# THE PRIVATIZATION OF THE ARGENTINE TELEPHONE COMPANY

# LESSONS FOR THE FUTURE

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de Buenos Aires (1982)

SUBMITTED TO THE ALFRED P. SLOAN

SCHOOL OF MANAGEMENT

IN PARTIAL FULFILLMENT OF THE REQUIREMENTS

FOR THE DEGREE OF

MASTER OF SCIENCE IN MANAGEMENT

JUNE 1991

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Submitted to the Alfred P. Sloan School of Management on April 23, 1991 in partial fulfillment of the requirements for the Degree of Master of Science in Management.

ABSTRACT

Argentina and other developing countries have been struggling with their economies for a long time. In recent years, following an international trend, several governments have begun privatization processes in order to reduce their fiscal deficits and increase economic efficiency. At the same time they have been looking for new debt reduction mechanisms, because they are unable to repay their debts in full.

In this context, I analyze the privatization of the Argentine telephone company (ENTel). This was the first privatization of real importance done in Argentina, and also the first of a long list I am sure will follow.

ENTel's privatization is interesting not only for introducing a debt for equity swap mechanism as a way of paying for the company, but also for having common characteristics with other state-owned third world companies in terms of human resources, service, financial structure, tariffs and technology. These issues are analyzed in deep throughout this work.

It is too early yet to have an appraisal about the privatization's success. However, the whole process was clear and fulfilled on schedule. In the three year period technically required to re-build the network, we could have a clear idea of the success of the process and the ability of the new owners to manage the company.

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## TABLE OF CONTENTS

The Privatization of the Argentine Telephone Company

Lessons for the Future

Abstract ..... 2

Part A - Background Information ..... 6

Chapter 1 - General Introduction ..... 6

Chapter 2 - The Underlying Situation ..... 8

2.1 Fiscal Deficit ..... 9

2.2 Inefficiencies .....10

2.3 The Debt Problem .....13

2.3.1 General Introduction .....13

2.3.2 The Case of Argentina .....19

2.3.3 The Actual Situation .....22

Chapter 3 - What has been Done .....24

Chapter 4 - Privatization and Capitalization .....30

4.1 Privatization .....30

4.1.1 Issue in Privatization .....30

4.1.2 Different Privatization Processes and the Case of Argentina .....35

4.2 Capitalization .....37

4.2.1 General Introduction .....37

4.2.1.1 Cash Repurchases .....38

4.2.1.2 Senior Debt Swaps .....41
4.2.1.3 Debt for Equity Swaps .....42
4.2.2 Advantages and Disadvantages ....48
4.2.2.1 How the Market Based Approach Works, Cost and Benefits .....48
4.2.2.2 Cash Repurchases .....49
4.2.2.3 Debt for Equity .....49
4.2.2.4 Conclusions and the Case of ENTel.....51

Part B - The Case of ENTel .....53
Chapter 5 - ENTel. Company History and Present Situation.....53
5.1 Company History .....53
5.2 Description of the Company .....56
5.3 The Situation at Transfer Time .....62
5.3.1 Human Resource Problems .....63
5.3.2 Marketing Problems .....66
5.3.3 Financial and Economic Problems .67

Chapter 6 - How to Transform a Loser in a Successful Company.....69
6.1 The Service .....71
6.2 The Social Contract .....72
6.2.1 Union Relations and Labor Legislation.....73

6.2.2 Company Employees .....74
6.3 The Tariffs .....77
6.4 The Financial Structure .....80
6.5 The Technology .....82
6.5.1 For the Domestic System .....83
6.5.2 For the International System ....85
6.6 The Market .....86

Chapter 7 - Conclusions .....89
7.1 General Considerations .....89
7.2 Lessons for the Future .....90
7.3 Final Comment .....93

Exhibits I-VI .....95

Bibliography.....102

## Part A - Background Information

### Chapter 1 - General Introduction

Soon after a new government took over in July 1989, the Argentine Congress approved a law authorizing the President to privatize partially or totally a number of state-owned companies in different areas such as energy, communications, petrochemicals and transportation. By far the most important of the companies the government decided to privatize in the first stage was ENTel.

Presidential decrees implemented this privatization through an international public bid procedure, authorizing the use of "debt for equity" conversion as part of the payment.

The company was to be divided into four new ones. "Telco Norte" and "Telco Sur" both responsible for providing basic domestic telephone service for an unlimited period, and on an exclusive basis for the first seven to ten years; "SPSI", owned 50% by Telco Norte and 50% by Telco Sur, responsible for international long distance services; and "SSEC", with the same ownership structure as "SPSI" in charge of telex, data transmission, marine radio mobile, and other value added telecommunication domestic services.

The equity structure of "Telco Norte" and "Telco Sur" were to be as follows: 60% by the winner of the international bid procedure, 25% by the public through a

public offering in the Buenos Aires stock exchange, 10% by the employees, and 5% by private companies that already provide telephone service in small areas.

This work is divided into two parts. The first one, including chapters 1 through 4, is background information needed to put the reader in context. Chapter 2 deals with the main economic problems the country has had in recent years and was written for the reader who has little information regarding Argentina.

Chapter 3 analyzes the different options the government had in dealing with ENTel, and the real objectives this privatization had.

Chapter 4 provides some information about privatization and capitalization, again written for the reader with little or no previous information on these issues.

Part B goes directly to the analysis of the company, providing some historic data and a description of its main problems (chapter 5), and analyzing then the most important issues the new owners will have to deal with, soon after privatization (chapter 6). Finally, chapter 7 reflects the conclusions of this work emphasizing those points that would be useful to either improve or copy in future privatization.

## Chapter 2 - The Underlying Situation

The decision of the Republic of Argentina to privatize ENTel derives in large part from the political and economic factors currently facing Argentina. The privatization of ENTel as said above forms one part of a broad privatization program currently being implemented under the administration of President Menem.

In July 1989 when President Menem took over, the country was experiencing its most dramatic times measured in economic terms. Immersed in hyperinflation, with a 200% rate forecasted for that month, and with widespread supermarket looting.

All economic indexes reflected the severity of the economic problems. Per capita GNP had been almost stagnant for the last ten years at a level 12% lower than the average of the previous decade, an investment rate that was 9% less than the average of 1971/1980, and a huge fiscal deficit. In a recent interview four MIT economists, Modigliani, Thurow, Krugman and Dornbusch, emphasized the necessity of the reduction of the fiscal deficit as a first step for any long term solution of the Argentine economic problems, (El Cronista Comercial, 1991).

There was no doubt that the whole system had serious problems, and the three main ones were:

1) fiscal deficit

2) inefficiencies and

3) debt problem

## 2.1) Fiscal Deficit

> The budget influences inflation as well as investment and growth because it influences the distribution of resources in the economy. The possible choices of budget strategy are to service the debt, sustain consumption, or use resources for growth. (Dornbusch-de Pablo, 1989).

Argentina had had continuous fiscal deficits in the last decade, financed either by new taxes, by external debt or by inflation. The main causes were: first, too big a portion of the economy, inefficiently administered, in state hands; second, too large a government bureaucracy; and third, the combined effects of the inability of the government to collect taxes and the unwillingness of contributors to pay them.

As of July 1st 1990 there were 230 public enterprises, twenty-nine percent of which depended on the federal government and the rest on the provincial governments. The enterprises dependent on the federal government accounted for 33% of total public expenditures and about 10% of GNP. The estimated transfers from the government to the seven biggest state companies between 1984 and 1988 were $ 3 billion.

As mentioned above one of these continuous deficits

were financed through monetary emission, which only resulted in more inflation. One of the main concerns of the last administrations was to reduce inflation to a tolerable level, let us say, less than 40% per year, in order to restore confidence in the country and re-start the flow of investment and growth.

2.2) Inefficiencies.

The second problem the Argentine economy still has, is inefficiency. This problem is not confined to state run companies, although these are the most evident example. The deterioration the country has been suffering for years invaded almost all the areas of the economy, including a tremendous waste of personal time. An example will illustrate better what I am trying to describe.

Let us imagine that a new stabilization program (like the "Plan Austral" of June 1985) is implemented by the economic authorities. The plan is successful (at least at the beginning) and inflation is drastically reduced to levels of 2-3% per month. However, as a private company, for the first six months you cannot focus directly on improving manufacturing productivity (that you could not attend to, when inflation was 30% per month), because all your contracts have been modified due to a new money and you need first to protect their value. That is, the company will waste five to six months

negotiating either with other private companies or with state companies till all their contracts are in order.

Second, you start to realize that your energy bills have multiplied maybe ten times. After two weeks of desperate checking with the companies and even with friends, you finally conclude that both the electrical company and the natural gas company (both state owned) have increased their rates disproportionally as a way to collect "taxes" to alleviate the fiscal deficit (and reduce inflation, our first big problem).

Third, your company starts receiving reduced orders from the oil company (state owned, and your best client). This is because the new stabilization plan provides that the Ministry of Economics will manage the financial departments of the "big spenders" (state companies) with a drastic cut in purchases of essential materials, thereby stopping the production of the amount of oil the country needs. So, suddenly you need to close down one of your lines of production. You try not to fire anyone, first because it is very expensive, and second because you know that when the government realizes that the country will need to import oil, they will run to you asking to re-open the production line you closed, in order to maintain oil production at a normal level.

