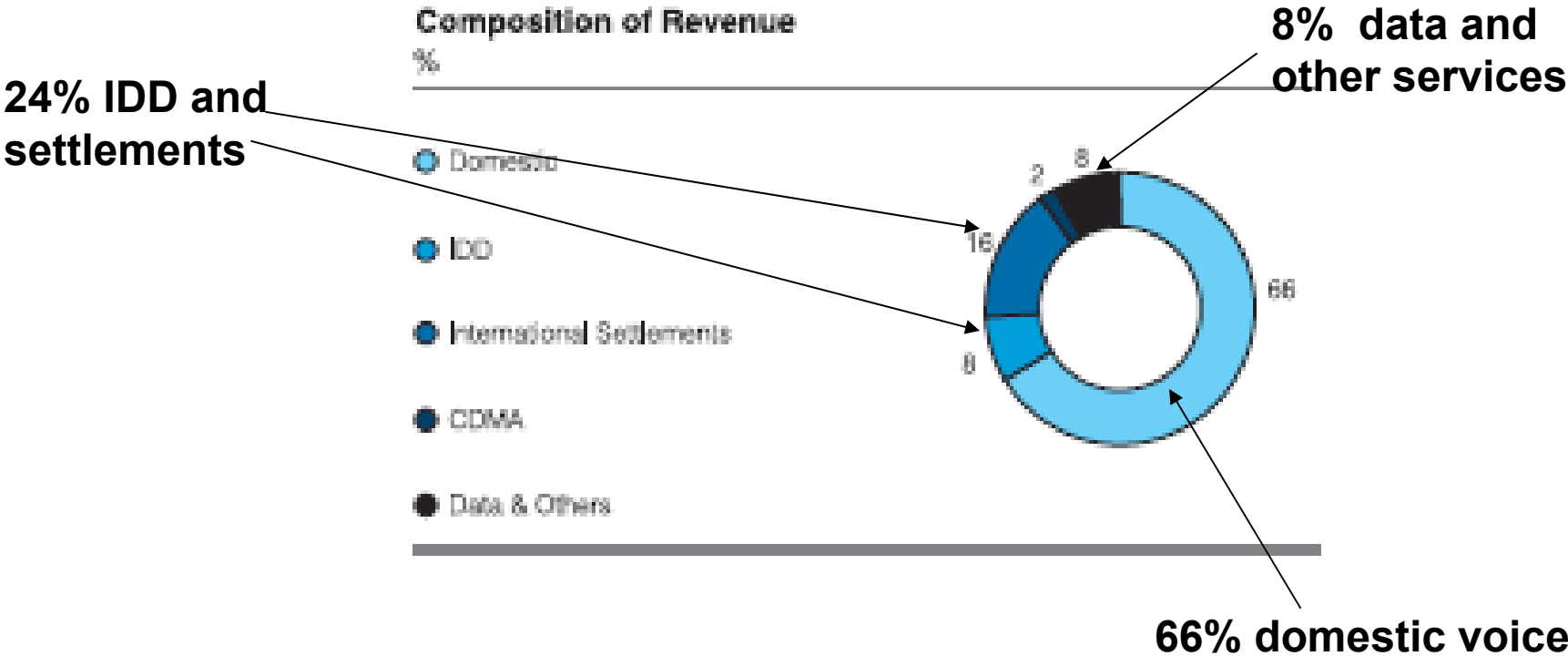
* <http://www.lirneasia.net/2006/08/baseline-sector-analysis-of-sri-lankas-bpo-industry/>

International tariffs

- ❑ Most international calls at around 10-20% of monopoly prices
- ❑ Some operators offer international (to some countries) at local rates
- ❑ Domestic prices are dropping in mobile and not increasing in fixed



