Investment in electronic communications sector in SEE and enabling regulatory framework

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Abstract - Recent investments in electronic communications sector in the South Eastern Europe by major telecommunications operators – including Vodafone, Telenor, Telecom Italia – illustrate a renewed interest of foreign investors in the region and create expectations that other companies would follow by placing their technologies, strategies, skills and capital. An assessment of the overall market conditions in the region allows to conclude that electronic communications market indeed represents a major growth opportunity. The main challenge for the region’s policy makers and regulatory authorities is, however, whether, the regulatory environment will be able to deliver on this expectation in the near term.

Keywords: SEE market, Regulation, Investment,

I. INTRODUCTION

This paper looks at the recent investments in electronic communications sector in the South East European countries by major Western European telecommunications operators and analyses to what extent the market conditions and the regulatory framework prevailing in these countries enable a competitive market entry.

The market data used in this paper are based on the three-year project, called “Monitoring of South East Europe - telecommunications services sector and related aspects”, that is funded by the European Commission, and performed by Cullen International. The project covers the ten following countries and geographic units: Albania, Bosnia & Herzegovina, Bulgaria, Croatia, Romania, Serbia, Montenegro, Kosova (as defined by the UNSCR 1244), the former Yugoslav Republic of Macedonia (Macedonia, further in this text), and Turkey. The project covers the ten following countries and geographic units: Albania, Bosnia & Herzegovina, Bulgaria, Croatia, Romania, Serbia, Montenegro, Kosova (as defined by the UNSCR 1244), the former Yugoslav Republic of Macedonia (Macedonia, further in this text), and Turkey. This project involves a series of four reports, prepared every 9 months in the period from 2005 to 2007, that are monitoring the progress in regulatory developments as well as the effects observed in the markets. Two progress reports have been published so far.

II. RECENT INVESTMENT IN THE REGION

Serbia. On July 31, 2006 Telenor won the auction in Serbia for a 100% share of mobile operator Mobi 63, one of two mobile operators in Serbia. The winning bid of EUR 1,513 million, secured the ownership of Mobi 63, and a 10 year licence for GSM 900/1800 and a 3G/UMTS licence for the company, subsequently renewable for a successive 10 year period on application. The transaction represents the largest foreign investment in Serbia up to date. Telenor first entered the Balkan region more than 10 years ago by acquiring 100% share of mobile operator Promonte in Montenegro.

Turkey. In May 2006, following the announcement of December 13, 2005, UK-based mobile operator Vodafone completed the acquisition of the assets of Turkish mobile operator Telsim from the Turkish Savings and Deposit Insurance Fund (TMSF). Vodafone offered $4.55 billion for Telsim. The operator adds 8.7 million customers to Vodafone’s global subscriber base of 165 million. Turkey will also be Vodafone’s fourth largest national market. Vodafone also intends to invest further $1.2 billion over the next two years.

On November 15, 2005 Oger Telecoms Joint Venture Group, led by Saudi Arabia’s Oger Telecom and Telecom Italia, completed the acquisition of a 55% stake in Turk Telekom for €5.6 billion. The deal represents the largest privatisation to date of a state-owned company in Turkey.

Makedonia and Kosovo. In April 2006 the Slovenian incumbent Telekom Slovenije acquired for €5.7 million a 76% share in Macedonian ISP On.net, the second largest ISP in Macedonia, providing dial-up, ADSL, broadband, fixed voice telephony and wi-fi internet access. On.net also established a mesh wi-fi network covering 95% of the Macedonian population.

In May 2006 Telekom Slovenije continued its international expansion investing €19.5 million in the leading ISP in Kosovo, Ipko Net. 10 million of this amount represents direct investment that will ensure further network development and infrastructure modernisation in the further two years. Ipko Net maintains its own fixed-line and wireless network and covers over 80% of Kosovo's territory.

III. INVESTMENT AND REGULATION

In July 2006 the European Commission published a study prepared by London Economics and PricewaterhouseCoopers that explores the relationship between the level of investment in the electronic communications sector and the regulatory framework. Among other issues, the study also addresses the investment by the EU companies in non-EU countries.
According to a survey conducted by the authors, when asked which of these factors was the most important, “higher market segment growth prospects” and “regulatory environment” were chosen as the most important factors, each with 30% of responses. Figure 1 below shows the complete sample of responses by representatives of different market segments, each emphasising the importance of regulatory environment and market growth prospects.

IV. MARKET GROWTH PROSPECTS IN SEE

From the market growth prospects perspective, several macroeconomic and sector specific characteristics can explain the interest in the region recently shown by foreign investments in the electronic communications sector.