In addition, you arrive home after a long day's work, to remember that the best time to get a shower is

at 2 am. Due to this "unpredictable" winter (which comes every year at the same time) there is not enough natural gas to satisfy the demand for heating water and heating homes.

That is the moment when you start missing summer, when there is plenty of gas and you can take a shower at any time, but suddenly you remember that it was mainly in summer (when everybody decided to turn on their air conditioners) that the supply of electricity was not enough. The explanation was that due to continuous economic problems of the electrical company (state owned) they have not been doing necessary maintenance, so the system is not prepared for the summer demand. Maintenance problems exist also in all the generating facilities, hydroelectric, thermal and nuclear.

So finally you go to sleep after setting your alarm clock for 5 am, so you can reach the telephone company office (state owned) by 6 am. The line will not be very long at that time (two hours before the opening), and maybe you will find that dreamed of answer to why your telephone died three weeks ago and despite daily calls to the repair number, nothing has been done yet. Of course you will not arrive at work at 9 am, but never mind, your boss knows very well about these problems, in fact he told you he also will have to go to the phone office for the same problem.

To summarize all the inefficiencies described, we find inefficiencies in the administration of the state owned companies, in the administration of the private companies, in the time individuals spend in sorting and such matters (affecting also the time they devote to their work and their good disposition at work), and inefficiencies in the utilization of social resources like energy. As a result the society as a whole is very inefficient and the companies spend their money on things like: huge staffs of financial analysts, private mail companies (much more expensive than what a unique, well administered, mail company would be), clandestine telephone lines, time to adjust to continuously changing government rules, time to negotiate with state officials whose decision making processes are much less flexible than those of private company officials, etc.

## 2.3) The Debt Problem

### 2.3.1) General Introduction

The debt crisis was probably triggered by the doubling of the price of oil by OPEC in October 1973. This increase and subsequent ones, provoked a chain reaction that deeply influenced the international financial and economic markets.

This was only the beginning of the crisis. The decision of the industrial countries to start recycling

petrodollars generated by the new oil prices was the next trigger. Then, increased interest rates and protectionist policies of the industrial countries completed the picture. Finally, the inept management of debtor countries to deal with their own economies, was the last straw.

Some Argentine economists, while recognizing external causes, put the bulk of the blame on the governments of the indebted countries. Roberto Lavagna, an Argentine economist maintains, the foreign debt issue is more an internal problem than an external one. There is no way that only external factors can be the only cause of the debt crisis. Certainly the external factors did not help, but in his opinion the origin was mainly due to incorrect internal policies.

Since 1972 Argentina went through three very different political processes. However their economic results were very similar. I will analyze those three processes and also refer to the Latin American situation in that same period, (1972-1989).

Third Peronnist Administration (1972-1976)

In the first two years of that governmont, and according to a FIEL study (Foundation for the Investigation of Latin America Economics, FIEL, an independent and prestigious institution), government expenditures increased by 10% of GNP. This generated a

record (at that time) fiscal deficit of 14.37% of GNP. The rate of inflation in 1975 was 335.7%, compare with 39.1% in 1971 (one year before the peronnist government). Also the external debt was 50% higher than when they took over.

Military Administration (1976-1983)

Government expenditures as a percentage of GNP grew from 46.4% in 1975, (the last year of the peronnist government), to 55.78% in 1983, (the last year of the military government). Total deficit in the same period grew from 11% to 15.56%. External debt grew from $7.6 billion to $45.0 billion. Gross fixed investment decreased from $1.96 billion to $1.46 billion. The compound rate of inflation of the period was 317,232%. The balance of payments showed an improvement, from negative $860 million in 1975 to positive $2,932 million in 1983 but, if we add to this concept the financial servicing of the external debt, we have a negative $1,285 million in 1975 and negative $2,461 million in 1983. These figures can be seen in Exhibit I.

One of the government objectives reached in this period was the monetization of the economy. However, the price paid was very high. Between 1978 and 1980 the annual interest rate in dollars obtained in Argentine banks was 60%.

Radical Party Administration (1983-1989)

From 1984 to 1989 the Radical Party, center left in the Argentine political spectrum, governed the country. Although having had the opportunity of restructuring the economy, privatizing state-owned companies and deregulating the economy, it lacked the ideological support to do it and missed an excellent opportunity to help the country. The consequences finally exploded in 1989 with the first hyperinflation period, from February to July. The rate of inflation in 1989 was higher than 4,000%.

Regional Situation

Governments of lender countries (through their central banks), institutions like the IMF or the World Bank, and commercial banks, put together a common strategy to prevent a generalized failure of payments with its associated risks for the banks.

All the strategy was based on the incorrect assumption that the countries had only a cash crisis. With that presumption in mind, the governments (under strong pressure), agreed to short term recessive policies based on import, consumption, and investment reductions, aimed at increasing the net positive result of the balance of payments.

Facing the crisis in this way was a mistake because the countries were not able to meet the new conditions

from the very beginning, and also their economic policies did not settle the bases for real structural adjustments.

In October 1985, the Baker plan tried to remedy this situation. It emphasized the necessity of taking into account the growth of debtor countries and to increase new credits to those countries willing to make the needed structural reforms. However the Baker plan was not a real success. Those countries lacked the conviction to make strong enough structural reforms they needed, to make their economies more feasible. As a result the total debt of the region increased constantly, (due to refinancing interests). The net transfer (incomes, minus interest payments, minus profit transfers) of capital from the indebted countries to the lender countries, was around $100 billion (1983 to 1988). Economic growth was almost zero in this period. Huge amounts of capital left the region and investment fell from 23% in 1982 to 15% in 1988.

The first three years between 1982 and 1985, although useless for the debtor countries, were useful for the lender banks because they were able to strengthen their equity position making internal provisions for the possibility of nonpayment. They also continued receiving cash for interest payments. The ownership of the debt was concentrated in a small group of big international banks.

This concentration within a few banks was due to new

kinds of instruments that started to appear like: on lending, capitalization, exit bonds, and others.

In 1988 also, the amount of the Latin American countries' debt and their market value were as indicated in Chart I.

CHART I - Debt and market value of Latin American debt.

| COUNTRY | DEBT (billions) | MARKET VALUE (%) |
|---|---|---|
| Brazil | 120,100 | 47 |
| Mexico | 107,400 | 48 |
| Argentina | 59,600 | 22 |
| Venezuela | 35,000 | 51 |
| Chile | 20,800 | 61 |
| Peru | 19,000 | 8 |
| Colombia | 17,200 | 67 |
| Ecuador | 11,000 | 24 |
| Bolivia | 5,700 | NA |
| Costa Rica | 4,800 | NA |
| Uruguay | 4,500 | NA |
| TOTAL | 405,100 | |

The low valuation that these bonds presented (much less than their present value), made possible in 1984 Mexico's first debt-equity swap program. After that, a variety of different models to repurchase the countries' own debt at secondary market value (or similar) have

appeared.

These options generated different strategies from the bankers. The small ones or ones with little amount of credit and no permanent business in the region decided to sell in the secondary market. Others, mainly the big ones or the ones willing to continue working in the region, pushed for transforming their credits into new investments through different kinds of debt for equity swap.

2.3.2) The case of Argentina

Since 1982, the year in which the debt problem exploded in the region, the Argentine economy grew at a much slower rate than before (see Exhibit II). Although many attribute this fact to money transfers made to foreign countries paying interest and principal, Argentina did not pay more than 50% of the money due.

Javier Gonzalez Fraga presented a remarkable explanation of what happened since 1982 and the relationship among foreign debt, fiscal deficit, and investment in this period. I will briefly summarize his work.

It is a fact that good years, in terms of fulfillment of obligation to the lenders, were years of growth and stability. On the other hand, years in which Argentina paid almost nothing, coincided with high

recession and high inflation periods.

Nevertheless, there is no doubt that foreign debt generates recession, but its impact is not as direct as saying: more payments, more recession. The contrary would mean that no payment at all would generate economic growth, and Brazil and Peru's experiences demonstrate the opposite.

Economic growth is directly related with the amount and quality of the investment, quality meaning macroeconomic productivity. Argentina since the 1940's has had a closed economy based on imports substitutions that encouraged investments in internationally non-competitive sectors, based only on a small internal market and on a big and rich federal government that spent a lot.

International economics started to change in the 70's, making such an economic model inviable. In fact the 70's marked the first high inflation periods and the beginning of the Argentine external problems. But, the recycling of petrodollars, lending easily to almost any country, helped to prolong the previous situation for some more years.

In Argentina, in contrast with many other countries, external funds, were not used to modify the economic structure of the country, but to finance a growing and inefficient entrepreneur state. As a conclusion the

foreign loans (now the foreign debt) that today jeopardize the country's growth, have not even contributed to expanding the economy. Partial payments Argentina has been making, diminish the country's capacity to invest, increase the fiscal deficit and generate monetary expansion, but are not enough to completely explain the economic stagnation. Due to the country's history, it is difficult to know what would have happened if the country had not paid at all.

So, the negative impact of the debt is related to the instability of the adjustment policies introduced in this period, due mainly to its short term perspective and the lack of structural reforms.