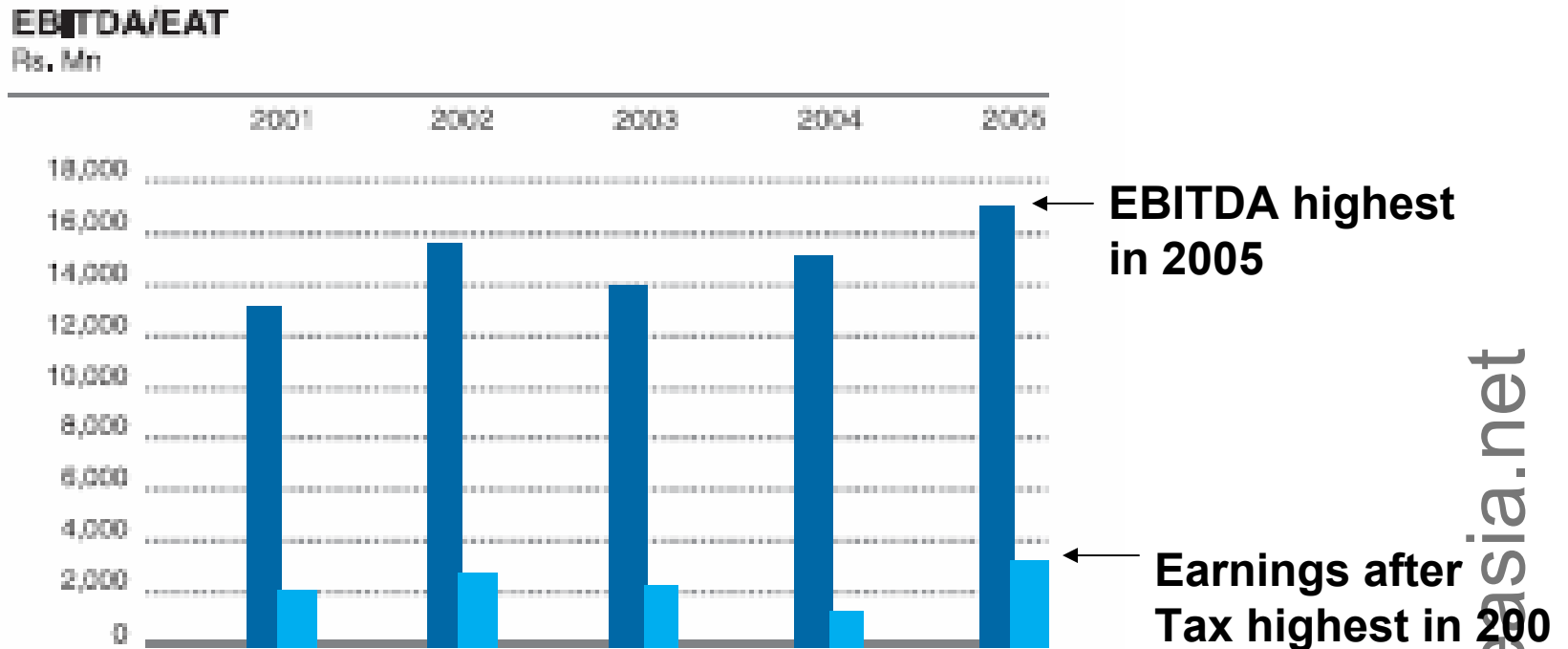
From 60%+ dependence on international, incumbent now has a more normal mix of revenues



Source: SLTL Annual Report 2005



But what about profits?