With the total population of 125 million (30% of the EU-25), average annual GDP growth rate of 13% in 2004 (against 2.3% EU-25 average) and average GDP per capita of €3,100 (against €22,700 in the EU-25), the SEE region appears to show attractive market growth prospects. Total telecom market value (covering fixed and mobile telephony, data services and cable TV) in SEE in 2004 was estimated at €16 billion, i.e. 4.16% of GDP (against €277 billion and 2.66% of GDP in the EU-25). This reflects the fact that the SEE countries have a lower GDP per capita than the EU-25. However, it is also indicative of the important role of the telecommunications sector in these countries, which should provide a platform for further growth of the national economies.

In most of the countries, mobile services remain the main driver of the market value. Figure 3 below shows that Croatia and Montenegro have the highest spending on telecommunications with around €300 per capita a year, clearly driven by their mobile telephony markets. Only in Serbia, which has an annual per capita spending on telecommunications slightly higher than €80 euro, is the fixed network market significantly larger than the market for mobile networks. The corresponding spending per capita in the EU-25 countries in 2004 was €604.

Comparison of mobile and fixed penetration across the SEE region with the EU-25 averages as shown in Figure 4 below also indicates a significant growth potential.

V. REGULATORY ENVIRONMENT

Regulatory framework. All the ten geographic units are in the process of adopting and/or implementing the EU regulatory framework for electronic communications. Their position on the regulatory development varies from a very advanced status of Romania, which adopted the 2003 acquis already in 2002 and is now well into its implementation, to countries that are still establishing the initial conditions for a competitive telecommunications sector.
Macedonia introduced the EU 2003 regulatory framework, but its implementation has been slow pending on the delayed phasing out of the concession agreement with the incumbent operator. The regulatory regimes in the remaining countries are based on the EU 1998 framework, although Bulgaria is now in the process of transposition of the EU 2003 regulatory framework, and Croatia and Turkey have also introduced some elements of the 2003 framework in the national legislation.

National regulatory authorities. The establishment of an independent regulator is a cornerstone of the EU regulations for telecommunications. All the ten countries and geographic units have now established regulatory authorities through legal provisions aimed at ensuring their independence. The youngest regulator in the region is the Serbian Telecommunications Agency (RATEL) established in 2005.

As in every country, true independence of a regulator is not something that can be fully ensured through legislation. National legal traditions and culture play important roles and independence is a quality that must be earned over time and proven in testing situations. Common challenges of the NRAs, all established during 200-2005, include acquiring regulatory and legal expertise, straightening the division of tasks between NRA, the relevant ministry, broadcasting and competition authority, establishing effective appeal and dispute resolution procedures. Furthermore, political influences remain a major threat to the NRA independence and regulatory certainty, as very often a government change brings along changes to the NRA organisation.

VI MARKET ACCESS CONDITIONS

Privatisation. Privatisation of the incumbent operators is a further aspect closely related to the NRA independence and the credibility of regulatory commitments. Figure 5 below shows that almost all countries and geographic units have some involvement in ownership. The only exception is Montenegro, where the privatisation process of the incumbent operator was completed on April 1, 2005 by selling the 51.12% share owned by the State to Magyar Telecom. Bulgaria has completed its privatisation process, but has retained a golden share that permits the government to veto decisions by the board of the incumbent operator. In Croatia, Romania, the former Yugoslav Republic of Macedonia and Turkey the State only holds a minority share as the control has been taken over by a strategic partner.

Figure 5 – Privatisation of the fixed incumbent operators

Tariff rebalancing. The rebalancing of telephone tariffs was introduced by the EU 1996 “full competition” Directive, which opened up voice telephony services to competition. It means that the tariffs for the different telephony services (telephone subscription, local communications, long-distance communications) should be based on their respective costs. This alignment on costs, intended to prevent certain activities from financing losses incurred in connection with activities which are more exposed to competitive pressures, is an essential prerequisite for ensuring the access to, and viability of undertakings competing with incumbent operators.

It is beyond the scope of this report to perform a sophisticated tariff analysis to determine where the geographic units stand on tariff rebalancing. A simple graph provided in Figure 1 below, however, could serve as a useful illustration. Placing the countries and geographic units into this graph based upon their residential tariffs relative to the respective EU average tariffs, separates them into two fairly separate clusters. The first cluster has low local tariffs and high international call tariffs that are typical for unbalanced tariffs. This cluster includes Albania, Bosnia & Herzegovina, Montenegro, Serbia, Kosovo, and Macedonia. The other cluster has local call tariffs that are moderately above the EU average and international call tariffs that are around the EU average. This cluster, which suggests that tariff rebalancing has been carried out, includes Bulgaria, Croatia, Romania, and Turkey.