Another problem that complicated the negotiations, is the difference between the dollars generated by the balance of payments and the fiscal deficit. In 1982 the debt was nationalized, so today only 10% is owned by private interests. The higher the amount generated in the balance of payments the more the bankers pushed for more payments. This position did not take into account that the government needed to have a fiscal surplus to buy those dollars. In many cases the government issued local currency to buy those dollars with the inflationary consequences.

2.3.3) The actual situation

In June 1989 Argentina's debt was declared as "value impaired" within the American banks. This implies that the banks should make a compulsory provision of 20% over its loans with payment delays. In December 1990 the compulsory percentage was 60%. Other countries in the same situation are: Poland, Nicaragua, Peru, Bolivia, Costa Rica, Zaire and Sudan.

The agreements signed in 1987 with the IMF, the Paris Club, the commercial banks, and in 1988 with the World Bank have not been fulfilled. In June 1989 the estimated payment delays were around $4.5 billion, including delays with institutions, like the IMF, the World Bank or the IDB. Argentina is member of all these institutions.

Payment delays have provoked banks to limit the possibilities for new medium or long term loans, and greatly reduced commercial short term lines of credit, making it very difficult (and more expensive) to import new equipment.

Exhibit II shows the evolution of the foreign debt with the different lenders, and an estimation of delays in June 1989. Of the $60 billion indicated as total debt In December 1988, $55 billion were government debt. This figure related with the total GNP for 1989 ($ 76 billion) and the enormous fiscal deficit the country has, gives an

idea of the overall situation Argentina is today.

## Chapter 3 - What has been Done

As stated before the decision of the Argentine government to privatize ENTel derives in large part from the political and economic factors the country was currently facing.

Assured that the system could not last any longer, the Peronist government of President Menem decided to shake-up the whole system. Going against all the Peronist dogma of the previous forty five years, Menem decided to privatize state owned companies and promote competition in sectors of the economy that had been state monopolies for a long time.

Although his government first privatized some television channels for reasons that were more political than economical, the first real decision to modify the existing situation was the one of privatizing ENTel. No doubt this was a brave decision. The amount of the transaction was around 10% of the foreign debt and 9% of the GNP. The telephone union was one of the toughest in the country. And also ENTel was the symbol of gross inefficiencies, and public opinion was sick and tired of bad telephone service and corruption within the company.

The person given responsibility for ENTel and the whole privatization process was Ms. Alsogaray, she is a leading member of a rightists political party that has been proposing for many years the privatization of all

the run state companies. Her party also opposed the Peronists for many years.

There are two possible ways of understanding Menem's decision. One is that he was totally convinced of the economic direction to be taken and then he appointed the strongest opponents of the "state company". The other possibility was that Menem felt forced to privatize, but appointed someone completely outside his party to avoid responsibility in case of failure.

To analyze and judge the merits or demerits of the process, there is a basic question that should be answered first. What was the main reason for deciding to privatize ENTel? Was it the need to have a strong and efficient telecommunication sector as a base of attracting new investments, knowing that in today's world, telecommunications is a base for being competitive? Was it the desire of having better and more accessible telecommunications, as a way of providing a higher standard of living to the population? Or was it only the strong necessity of reducing the fiscal deficit and eliminating as many public employees as possible?

It is not that these objectives are incompatible, but they reflect different types of political objectives. In the case of the first two questions the objectives are long term and allow for gradual changes. Only in the third case is there an urgency of transferring the

ownership of the company.

My opinion is that the pressure imposed by the economic situation, made the government forget about the importance of the first two points and focus only on privatizing, as a way of reducing the fiscal deficit and as many public employees as possible. This fact allowed the people involved to avoid facing in deep some important points, as the regulatory issue that will ultimately have to be confronted.

Going back to the political context the government faced, in July 1989, we will analyze the options the country had to cope with ENTel, (analyzing what things could have been done differently if the political context had been another):

1) reorganize it
2) sell it (in one piece or in fragments)
3) sell it for cash, for debt papers, a combination of both, etc.
4) given ENTel in concession for a long period of time.

The first option (reorganization), was in conflict with the main objective, and the previous attempts to do so demonstrated that it was impossible to transform ENTel into a profitable and efficient company, that is, one able to grow and catch up with the latest technologies in the world, if it continued being a state-owned monopoly.

To sell it, was a solution that public opinion had been demanding increasingly for a long time. The decision to divide the company, separating the long distance services and the rest of the value added services from basic services was logical, if the intention were to break the monopoly, (although because of the exclusivity period, it would be only on paper for the first seven years).

In terms of basic services, the purpose of breaking the company can be analyzed in different ways.

> ...the splitting up of large telecommunications enterprises into parts that can be more readily financed and managed, and other measures, can facilitate bringing in domestic and foreign private capital. (Wellenius, 1989).

For the Argentine government was to make the privatization irreversible. But other analysts think that breaking the company into even more pieces was not a reliable way to prevent re-statization, and base the irreversibility on the participation of the public through the stock exchange, in fact the base of capitalism.

The option of selling ENTel for cash, I think would have been very risky. At first glance it should not present any difference to sell the company at its cash value and with that money repurchase debt in the secondary market, than selling the company swapping debt

for equity. However, the first option as said before would have presented some risks. In Chapter 4 (section 4.2.1.3-b) there is an explanation of this point.

The government required some cash amount, and then the companies were to compete in terms of the amount of debt they were going to swap for equity.

If we analyze this scheme by means of the main three problems of the country, we will realize that within this process the government is dealing with all three problems.

First, the budget deficit. By selling ENTel the government is eliminating an annual deficit of approximately $ 1 billion, and will surely receive in a few years more taxes from company profits. Second, inefficiencies will decrease. The contract with the buyers calls for some improvements in the service and also the end of the monopoly after some years. More important, the only way the buyers have to transform the company into a profitable business is by providing more and better service to its users. And third, the debt problem. The fact of allowing capitalization of foreign debt, first reduces the total debt of the country, and second creates a greater commitment from the commercial banks with higher credits, to the country.

Finally, 10% of the company will be sold to the employees (this generates a personal interest in them),

and 25% will be sold in the stock exchange. As said before this last point is very important because it makes it very difficult for another administration to go back on this decision.

The last option the government had was to give the company in concession for a long period (30 to 40 years). This alternative presented the advantage of being more easy to reverse than the transfer of ownership. From an investor perspective, maybe there was not a great difference. Investors buy cash flows. In a concession scheme, the government would have asked for some investments at front.

To conclude, I think that the alternative adopted was a reasonable one, although the government neglected a very important point which is the regulatory framework in which these companies will operate.

## Chapter 4 - Privatization & Capitalization

The Argentine economy has deteriorated to such a degree that there are not many viable economic paths to take. In this section I will analyze the linkages between two issues very related to the privatization of ENTel and to the future of Argentina. No matter which sectors would temporarily opposed, finally privatization and capitalization will be present in any long-term attempt of solving the country's problems.

### 4.1) Privatization

#### 4.1.1) Issues in Privatization

Privatization means many things to many people, ranging from a ideological cleansing of the economy to a technical adjustment of the fiscal situation. Overall, privatization can address several different objectives including an economic strategy to reduce fiscal deficit, a political strategy to redistribute wealth, or a political strategy to reduce state bureaucratic power.

Every privatization process is likely to encounter several obstacles. At a conference in Buenos Aires, Madsen Pirie, President of the Adam Smith Institute, discussed different issues in privatization when considering policies to promote it.

In Dr Pirie's view, privatization means taking out wealth from state hands to be placed in community hands.

He posed different questions like:

> How can we privatize a company with the existing bureaucracy? How can we be sure that we are selling the company at the correct price? How can we arouse public interest in the process? What is the attitude towards the unions? How can we introduce competence when the company to be privatized has always been a monopoly? How can we arouse the interest of the work force when it does not know about stock? Who is the best buyer? or What do we intend to do with privatization?. (Pirie, 1989)

The answers to these questions can be summarized from the conference referred to above.

How can we privatize a company with the existing bureaucracy? The advice was to offer company stock to the existing work force as a way to replace the sense of security that the workers felt in a state company. This method was applied in the privatization of the British telephone company. Another example, also in England, was the privatization of the transport service. The entire company was sold to the workers. (This British privatization was modeled on the privatization of the Argentina bus-transport service in 1963). Another interesting example is the case of the company that provided ferry service across the Channel. Its value was so low that the government gave it to the workers for free. Two years later the workers sold it for 4.3 million pounds.

How can we be sure that we are selling the company

at the correct price? It is very difficult to set the correct price when dealing with a company that has been in the public sector for decades. Sometimes evaluators make mistakes in setting the price. It was recommended that consultants be hired for doing this job. Privatize the privatization process is the first step. Hire all the consultants needed to do the job that the government does not know how to do.

In the case of stock, sell in the open market, but not all at once. If it is sold at the wrong price the first time, it can be modified the second time.

How can we arouse public interest in the process? The answer is publicity. When an advertizing campaign is launched on TV, the government is not only advertising the company itself or its stock, but the success of the government. The British marketing strategy was to let the British public know about the opportunity it had to buy stock of the privatized companies. The government simplified the purchase procedures to give everybody a chance to buy stock. One example was the convenience of allowing the public to buy stock at the post office.