Peak of litigation over bypass

Exclusivity ended

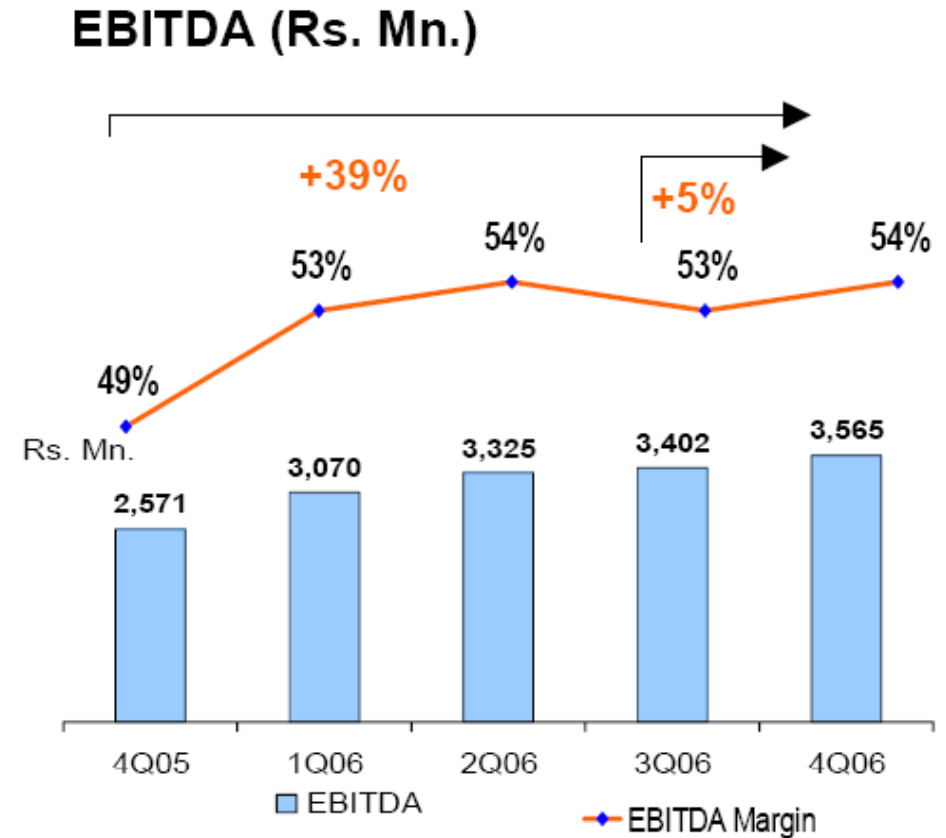
Losses from mobile Subsidiary acquired in 2002

Source: SLTL Annual Report 2005



And what of the competition?

- Largest mobile operator is largest company in LK by market capitalization
- EBITDA margins around 50%