Figure 6 - Residential local and international call tariffs relative to EU average tariffs

VII AUTHORISATION REQUIREMENTS AND FEES

Under the EU 2003 regulatory framework, Article 3 of the Authorisation Directive (2002/20/EC) establishes a general authorisation regime for the provision of electronic communications networks and/or services. Undertakings may be required to notify the intention to commence the provision of electronic communication networks or services and to submit information required to allow the NRA to keep a register or list of providers, but there is no
requirement to obtain an explicit decision by the NRA before the start of activities.

Only Romania and Macedonia currently have authorisation frameworks in place that are in line with the provisions of the Authorisation Directive. In all other countries, an individual or a class licence is required, with some variations depending on whether the business activities involve the use of scarce resources, such as spectrum and numbers.

<table>
<thead>
<tr>
<th>Country</th>
<th>Authorisation requirements</th>
<th>Authorisation fees</th>
<th>Active providers</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>One-off</td>
<td>Annual</td>
</tr>
<tr>
<td>Albania</td>
<td>Licence</td>
<td>Tender</td>
<td>€56K (national)</td>
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<td></td>
<td></td>
<td></td>
<td>€160 municipality</td>
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<tr>
<td>B&amp;H</td>
<td>Licence</td>
<td>€500</td>
<td>€255K - €35K</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Licence</td>
<td>€31K – €21K</td>
<td>0.4% revenue</td>
</tr>
<tr>
<td>Croatia</td>
<td>Licence</td>
<td>€2,700</td>
<td>0.4% revenue</td>
</tr>
<tr>
<td>Romania</td>
<td>Registration</td>
<td>None</td>
<td>Max. 0.5% revenue</td>
</tr>
<tr>
<td>Montenegro</td>
<td>Licence</td>
<td>Tender</td>
<td>1% revenue + €120K</td>
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<td></td>
<td></td>
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<td>(int. traffic)</td>
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<tr>
<td>Serbia</td>
<td>Licence</td>
<td>Tender</td>
<td>€240 / 1000 users</td>
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<tr>
<td>Kosovo</td>
<td>Licence</td>
<td>€8.5K – €35K</td>
<td>1% revenue</td>
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<tr>
<td>Macedonia</td>
<td>Registration</td>
<td>None</td>
<td>N/A</td>
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<tr>
<td>Turkey</td>
<td>Licence</td>
<td>€110K–€250K</td>
<td>0.5% revenue</td>
</tr>
</tbody>
</table>

Figure 7 – Authorisation requirements and fees

VIII IMPLEMENTATION OF ‘COMPETITIVE SAFEGUARDS’

Carrier selection and pre-selection has been effectively implemented in Bulgaria, Croatia, Romania and Turkey. From October 2006, following a recently adopted regulation, carrier selection must be available in Bosnia and Herzegovina.

Number portability for both fixed and mobile networks has been so far implemented only in Croatia. In 2007, fixed and mobile number portability is expected to be introduced in Romania and Macedonia, while Bulgaria will introduce mobile number portability in 2007 and fixed number portability in 2009.

All countries and geographic units have designated their incumbent operators as having significant market power. The practical aspects of implementing SMP regulations, however, vary significantly.

RIOs have been published in all countries, except Albania, Serbia and Kosovo.

RUOs are available in Bulgaria, Croatia, Romania, Macedonia and the draft is currently under discussion in Turkey.

In terms of cost accounting and cost orientation, only Romania and Bulgaria have cost accounting methodologies in place.

Rights of way remain an important issue for new entrants. Few of the national frameworks for rights of way provide convincing and operator friendly solutions for network builders. When compared with some of procedures available in the EU countries, it appears that the solutions suffer from: decentralised procedures requiring many different local and regional approvals; lack of clearly stated time limits for approval procedures; and lack of efficient expropriation procedures applicable to public networks.

IX CONCLUSION

The market data presented in the two monitoring reports reflect the fast growth of the electronic communications sector in the SEE region that will attract foreign investment, in particular from the EU. Because the regulatory situation in this region is much less harmonised between individual countries than it is the case in the EU, a potential investor would have to address a broader range of topics in order to understand to what extent the regulatory environment constitutes conditions that are attractive for a longer term investment and a competitive market entry. Nevertheless, their typical questions will be concerned with transparency and predictability of the legal system, non-discriminatory market access conditions, effective enforcement of competitive safeguards in a liberalised market, and also existence of credible national regulatory authorities that are independent from the industry and politics and equipped with adequate resources. Furthermore, as the region includes countries that are potential candidates for membership in the EU, some in the shorter term and other in a longer-term perspective, another challenge in many cases will be to bring the regulatory environment in line with the requirements laid down by the EU framework.

REFERENCES


2. Data provided by NRAs for Report 3 (to be released in January – February 2007)