The advertising aspect is very important. Campaigns should be very intensive and imaginative when the people have a very negative image of the company.

What is the attitude towards the unions? Normally unions are strongly opposed to any privatization process.

It is preferable to avoid talking with union leaders and go directly to the workers. In the British Telecom experience, the union leaders advised the workers to oppose privatization, but 95% of them accepted the government offer and bought stock.

How can we introduce competence, when the company to be privatized has been always a monopoly? There is no a clear rule. Each case is different. For example, the electrical company in England was divided into several smaller companies, competing among themselves. Other cases required deregulation first, and privatization of the state monopoly second.

Who is the best buyer? In general, it is advised to avoid selling to a single buyer. This could be the most unpopular alternative except in the case of high risk companies where people's savings could be jeopardize. To handle extreme situations, the government can either sell lots of shares in small amount at the post offices. Or the government can call for bids from highly qualified companies on big portions of stock. Intermediate situations where neither a small investor nor a single buyer is desired, could be handled by setting a minimum of shares to be bought.

Now it is interesting to see how the privatization of ENTel followed the points analyzed above.

To create some commitment from the employees, ten

percent of the company was sold to them.

The price generated a fierce debate in the country. Finally the decision was made to fix a small cash amount as a basis for all bidders and the real competition was determined by the amount of debt to be capitalized. This methodology makes it very difficult to know what is the final price received by the government. The cash portion is very clear, but the debt portion can be measured in very different ways.

There are two aspects related to the public interest. First, public support of privatization and public opposition to continuous unions strikes. This support existed from the very beginning. Second, their interest in buying shares in the new companies. At the time this work is being written, this has not yet occurred, and it will not be easy. The Argentine stock market is very small. The public is not used to buying stock so the whole process needs to be simplified a lot. There is also the problem of confidence in the economy. The public could perceive that the companies are doing well but fears of future high devaluations or hyperinflation peaks could prevent them from buying stock, although it may look attractive at the moment.

The negotiations with the unions, in my view, is one of the most interesting. Their power has been declining continuously. Five years ago I thought that no state

company would be able to privatize in Argentina due to the strong opposition of the union leaders, but the poverty the country is experiencing in the last years and the increasing support of the public has allowed the government to initiate this process. Hopefully, the first privatization will demonstrate to the workers that being part of a private company is not so bad, and this in term will debilitate union leadership even more. In fact, five months after ENTel's effective privatization took place there are some state-companies union leaders that are asking the government to privatize their companies.

The next point is concerned with the possibility of transforming a monopoly into one or more competitive units. In the case of utilities introducing real competition is not so easy. However, in telecommunications, competition is more feasible because of the existence of value added services. In the core business, the decision to divide the company into two new ones covering different areas, will also allow comparisons between the quality of the service of both companies.

### 4.1.2) Different Privatization Processes and the Case of Argentina.

Maybe the best way to summarize the different privatization processes is to refer to World Bank

Technical Paper # 88, "Techniques of Privatization of State-owned Enterprises, volume I, Methods and Implementations", by Charles Vuylsteke, written in 1988. He says that the most commonly used methods are:

1) Public offering of shares.
2) Private sale of shares.
3) New private investment in a state-owned enterprise (SOE).
4) Sale of government or SOE assets.
5) Reorganization (or break-up) into component parts.
6) Management/employee buyout, and
7) Lease and management contract.

> Several of this methods can bring about total divestiture or denationalization or can be implemented partially or gradually. Several combinations of the above exist as well. Partial privatization often takes the form of joint ventures. The choice of a particular method will be dictated by the objectives being sought and other factors, and will generally be based on an evaluation of alternative methods. (Vuylsteke, 1988).

Argentina is working nowadays in almost all of this processes, in very different areas of the economy.

In the case of Entel, the government is selling the assets of the company to four different groups, big companies, public in general, employees and existing small telephones companies that will be absorbed by the new ones.

Beyond the methods mentioned above, are other actions linked to privatization that ought to be mentioned:

* Introduction of competitive features into an SOE (e.g. performance-related incentives).
* Economic policy reforms, such as demonopolizing certain activities or liberalization.
* Increased use of private sector financing of new activities, such as contractor equity financing, (e.g.: construct, own and operate contracts), or switching of the source of financing for the supply of a good or service, from taxation to user charges (e.g.: north-south highway in Malaysia to be financed by toll revenues).
* Privatization by "attrition" (e.g.: an SOE operating as quasi monopoly but not renewing investments, gradually permitting the private sector to invest in plants and related facilities and take over all or part of the SOE's operation). (Vuylsteke, 1988)

## 4.2) Capitalization

### 4.2.1) General introduction

The necessity of new loans either for financing new infrastructure projects or federal deficits and the necessity of credit lines for commercial activities gave banks the possibility to exercise pressure, over debtor countries pushing for more payments.

In the Latin American context and after some years of tough negotiations, the banks realized that there was a limit in pressuring countries. After a certain point, receiving more money from the indebted countries now, creates the possibility of receiving money in the future riskier.

For this reason several methods for reducing debt have appeared since 1982, all based on debt secondary market. Generically they are called market-based schemes.

> Market-based schemes all involve debt repurchases at a discount. However, the value of such purchases to both debtors and creditors is very sensitive to the precise structure of the repurchase. While in all cases bank debt is retired, different obligations are used to replace it. The nature of this new obligations (i.e., whether they are cash, exit bonds or equity) and their source (i.e., the debtor themselves, creditor governments or multinational institutions) will directly influence the desirability of these schemes. (Froot-Krugman, 1990).

The following is just a list of suggested different ways of reducing the debt burden, based on secondary market value of debt.

1) Cash repurchases (using own funds or donated funds).
2) Senior debt swaps (using issues of new bonds or new loans).
3) Debt for equity swaps.

4.2.1.1) Cash repurchases

Under cash repurchases we can include every situation in which some bank debt is purchased in the secondary market.

It can be done directly by the government with previous approval of the creditor (because generally debtors are not authorized to directly repurchase in the

secondary market), or by private institutions or individuals.

To avoid costly negotiations between governments and credit banks, the government can introduce different plans to motivate others to make cash repurchases in the secondary market. To clarify this method I will provide an example. Capitalization of bank liabilities with the Central Bank of Argentina.

In this case the Central Bank authorized local debtors banks to cancel their debts by paying the Central Bank with foreign-debt bonds which they will accept at face value.

This situation should be understood in the following context. In Argentina there are lots of national and provincial banks. For a long time they have been financing provincial government deficits and regional companies with financial difficulties. The banks try in every case to avoid government default and company bankruptcy for political reasons. These banks periodically receive financial help from the Central Bank, which, in fact, finances such subsidies either with genuine funds (minimum percent), with more debt (internal or external), or with monetary emission.

So we arrive to an unsolved situation in which companies and local governments have debt which they cannot repay to local banks. Meanwhile these banks have

debts which they cannot repay to the Central Bank, and this, in term, has huge liabilities against foreign banks.

This mechanism of capitalization of bank liabilities with the Central Bank seems to be a good one to reduce this chain of debt problem. The indebted companies buy debt papers in the secondary market at a big discount, thereby canceling debt with their banks which accept those bonds at face value. The banks do the same with the Central Bank (i.e., canceling the same amount from its credit account and from its debt account). The Central Bank also cancels a credit (in local currency) and a liability (in a foreign currency). As a result, the companies are much better off with a clear profit from this operation. The local banks although without any monetary profit, are better off because they have eliminated a doubtful debtor from its credit account. The Central Bank also eliminated a risk and reduced in part its obligations to the foreign banks. Foreign banks although losing the possibility of receiving the full value of what they had loaned, receive at least a part of it. More important than this payment received, is the fact that the value of the remaining debt increased (due to the demand for bonds in the secondary market and the reduction of the total debt). As an example of this last point, during 1990 when some banks were trying to buy

some kinds of Argentinean bonds to pay for the acquisition of ENTel, their parity rose from around 15% to 35%.

4.2.1.2) Senior debt swaps

Another mechanism for reducing debt based on secondary market value of debt is Senior Debt Swaps. In this case the government may negotiate with the banks to repurchase part of its debt at a price based on secondary market price. It will not be the market price itself. It may be the estimated price of the remaining debt after this repurchase.

At this point the government may face the problem of not having adequate funds. One possible solution would be to issue new bonds with higher seniority than the ones already in the market. This last point is a crucial one. If the country is not able to convince the market that this new debt will have preference over the others, people will think that they will suffer the same loss as the actual difference between the face value and market value of the old debt.

There have been some cases of attempts to introduce new bonds in the market with more seniority than the bank loans. As an example, Mexico in 1987 initiated a debt swap scheme by trying to introduce in the market new bonds for a total value of $10 billion. The scheme failed

and only $2.56 billions of the new bonds were issued.

The best option is to get new loans from international institutions, because obligations to them are most likely to be treated as senior. This is a relevant issue in the Brady Plan where international institutions would provide the funds for the buybacks.

4.2.1.3) Debt for Equity Swaps

> The basic idea of a debt-equity swap is that the holder of some debt is allowed to redeem the debt, perhaps at a discount, on the condition that the proceeds be used for direct investment in the country. (Froot-Krugman, 1990).

