The Race to European Eminence
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Direct Foreign Investment in Telecommunications: Comments

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Why is direct investment in telecommunications an issue now? The historical context provides answers. On the supply side a general trend towards liberalisation has unshackled PTOs and led to their reorientation into non-territorially oriented companies. For example, Sweden's Televerket changed its name to Telia—there is no territorial reference anymore, meaning that it is not necessarily a Sweden-oriented enterprise but an internationally oriented firm. Such companies are entering global activities. At the same time, on the recipient end of direct investments, there is significant reorientation too. Developed countries began to liberalise and open up to outside investment and in the less developed world there is great pragmatism about who can come in and also about national ownership. As these two trends come together, they raise the question: is it a brief infatuation or a match made in heaven?

International direct investment has always existed, especially in the early years of telecommunications. It was only later that telecommunications came to be largely national, territorial and governmental. But in the early decades of telecommunications, there was much Bell-company investment in Canada, Sweden, France, Great Britain and several other countries. Later ITT ran the Spanish and Chilean systems. Most of these involvements disappeared and the question is why? Are the same cyclical dynamics going to reassert themselves again?

Among the reasons for abolition of foreign ownerships in the first era of internationalization are, firstly, economic sovereignty and, secondly, the performance of those companies abroad. These forces will be important at this current stage of internationalization as well.

To develop this argument further, some disaggregation of foreign direct investments and countries involved is necessary. Let us first address the developing world.

After gaining independence from colonial powers, the original trend was clearly to have one's own telephone system. Today, it is becoming more acceptable to think and talk about privatisation and direct foreign investment. But there is a serious divergence of expectations here: while the LDCs expect investment and expertise, the international telecommunications companies expect revenue generating operations. In a past conference a speaker from Argentina spoke enthusiastically of how Spain's Telefonica was going to bring in money and build up the Argentinian system. The Telefonica speaker, on the other hand, stressed how this company, under pressure to improve operations in Spain itself, would bring in expertise, while investment funds have to be generated locally.

Faced with such divergent expectations, a certain disappointment is therefore inevitable. Developing countries expect a first-rate telephone system within a few years. But the amounts of money necessary are prodigious. To get a sense of this magnitude: the German—formerly West German—telecom organisation must invest 60 billion marks directly in East Germany in one decade, plus, probably, 10 billion marks worth of expertise. This is about 40 billion dollars for a region of about 15 million people, or approximately 10,000 dollars per household.

Obviously that is not an economic calculation. Its purpose is multifaceted, yet a private firm is not going to put 40 billion dollars in 10 years into just one country, which wasn't so backward to begin with, merely to get the telephone service up to par. Especially if it can't repatriate its profits.

Furthermore, it will be difficult to self-generate profits locally. Telefonica plans to make money in Argentina and plough it back into the telephone network. This sounds attractive but consider the applications. Prices are either set by competitive markets, or they are set administratively. If they are set administratively, they are invariably politically sensitive. It is hard enough in the American regulatory system, involving home-grown American firms. Now imagine the same situation where nationalism is part of the discussion. Suppose an American company wanted to increase prices by 20% in Argentina. Political demonstrations and calls of "Yankees go home" would ensue. And while it can be argued that the profits will go back into the network, realistically, the interests of the people and companies who have to pay telephone bills will have a powerful voice in the matter.

Related to disappointed expectations are restrictions on the investing companies. These are typically regulated companies like US West or BT that have certain obligations at home. Therefore, if they do something abroad, the question invariably asked in their home country is "how come you've got money left over to invest abroad?". The example of Telefonica emerges again as a good one. Telefonica was starting to go into Mexico, Argentina and Chile, when people in Spain started to say "wait a moment, we've got lousy service in Spain, how come you have time and money for Latin America?". It is not easy to get away from it all.