Source: **Dialog**
TELEKOM



□ EBITDA
margin rises
from 43% in
2002 to 52%
in 2005

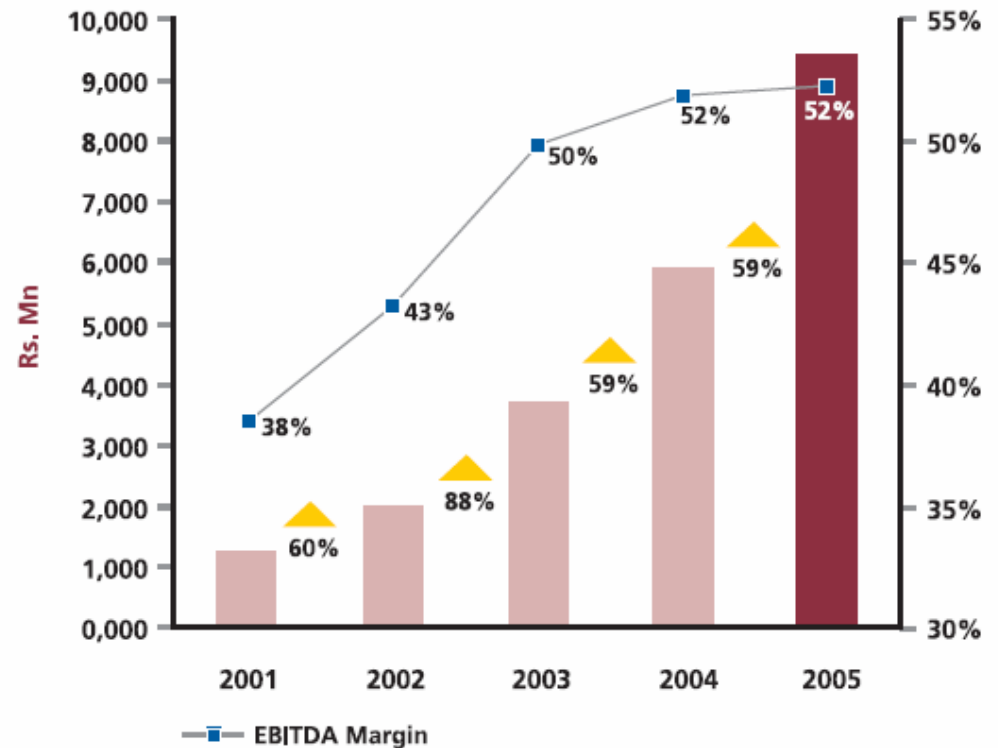


Figure 14 : EBITDA

Source: Dialog Telekom Annual Report 2005

Revenues and profits up

(All Figures in Rs. Mn)	YEAR ENDED 31 DECEMBER					CAGR %
	2001	2002	2003	2004	2005	
Revenue	3,218	4,590	7,477	11,407	18,034	54
YoY%		43	63	53	58	
Direct Cost	1,300	2,032	2,973	3,932	6,214	48
YoY%		56	46	32	58	
Gross Profit	1,918	2,558	4,504	7,475	11,821	58
YoY%		33	76	66	58	
Gross Margin %	60	56	60	66	66	
Administration and Distribution	1,036	1,191	1,854	3,152	4,557	45
YoY%		15	56	70	45	
EBITDA	1,239	1,985	3,729	5,917	9,416	66
YoY%		60	88	59	59	
EBITDA Margin %	38	43	50	52	52	
PBT	955	1,306	2,414	4,140	7,054	65
YoY%		37	85	72	70	
PAT	733	1,083	2,859	4,101	7,012	76
YoY%		48	164	43	71	
PAT Margin %	23	24	38	36	39	
Earnings per Share(Rs)*	0.97	0.59	0.70	0.98	1.15	4
YoY%		-39	19	40	17	

* EPS has been adjusted to reflect the capital structure changes made in 2005

Table 2: Audited Profit and Loss Statement for FY 2001-2005

Source: Dialog Telekom Annual Report 2005

- 54% CAGR in revenues and 76% CAGR in profit



Earnings

LKRm	FY02	FY03	FY04	1H05
Revenue	4,590	7,477	11,407	8,138
Revenue Growth (%)	43	53	53	43*
Voice (incl. rentals) + VAS	4,258	6,695	9,915	7,044
EOC/NLAC	-	378	885	707
Other	334	408	627	387
EBIT	1,398	2,667	4,352	3,574
EBIT Margin (%)	30	36	38	44
EBITDA	1,985	3,729	5,917	4,538
EBITDA Margin (%)	43	50	52	56

Source: Company Reports

* - Annualised

↑
**International
Gateway
Liberalization**



In sum

- Reforms, even of vaunted international monopoly markets, yield good results for all
 - Incumbent/former monopolist
 - Other operators
 - Consumers
 - Economy, through job and export creation
 - Government, through broader tax base



Government actions affecting investment, & thereby sector performance

- Government cannot eliminate market risk
 - Duopolies, monopolies, exclusivities are examples
 - Cause long-term bad effects
- Government must reduce regulatory risk
 - Term of art that is not limited to actions by regulatory agency
 - Actions to make market-entry rules rational and transparent (policy-regulation)
 - Actions to improve regulatory environment (regulator)
 - Also, actions to make taxation and other general rules more coherent and transparent (government)



What is regulatory risk?

- Likelihood of administrative expropriation
- What is administrative expropriation?
 - Expropriation other than nationalization
 - May take forms such as
 - Setting prices < long-run average costs
 - Mandates re investment/equipment purchases
 - Conditions in labor contracts



Why are regulatory risks high in infrastructure industries?

- High proportion of costs are sunk costs
 - Willing to operate as long as operating costs covered, even if investment not recovered
- Broad distribution of consumers makes pricing/access inherently political
- Small number of suppliers → monopoly/oligopoly; leading to vulnerability to public pressure
 - Exacerbated by foreign investment



Unless regulatory risk is reduced . . .