Almost every Latin American country has introduced a debt for equity swap scheme. Although similar in their concepts, there are some differences worth mentioning. (The following information is based on government regulations at the beginning of 1989).

Convertible debt includes in almost every case private and public debt, but in Mexico and Argentina only the public one. (Argentina transformed all the private debt into public in 1982, so the percentage of private debt is very low). Some countries have not fix any limit over either the total amount to convert or the partial quotas, but some others as Argentina, Chile, and Mexico have. Debt holders usually receive 100% of the bond value, except in Costa Rica where they cannot receive

more than 70%. In Mexico the value goes from 70% to 100%. And in Argentina there is a bidding process. In almost all the countries except in Brazil, Chile and Ecuador there are preferred sectors for investments. Argentina is the only case in which it is necessary to invest one's own money. Money received from the exchange cannot be more than 70% of the total investment.

In Argentina this kind of debt for equity swap was applied in different contexts. The first one (explained in the above paragraph), was implemented in 1987. Its intention was to promote new industrial projects to increase the export capacity of the country. It lasted two years and converted $1.3 billions. The second is the one used to privatize ENTel, and the third option, very much promoted in Argentina but not yet applied, is to sell assets.

a) Capitalization for New Investments:

The investments should be focussed on purchases of new equipment, or construction of new industrial plants. In both cases the projects should be aimed at increasing the total production capacity of the country and the amount of exports.

There was bimonthly bidding in which the companies offered the Central Bank the percentage of the face value they would sell the bonds. The proceeds could not be

applied to the purchase of imported goods, and only 70% could be financed with the conversion funds.

To better understand this mechanism let us analyze an example, (copied from Boletin Informativo Techint, March-April 1989. "La Capitalizacion de la Deuda Externa", Frediani). A company has a project for a new plant where the total investment is $1 million. Two hundred thousand dollars correspond to imported equipment. From the remaining $0.8 million, only 70% ($0.56 million-A 8.23 million with a rate of exchange of A/$ 14.7) could be financed this way.

The company bought debt bonds at 21% of their nominal value, receiving bonds for $2.66 million. As the company bought these bonds in the Argentine market paying in local currency (Australes "A"), and the rate of exchange was A/$ 14.7, it finally paid A 8.23 millions. The company bided a 72% discount to sell the bonds to the Central Bank. They accepted the offer and paid:

$2.66 million x A/$ 14.7 x (1-0.72) = A 10.97 million.

The difference between A 10.97 million and A 8.23 million is the subsidy the company received for having recovered foreign debt bonds. With this mechanism the Central Bank avoided using foreign currencies and instead used the local currency.

Some advantages of this process are, first: although

the market value of the debt is worth 21% of its nominal value, the Central Bank paid 28% of it saving 72 cents per dollar of debt repurchased. The second advantage is that this mechanism helps to bring back capital that left the country before. In average 1/3 of the investments are financed with local currency and the remaining with foreign currencies. With this mechanism the Central Bank does not use a single dollar and the imports of goods were done with the companies foreign funds.

b) Transferring state owned companies to the private sector:

This situation implies two economic transactions done simultaneously. The first one would be if "entity A" sells an asset to "entity B," and the second one would be the cancellation of a liability "entity A" had with "entity C," using the proceeds of the first transaction.

In the case of using capitalization, "entities B & C" are the same.

Why is it that the Argentine government decided to capitalize foreign debt instead of selling for cash and applying the proceeds to repurchase debt in the secondary market?

There are two arguments toward choosing the first alternative. The first one is that as soon as a government starts buying debt, its secondary market price

rises, and the government is unable to repurchase the same amount of debt it can get under capitalization. Additionally, it would be very difficult for the government to arrange to which banks and in what proportion the repurchase will be done.

The second argument concerns the banks (mainly the American banks). If they decide to invest "fresh money" in risky countries like Argentina, the FED will require an increase in capital; whereas if they decide to change a credit (already partially under-written) for equity in a local company, the FED will not require anything.
For these two reasons Argentina and other countries are adopting capitalization.

Transferring state-owned companies to the private sector allowed Argentina to reduce its debt by more than $5 billion, with ENTel's privatization alone. The following is the translation of the clause that introduces the swap of debt for equity in the bidding conditions: "The offerers should include the amount they will pay over the cash price, given titles of the Argentine foreign debt previously verified by the Central Bank of the Argentine Republic, and ready to be canceled. That amount will be expressed at nominal value plus interest till the pre-adjudication day. Those interests and the following ones will be for Entel. While signing the trespassing contract the grantee will receive the

verification proceed."

The second company to be privatized using this same mechanism was the national airline. Its bidding conditions specified the exact amount of cash that should be offered and gave the option to pay the rest either with cash or with capitalization.

c) Selling of Assets

The Argentine Central Bank one year ago had more than $3 billion in assets of companies and banks that for one reason or another failed to pay their obligations and lost their properties. Usually these are buildings and land. The bank is not efficient in selling these properties and there are not to many people interested in buying them. One possibility is to sell these assets offering the buyers the option to pay with bonds of foreign debt.

As we have seen, the mechanism is simple; maybe there are some complex operative steps, but the benefits are worth those difficulties. One benefit either in this case or in the previous one is that the government gains new tax payers. In the case of Entel the government also reduces its fiscal deficit.

#### 4.2.2) Advantages and disadvantages

Every method to reduce debt mentioned here has pros and cons. These pros and cons depend upon the perspective from which you analyze the situation, from a debtor or from a creditor perspective. First I will present some comments that are common to either method, and then some peculiarities of each one.

##### 4.2.2.1) How the Market-Based Approach Works, Cost and Benefits

The first thing to be mentioned is the difference between the average and the marginal cost for debtors (or benefits for creditors) of an additional dollar of debt. The value of the debt in the secondary market depends mainly on: the amount of debt, the cost of that debt, the risk of the country and the volume traded in the market. So, as soon as some debt is repurchased, the value of the remaining will rise. In an extreme situation if all the debt were repurchased, creditors would give up their last bonds only at par value.

As any transaction must leave creditors indifferent between selling or retaining the debt, the price should be the post-buyback price. (This concept is applicable for concerted transactions, but not in other cases where the volumes are small and fragmented).

4.2.2.2) Cash repurchases

The situation described in point 4.2.1.1 allows different sectors of the debtor country to solve difficult situations. Although in theory every dollar of debt repurchased makes the price of the remaining debt rise, the system does not work as a continuous function. There are subjective issues (such as the way the country is perceived) that influence the value of the debt in the secondary market. The debt also increases continuously, so small reductions generally have no effect on the value of the debt, and they only contribute to make it grow at a lower rate.

4.2.2.3) Debt for Equity

This mechanism implies a higher degree of political commitment than the previous ones. Two different scenarios can be conceived of to analyze its merits or demerits.

In the first one the value of debt in the secondary market is very low. This value has a very high implicit risk premium. Here the most convenient situation for the country is to try to balance the buybacks to avoid a recovery of the market and to allow the debt reduction mechanisms to work.

Although good temporarily, this scenario will not have the necessary flux of investments that the country

requires, because of the high risk premium that the country presents.

The long-term strategy should include the reduction of negative expectations about the country. In this scenario a reduction of the total debt (as a consequence of an agreement with all the creditors to reduce interest for some years) will imply a reduction of the risk premium. In this situation, with a secondary market value of the debt close to its technical value, capitalization of foreign debt will not be so much a mechanism of reducing debt than a way of accelerating investments in debtor countries, reducing the financing cost of the projects.

When dealing with capitalization for new investments there are a couple of issues that governments worry about. The first thing is not helping financing projects that would have taken place anyway. Second is the issue of the supply of money. When changing debt bonds by local currency (although convenient from a debtor's balance sheet perspective), a country like Argentina (with a huge fiscal deficit and maybe little chance to sell new bonds internally) would be paying the buybacks with money emission. This implies more inflation and more instability.

4.2.2.4) Conclusion and the Case of ENTel

As in any situation in which one part can win at the other's expense, the best long term solution is a concerted one in which the described mechanisms of debt reduction can be included. The final goal should be the restoration of the debtor country credibility to be considered a more or less safe place to invest. Meanwhile, some countries whose economic situation is very bad (almost no investment, fly of capitals, huge internal deficits, etc.) can consider these mechanisms as a partial relief, and also as a way to, at least, diminish the rate of growth of its foreign debt.

In the case analyzed here, it is clear that there is an agreement in which the country decides to reduce in part the burden of its debt by capitalizing it, and the banks agree to make that exchange betting that the assets acquired will be more profitable in the long run than the credits they have.

The bidding process, regulated by a main document called "Pliego de Bases y Condiciones," was open to existing telephone companies, participating either alone or associated with other companies. However, the structure of this privatization caused all the groups interested in the contest to have the same configuration: a telephone operator, a bank, and a local company.

The "Pliego" was very strict concerning the equity

capacity of the associated companies. The combined equity should be at least four billion dollars. The telephone company's equity should be more than one and half billion, and any other participating company with more than 10% should have at least an equity of one billion.