The problems and barriers notwithstanding, there are several reasons for direct investment. In Latin America, foreign investment was driven by debt swaps. Countries were so heavily in debt that they traded in their debts and basically sold national assets. Eastern Europe is also in a historically unique period. These countries are relatively advanced, but not in their telecommunications infrastructure, and want to upgrade quickly. They also experienced a certain historical resentment against government solutions. That sentiment is fading—partly as expectations are disappointed.

An additional reason is the opportunities of new services. But in this area, the market segments that tend to be profitable and easy to do, such as mobile communications, are also coveted by local investors. If they do not have the expertise, presumably they can get it through turnkey solutions from foreign manufacturers. A related argument for local ownership is that those specialised segments such as cellular communications are needed to make money that can be put into basic service.

And what about direct investments among the industrialised countries? Here, the barriers are falling and the possibility of cross investments is good. The primary reason is that economies of scale are reasserting themselves. In the past, the incumbents used arguments of economies of scale and natural monopoly to defend national monopoly, but not to advocate supranational companies. Therefore, there were e.g. separate Belgium and Luxembourg telecom organisations. Once the barriers are lowered, expansion and joint ventures become possible. This way leads to the more powerful PTOs like France Telecom or Deutsche Telekom to expand while the smaller PTOs form alliances with one another.

However, there are several problems with this type of expansion. As long as the companies are near-monopolies, they will be regulated in some way, only now they would operate across multiple jurisdictions. The experience in the United States has been that once you have multi-jurisdictional entities you get into complicated issues of allocation of costs and revenues. These multi-jurisdictional ventures can be used to shift costs and revenues in order to show lower profits.

This encompasses not only carrying transmission, but also issues of content that are affected by national sensitivities about media and cultural policy. Other difficult regulatory issues arise in the United States; it is a politically sensitive question whether the Bell Companies should be in information services. Now, imagine if one of these Bell Companies was Japanese-owned. Similarly, Europe has a sensitivity about American media domination.

In most instances, direct investments among developed countries are not possible yet due to remaining barriers. Often, joint ventures are pursued largely because a company wants to get its foot in the door but cannot access the market directly. Therefore, if the ratio of joint ventures to companies going into the country directly is high, it would indicate that there are still significant barriers, and that one has to partner one's way into a market rather than invest one's way in. What the developed countries need, perhaps, are also not direct investment of the sort that says that BT is going to buy 20% of MCI, but perhaps more of the kind that permits direct competition, where France Telecom goes into Germany, Germany Telecom goes into Sweden, and so on. The result is a greater challenge to the existing organisations, with less co-operation and more competition.

In the equipment market, for a long time companies wanting to sell equipment in country X had to promise that they would also build a factory in that country or establish a joint venture. This requirement will decline in a competitive environment, if carriers have to keep costs of procurement down.

One final observation: developing countries need basic telecommunications more than they need advanced services. Yet they often praise the technologies and organisational model of the national telecom organisation. But this may be the wrong model. Focusing again on the history of telecommunications in the United States, large parts of the country were not originally served by the Bell system because they were rural areas. Small, independent, decentralised organisations, many of them co-operatives, put together fairly simple telephone systems to serve these areas. Finland is another example of this model. It has small local co-operative telephone companies working very well. What the national organisation does is that it links them together, sets some of the standards, co-ordinates the international communications and takes care of unserved areas.

Therefore, just as important as sending investment dollars overseas is the transfer of different organisational models, which would permit a decentralised evolution of telecommunications based on local initiative and control, assisted by foreign technology and investment. To think that a private profit-making Western company could effectively run the rural infrastructure in far-off places is not realistic in economic, organisational or political terms.

To conclude, the forces that reversed the previous era in internationalization – economic sovereignty and low economic performance – will reappear and curb the internationalization process in developing and rural areas. Furthermore, internationalization moves in developing countries will be scrutinized by regulators and increasingly meet political opposition. Therefore, the recent internationalization process may slow down quicker than current trends suggest, although not necessarily come to a halt.