- Private investors may not enter
 - Or will enter sectors other than core infrastructure, where investment can be recovered quickly
 - Bias toward mobile networks and away from backbone in Africa
- Cost of capital will be very high
 - Resulting in high prices etc.
 - Demands for exclusivities

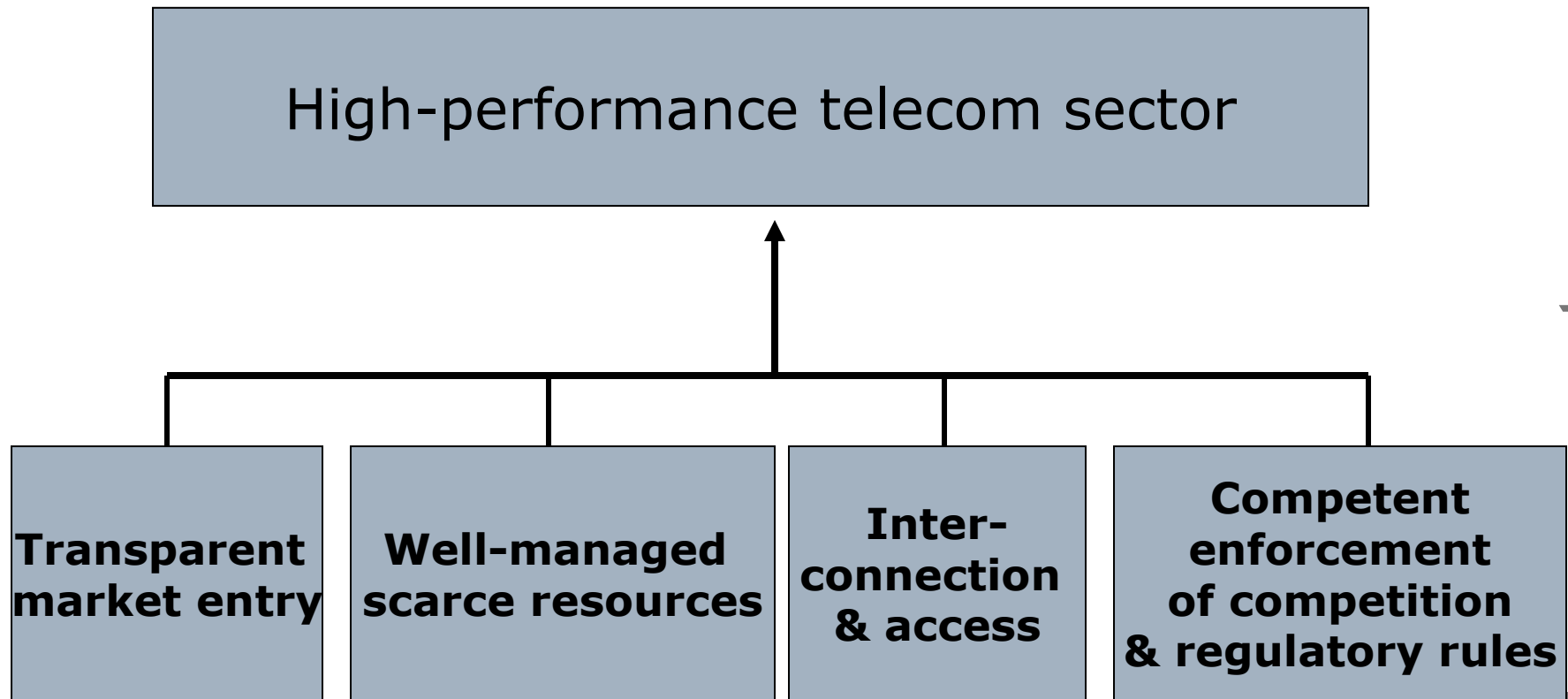


Essential condition for reducing regulatory risk

- Independence of regulator
- Minimal definition: “The regulatory body is separate from, and not accountable to, any supplier of basic telecom services. The decisions of and procedures used by regulators shall be impartial with respect to all market participants” (WTO Regulatory Reference Paper, Art. 5)



Schematic of regulatory implementation actions



Implementation is what matters

- ❑ All the laws and regulations will mean little unless regulator performs
- ❑ Transparent, efficient, consultative action
- ❑ Communication of those actions to all stakeholders so that legitimacy is built up