> Telefonica of Spain offered $2.83 billion for the southern zone of ENTel and $2.41 billion for the northern zone. Bell Atlantic Corp. of Philadelphia offered $2.33 billion for the northern zone; it did not bid on the southern zone. And STET of Italy offered $2.44 billion for the southern zone and $2.2 billion for the northern zone. In all cases the offers include cash payments of $100 million for the northern zone and $114 million for the southern zone, with the rest in the form of assumption of debt and interest payments.
> The bids far exceeded the government's floor prices for both zones, blunting previous criticism that the setting of a debt floor would drive bidders away, though other had alleged that ENTel is being sold too cheaply. (The Wall Street Journal, 6.26.90)

As I said before all the telephone operators were associated with a bank and a local company. In the case of Telefonica, its partners are Citibank and Techint; in the case of Bell Atlantic the partners were Manufacturers Hanover and several small Argentine companies; and in the case of STET they are J.P.Morgan, Perez Companc and Cable & Radio of France (another telephone operator).

## Part B - The Case of ENTel

## Chapter 5 - ENTel-Company History and Present Situation

In this chapter I will start from the very beginning of telecommunications in Argentina, going through the important issues of this century, ending with a full description of the company, some comparisons with other telephone companies and an analyses of ENTel main problems.

### 5.1 Company History

In 1880 Swiss capital established the "Societe du Pantelephone de Loch" in Buenos Aires. This was Argentina's first telephone company. Few months later two new companies were established, the Gower Bell and the Continental, and after these, several new companies appeared.

In the twentieth century political trends have deeply influenced the development of the communication sector in Argentina. The linkage of the communications sector with national defense and strategic issues have spread all around the globe and was the main reason for having national monopolies in telecommunications. Even today France and Germany maintain that monopoly, Britain privatized its telephone company during the eighties, and lots of other governments are currently thinking of privatization as well.

In the first decades of the century Argentina enjoyed a free competitive environment. Is important to say that the state-owned companies were very responsible in the development of the country in those early years. In the 1940's successive government administrations started moving to more restricting regulatory policies. In telecommunications the government first decided to set telephone tariffs. Other regulations continued, but by far the most radical change came in 1946 when the government decided to almost monopolize the service, nationalizing more than 90% of the existing lines.

It is important to explain briefly what was happening politically in Argentina at that time. In 1930, seventy-eight years after the Constitution had been promulgated, democracy was abandoned and the first military coup incorporated the military actively into the political scene. Two years later they gave power back to a "democratic" government, initiating an era in which people had voting power but the elections were manipulated by small but powerful interest groups. In 1944 another revolution started a succession of military governments. One colonel became an increasingly important personage in Argentine political life, his name was Peron, and after a new election (in this case a clean one), he became president. By that time companies started increasing their personnel in disproportion with their

operational needs, initiating the deterioration process of state-owned companies.

In 1972 a new telecommunications law increased the power of the state monopoly, and in some areas allowed the temporary existence of two companies (CAT and CET). This uncertainty caused these two companies to almost stop investments.

In the following years the situation with the state run monopoly became worse and worse. The company became part of the big bureaucracy, under the Communications Secretariat which in turn was under the Public Works and Services Ministry. As salaried government employees the managers did not have any incentive to productivity or quality. The rates were fixed by political officials outside the company, in many of the cases lowering them, using rates as a political tool.Furthermore, whenever the government needed funds the company had to transfer such funds to the federal government. Company purchases were subject to government regulations and requisitions, making purchases more expensive with longer procurement times.

The unstable political situation in the country that provoked continuous changes in government officials also influenced ENTel because usually each new ministry brought its new secretary, and he brought his own new president of ENTel, with new ideas and probably with some

more new top executives.

In summary we can say that till November 9 th 1990 ENTel was a state-owned company regulated by varying governmental bodies. Rates, salaries, indebtedness and investment have historically not been determined by ENTel's management. The company also has experienced a rapid turnover of senior management, having had twenty one presidents in the last 23 years. Because of over regulation, the political nature of the decision-making process, and the influence of its powerful labor unions, ENTel has not been operated rationally or efficiently.

## 5.2 Description of the Company

The services offered by ENTel can be classified into two main categories: telephone services and special services. The first group includes urban services, long distance inside the country and with Uruguay, and international services. The second group provides more specific services like: telex, public telephones, data transmission, remote area phones, maritime phones and cellular phones.

Only 20% of the lines have direct dial capability for international calls. Seven percent of the telephones have no access to national long distance service. There is a limited provision of value added telecommunications services, and there is insufficient public telephone

capacity. The 22,200 telephone booths installed, represent only 0.06 per 100 inhabitants, compared to 0.15 or more per 100 inhabitants in almost all OECD countries (Organization for Economic Cooperation and Development). Additionally most of the booths are out of service most of the time, only 10% have access to long distance services and practically none to international services.

In 1989 the company had 45,500 employees which meant 67 lines per employee. This level of productivity, although better than the 1986 figure of 56.2, does not take into account an enormous increase in overtime work from an average of 3 to 4 millions in the period 1977/82 to 18 million in 1989 (this represents an additional 8600 employees, or 58.3 lines per employee). Also the comparison with telephone companies from developed countries reflect how poor this productivity value is. Exhibit III shows productivity values for different countries.

Of these 45 thousand employees, 21% work in staff or supervisory functions and 18% are telephone operators. Management decisions are centralized in Buenos Aires where 73% of all employees are located. The average age of employees is 41 with 17 years of seniority.

Compensation is based on inflexible salary schedules according to category and seniority. Salary increases are usually automatic for the first fifteen categories. For

higher categories, they vary according to seniority and the employee's geographic and departmental location relative to available positions. Overtime represents 25% of personnel expenses. The limited incentives available to reward performance make overtime one of the few ways in which employees can attempt to increase their compensation.

All ENTel workers belong to one of four unions. FOETRA with 70.4% of all the employees is the largest, most powerful and the one that opposed privatization most strongly.

In terms of lines, in December 1989, there were 3,600,000 lines installed, with an average growth rate in the previous decade of 5%, very similar to the world average of 5.2%. However these figures represent just 9.6 lines per hundred habitants (10.4 in April 1990), far below 23.7 which is the average for the US, but equal to or higher than that of many countries in Latin America. Also there were only 3,060,000 lines in operation, which indicates inability to put all the lines to work.

In 1987, 94% of the lines still used electromagnetic equipment, and 66% of them were considered technologically obsolete. Throughout the country, 35.8% of the lines were 20 years old or older, which is considered the lifetime for these kinds of lines.

These problems were also aggravated by the

distribution of the existing lines. While in the Buenos Aires area there were only 3 inhabitants per line, in other areas the ratio was 35.

To fully understand the importance of the demographic concentration of the Argentine population in the Greater Buenos Aires region it is important to know that 29.7% of Argentina's population live in this area, which accounts for 60% of the telephone subscriptions and generates 76% of local and long distance calls.

Over the past several decades, the telecommunications sector in Argentina, has suffered from a gradual decline in service quality as limited investment in maintenance and expansion of the existing infrastructure have failed to keep pace with a growing demand for telecommunications services.

In 1987 there were 14 million "out of service claims," equivalent to five claims per year per line. Only 17% of these claims were localized and fixed on time. So, today, the average repair time is between 10 and 15 days, when it should not be more than two days. The company has an index ("quality index"), that measures on any day of the year what percentage of lines are out of order. Although the standard value is 0.5% (the internationally accepted maximum), today that value is 1.3%.

The most important index ENTel uses to measure the

quality of the service is the "service index," which is supposed to be 1 but today is 13. The service index is quality index times the average waiting time.

There is no reliable information to measure other indices like: waiting time while dialing, operator efficiency, or completed calls.

Average telecommunication sector investments in the period 1970-1987 was 4/1000 of GNP, with oscillations to less than 2/1000 of GNP. This value is far below other countries, for example: US 6.1/1000, Germany 8.1/1000, Switzerland 8/1000, France 7.3/1000, Portugal 7.4/1000, Spain 7.0/1000 or Italy 7.6/1000.

Another indicator reflects the annual increment of telephone lines per hundred people. Again in Argentina from 1970 to 1987, this value was 0.35, very low compared with Germany (2.63), Japan (2.23), Italy (1.75), Greece (1.63), Spain (1.6), Israel (1.47) or New Zeland (1.44).

In order to respond to the unsatisfied demand for services, ENTel launched a line installation program in 1985 (Megatel Plan). The objective of this plan was to develop a means for financing the necessary capital improvements with prepayments for installation of new lines by potential subscribers. Because every person who did not subscribe to the Megatel Plan ceased to be considered an applicant for a new telephone line, this plan invalidated the old waiting list. There were 665,000

new subscribers, of which approximately 180,000 have not yet been installed. Even with the Megatel plan, the total number of lines installed has increased at a very slow rate, being now at 10.4 lines per hundred inhabitants.

Another problem ENTel face is the obsolescence of its network. It suffers from a wide collection of mainly old equipment from different manufacturers and in some cases from a scarcity of spare parts.

Before 1969, all internationally communications were handled manually by an operator. In 1969 the first automatic analog switch was introduced. In 1978, the first automatic semi-electronic switch was installed, and it was not until 1987 that the first digital electronic switch was installed. International direct dialing is available to only 30% of the subscribers.

From an economic and financial prospective the company has been fairly stable from its statization in 1946 to 1980. In the early eighties a process of deficits and indebtedness began. In Exhibit IV is a 1980-87 income statement, (all the figures are expressed in US dollars-the average for December 1987).

Since 1981 the average revenue per customer went down from $ 210 to $ 142. This situation was provoked by the failure of rate adjustments to keep pace with general price increases. As an example the 1987 fees were only 30% of the equivalent fees in 1974.

Although specific to ENTel, the situation described shares certain basic characteristics with other telephone companies in the developing world.

> ...Developing countries are characterized, with few exceptions, by major under-investment in telecommunications, as is evident from the large unmet demand. Outstanding applications for telephone connections often exceed the number of lines in service. New applicants typically wait several years before obtaining a connection. There is heavy call congestion at all levels of service, particularly during business hours... Furthermore, services tend to be concentrated in one or a few large cities or towns. (Wellenius, 1990).

## 5.3 - The Situation at Transfer Time

This section will try to point out the main problems the company faced in November 1990 through the perspective of different companies or institutions, all involved with ENTel in one way or another.

For the "Sindicatura General de Empresas Publicas" (SIGEP), a governmental body in charge of controling the run state companies, the report of last quarter of 1989 basically contains the following points:

* Low level of quality in customer relations.
* High number of claims.
* Billing complaints from customers.
* Old and obsolete equipment.
* Not enough maintenance.
* Inadequate control over investments. There is no interrelated control among different

projects, and the clearest consequence is having 3.6 millions lines of equipment, but only 3 millions completely installed.

* No adequate labor training to put workers in touch with new technologies.
* No planning and control activity on a regular basis, with top and medium levels feeling it is not necessary.

This report basically shows the effects of deeper problems which will be discussed later in this chapter.

An internal World Bank report goes a little further in identifying these basic problems stating that

> ...the poor performance of ENTel resulted from a combination of factors, including: a) inefficient management of the company, b) low labor productivity, c) uncompetitive procurement practices, d) tariff policies determined by political factors with little regard for company profitability, e) inadequate financing for capital expansion, and f) ineffective government regulation and supervision. (World Bank Report No. P-5454-AR, 1991).

I prefer, for a more detailed analysis, to group ENTel's basic problems into three categories:

1) human resource problems
2) marketing problems
3) financial and economic problems

### 5.3.1 Human Resource Problems

I found two different ways of analyzing this issue

according to the point of view I took, that reflected in public opinion, and that of an experienced telephone executive.

Based on public opinion's perception as reflected in newspaper articles, or some Argentine telecommunications specialists the picture would look like this:

Low salaries, almost no incentives, lack of managerial capacity, lack of continuity of top management, increasing dislike from the public and lack of authority to completely control the company resulted in the fact that ENTel employees never had a clear idea of the overall strategy of the company, did not realize the necessity of planning, and felt that improving productivity or service would not be reflected in their salaries.

On the contrary, they worried that major changes (like this privatization), would cost their jobs.

However from an executive point of view things are different. They saw the upper levels of ENTel bureaucracy very politicized and corrupted, possible causing some problems in the near future. But they regarded first management levels and employees as motivated and well trained. (Baglietto; Burmaister, 1991).

Now, in my view, low labor productivity is due to over-staffing and some consequences of union-management negotiations such as promotions based on seniority,

prohibitions against wage incentives, labor union control of corporate structure and personnel mobility and an unwritten life employment contract. The result is job security for the workers at the cost of very low productivity.

There were other "benefits", enjoyed by a minority of the work force, but very important and need to be discussed in this section. Bribes in purchasing, unofficial sales of lines, thefts of lines and asking money to reconnect them, collecting "contributions" to repair phones, or stealing from inventories were some of the special "benefits" some employees decided to have. Such corruption was very difficult to demonstrate or prove because either users "cooperated" to recuperate their lines or ENTel suppliers "cooperated" for necessity of selling supplies to ENTel.

Although society is the first responsible for this situation, the justice system is also responsible. Recently a dishonest employee was denounced by a customer. Although the judge found the person guilty, he could not condemn him because of his low level in the company hierarchy.

In this framework, after many years in this non competitive and demoralizing environment, it is easy to understand why ENTel unions opposed privatization and why issues like: the application of new managerial tools,

basic planning, good customer service or productivity increases were not regarded as a necessity by successive company administrations.

Human resources is an extremely important issue, in my view the most important, because only through good management of such resource will it be possible to transform ENTel into a viable company.

### 5.3.2 Marketing Problems

The telecommunications industry has been developing at a faster rate than most industries. This implies that the demand for services has been increasing by several dimensions. First, demand for more service, second demand for better quality of service, and third new services. Although ENTel during the eighties tried hard to provide more services, it was barely able to catch up with the unsatisfied demand. Quality of service worsened instead of improving due to the lack of appropriate maintenance and necessary investments. And finally, new services were impossible in some cases or possible only to a very limited number of customers.

Unsatisfied demands were not greater than they already were because of demand dependence on the income level of the population.

There is a paradox in the Argentine marketing situation. In a normal context, even in monopolistic

markets, suppliers need to make a marketing effort to sell their product or services. In the case of telecommunications companies this marketing effort should focus on installing more lines for new service customers, or in providing new services. In the case of ENTel, this may have been the case a long time ago, but recently, unsatisfied demand has been so high that ENTel has been driven by that demand, installing the available lines for customers who had been waiting for a long time. ENTel also has been trying to introduce new services that in many cases have already been provided by other means.

### 5.3.3 Financial and economic problems

There is no doubt that a company desiring to grow needs financial resources. In the telecommunications sector, with its tremendous development in the last decade, growth through internal cash flow was not possible. If we consider the case of ENTel, with its tremendous deficit in infrastructure, the problem was worse.

The company was very dependent on the government for new investment projects. This dependence was associated to two different issues. First, the government used to fix rates in a political way. So, in trying to gain support from the public it systematically reduced the real value of rates, forcing ENTel to work for long

periods of time under the break even point. In other cases, mainly after an adjustment plan, the government decided to adjust rates to reasonable levels. That decision created harsh situations for consumers because of the magnitude of the increases. The main reason for these big increases was to collect money (that could not be collected through taxes), for balancing the government's fiscal budget. The consequences were in both cases the same - not enough cash to finance a sustainable growth.

Second, it was very difficult for the company to finance externally due to the country's indebtedness, (a common situation for every Argentine company).

If we analyze other aspects (less tangible than the investment in equipment or infrastructure) of the same problem, it is logical to conclude that without control of its revenue and of its cash flow it was impossible for ENTel to think of improving managerial systems or of serious developing its human resources.

## Chapter 6 - How to Transform a Loser into a Successful Company.

All the privatization process is inherently a conflicting one. In the case of ENTel there are five major groups, with conflicting goals and interests. Government, new owners, national union leaders, ENTel employees and consumers. Briefly we can say that government objectives are to: 1) reduce the fiscal deficit and 2) contribute to a successful privatization to set the bases for future ones. New owners have a profit objective, although it is necessary to make a distinction among telephone operators, banks and local company interests. National union leaders do not want to continue deteriorating their power. ENTel employees want to maintain their jobs and to improve their salaries and standard of living in accordance with private sector standards. And finally, consumers, maybe the less powerful sector, want to have a better service.

Through this chapter I will not only analyze the major issues new owners should focus in, but also remark all the conflicting issues that can appear and their possible consequences.

From a telephone company perspective there is no doubt that there is a big business opportunity at stake in this privatization. Although big investments and important changes should be undertaken, the

telecommunications business worldwide have demonstrated that it is profitable.

In terms of service quality the base reference, (which is the situation of ENTel at transfer time), is so low that any minor improvement will be greatly appreciated by the public.

One of the new company's business plan is to: improve the service quality to meet international standards, drastically improve basic telephone service and reduce the average waiting time to obtain service, pay special attention to providing sophisticated telecommunications services, implement efficient management and effective allocation of resources, and reach adequate return on capital in use.

In my view, to reach these objectives the companies should work on the following major issues:

1) the service
2) the social contract
3) the tariffs
4) the rebuilding of the financial structure of the company
5) the technology
6) the market

Let us now analyze each of these points.

6.1) The service.

This issue was treated as a mixture of requirements and incentives. Companies have some mandatory objectives to reach in the first seven years (exclusivity period), and additionally they can extend the exclusivity period for three more years if they improve the value of these objectives.

Chart II shows the mandatory objectives to be achieved in the future (these objectives were stated in the "Pliego"):

Chart II - Mandatory Objectives.

| | Current | 1993 | 1996 | 2000 |
|---|---|---|---|---|
| Network penetration (1000's lines/year) | NA | 311 | 581 | NA |
| Call efficiency | | | | |
| local | 49% | 70% | 85% | 94% |
| interurban | 28% | 60% | 80% | 90% |
| international | 40% | 45% | 55% | 55% |
| Operator efficiency | | | | |
| information (answer/10sec) | NA | 67% | 75% | 80% |
| maintenance (answer/20 sec) | NA | 67% | 75% | 80% |
| operator (answer/10sec) | NA | 67% | 75% | 80% |
| Failure allowed per 100 lines | | | | |

| | | | | |
|---|---|---|---|---|
| internal | 6% | 5% | 3% | 2.5% |
| external | 48% | 43% | 30% | 20% |
| Repair time (days) | 10-15 | 7 | 3 | 3 |
| Waiting time for installation of a new telephone | 4 yr | 12 mo | 4 mo | 2 mo |

Other required conditions are:

1) permit equal access to new companies willing to provide value added services.
2) maintain connections with all cities presently connected in the network.
3) after the exclusivity period, provide interconnection with other competing networks.
4) study alternative methods to maintain traffic in case of emergency or catastrophe.

All of these are mandatory improvements, necessary to fulfill contract conditions. If the companies can reach such objectives plus five percent, they will be able to extend the exclusivity period granted from seven to ten years, which is the maximum period the new companies will be allowed to operate as monopolies in each segment.

## 6.2 The social contract

In this section I will analyze the relations between

three of the five groups mentioned above: new owners, national union leaders and company employees.

### 6.2.1 Union Relations

In Exhibit V, I am including an article titled "Unions everywhere are resisting the region's privatization policies". It is a clear account of what is going on in Latin America, mainly in Argentina, in the privatization process.

Recently the unions in Argentina have been losing membership. This situation was caused mainly by the successive economic downturns and rising unemployment. It seems that union leaders have been slow to adapt and are unable to think in a different political framework that the one that existed during the last forty five years. However I do not think that this is only an economy-ideology problem but, also one related to the "benefits" some union leaders enjoy. An article published in The New York Times (Exhibit VI) discusses such benefits.

The relation with unions will be a very important issue. There are four unions. Three are management or technical worker unions. The forth, Foetra (the union of "blue collar workers") representing more than 70% of all workers strongly opposed the privatization process, although at the end changed its attitude and adopted a collaborative one.

In my opinion the relation with this union presents one of the most important challenges not only to the telephone companies' future, but also to the privatization process as well.

Five months after privatization was effective, substantial changes have been undertaken. A couple of examples will illustrate better. Employees categories have been reduced from more than 30 to 5. Works that with previous labor management agreements required three employees, today require just one. This collaborative situation reflects one Bell Atlantic executive view when he said that after an adjustment period it was likely that good relation between new management and union representatives would be reached.

### 6.2.2 Company Employees

Due to the high average age of the ENTel labor force, significant reductions of personnel are expected over the next five years due to retirement. Additional personnel reductions could be expected to result through the implementation of incentive-based voluntary retirement programs. These type of programs have been successfully implemented in many cases, either in private companies or in privatized companies. From preliminary information, they have been applied without frictions during the first months after the privatization.

The average annual salary (in 1990 was $ 8,750 including social security taxes) is expected to rise considerably as a necessary way to retain and attract high quality employees aiming at a linkage between pay and performance. As a result of the two actions just mentioned the total personnel expenses are expected to decline around ten percent in the next five years.

Education should be looked at very seriously by the buyers. Not only will they need to teach concrete managerial skills like broad PC usage, planning, projects control, or budget techniques, but also to spread to all levels important concepts fundamental for the future of the new companies such as: customer satisfaction, efficiency or focusing on the bottom line. In some cases companies will not have time to rely on training and will need to replace people for others with private sector experience.

Finally, new management should fight firmly against corruption, both internally and externally (encouraging users through specific campaigns to denounce these situations). Corruption can be classified into minor and high corruption. The former is when a employee bribes for repair a line, or when he stole some minor element from inventory. The latter can be found in the way of small and hide "companies" inside ENTel that collect the invoicing for themselves.

Let us go back to those three concepts mentioned above, and talk more in detail about them:

Customer Relations: if we add up the people that currently have the telephone service, people that are waiting to have it, and all of those who use it at work or through public lines, we can conclude that the customer in a broad sense is society as a whole.

It is very important that the customer perceive an improvement in the quality of the service. The first improvements in quality will not be in the communication service itself but in the promptness in which the calls are answered by the operators either for the directory assistant service, repair service, or international service. The second improvement can be in the way invoicing is done. The company should try to avoid errors and eliminate the long lines of people in front of its offices to inquire about those mistakes. Here I foresee two steps. First, some improvements could be reached through good predisposition of the employees and slight modifications in the bureaucratic systems. Second, all those problems would be eliminated through the massive use of technology and education of the employees, and salary increases.

Efficiency: this concept implies doing things correctly with the minimum utilization of resources. ENTel culture never focussed in this. State companies usually focussed

on doing things correctly without regard for resource utilization.

Focus on The Bottom Line: the final objective of any company is economic. This is not always understood even in private companies where some areas (mainly technical) focus on their specific tasks without remembering this essential goal.

All these actions should be accompanied by advertizing. Not the service, because demand is much higher than supply, but the improvements the new companies are making, and the way consumers are benefiting from the privatization. Advertising will also serve to motivate the employees.

Besides motivation, advertising has a second and very important objective; it is to convince people that the privatization is successful and to encourage them to participate in the purchase of stock. If this is done successfully, then society will accept more readily future privatization.

## 6.3 The Tariffs

This is a conflicting issue that involves the government, the new owners, and of course the customers. The tariff negotiations for ENTel, took place after the winners of the bid were announced. I will come back to this in the next chapter, but in the opinion of some

analysts the government was in a weak position to negotiate tariffs at that time. We have already spoken of the concept of risky country, and how this influences all negotiations. Foreign investors require a very high rate of return to invest in Argentina, and this rate pulls up telephone tariffs. These tariffs are so high that they will generate a big part of the cash flow needed for the necessary investments.

Historically the tariffs charged in Argentina by state-run companies have been unpredictable. Some services have been completely undervalued as a way to help people. Others have been overvalued, because they have provided an excellent way to collect taxes. There is no rationality in the way they have been valued; due to the monthly inflationary increases this situation can vary from one month to the next. Regional incentives or desincentives also exist, complicating even more the whole situation.

With privatization the problem is solved. The government administration that sold ENTel, raised the tariffs to levels that were accepted by the possible buyers and were considered appropriate by the sellers. As mentioned before, the rates will be very high but at least this time the proceeds will be used to modernize the network, not to pay government deficits in other sectors or to be stolen by the employees.

The next step, which is linked with the marketing issue, would be the implementation of differential tariffs based on the different market segments and the network possibilities.

Revenues from basic telecommunication services are derived from the sum of monthly basic service fees, measured service fees (measured in pulses), installation fees and revenues from other services such as public telephones, point to point lines, and telephone directories.

At take over time (after the government fixed the tariffs) the rates were as follows compared with the same rate categories some months before:

| | October 1990 | Before |
|---|---|---|
| Basic service fees | | |
| residential/professional | $ 9.80 | $ 6.28 |
| businesses | $ 25.16 | $ 20.95 |
| installation rate | $ 780 | $ 750 |

This installation rate is expected to decline to $ 541. in 1992 and $225. afterwards. The other rates (according to the list of conditions in the "Pliego") are supposed to be reduced 2% in real terms between 1993 and 1997.

A study made to estimate the price-elasticity and income-elasticity of demand for telecommunication services and the impact on demand of access to national

direct dial services reflect that pulses per line will drop from 13,665 in July 1990 to 10,183. An increase of 5 to 6% is also expected during 1991 and 1992 due to improved service quality (access to domestic direct dialing) and growth in domestic per capita income. In the future traffic per line is expected to increase by approximately 1.1% per year due to the reductions in tariffs which are required in the list of conditions.

## 6.4 The Financial Structure

A specialist in international communications, from a Washington DC law firm, said that basically there are four forms of financial restructuring.

They are:

1) A public stock offering. This usually involves the offering of a large segment of the new company's stock to the general market, sold in small amounts to each private investor. The government retain for itself or for a designated distribution list, the balance of the stock.
2) A buyout by management or employees. This form allows for the purchase of a large chunk of stock by the employees or other private individuals who have an interest in the company's operation.
3) Placing large quantities of stock with a number of institutions for brokering. This leaves open the possibility that large portions of the stock can be bought by a single individual.
4) The trade sale format turns over ownership and control of the telephone company to one private purchaser. (O'Neil, 1991).

As we saw before the framework used in the case of

ENTel is a mix of these methods. However it is important to emphasize that the decision for one of these alternatives or a combination of them depends to a great degree on the maturity of the capital markets in the country in which the privatization will take place and the confidence the whole privatization process arouses in the public opinion.

In a situation such as that in Argentina, the financial structure can makes this process irreversible. This is as important as the privatization itself. For this reason the last alternative mentioned above should be avoided.

The buyer groups paid the prices mentioned in Part I (Section 4.2.2.4) for 60% of the common stock of Telco Norte and Telco Sur. Both companies will assume only specific liabilities of ENTel such as: payments for construction in progress; purchases of equipment; the obligation to install telecommunication lines for which payments have been made. Additionally as specified in the List of Conditions of the "Pliego", both companies will issue a $202 million promissory note to be paid to ENTel in six semi-annual installments.

ENTel will not transfer any outstanding receivables from customers to the new companies. Furthermore, it will be the companies' responsibility to act as collection agents for ENTel.

This situation implies that the new owners will start operating companies without the debt burden ENTel has at present. However the companies will need to build new relations with banks in order to finance their operations and investments. The financial relationship will no longer be with the government and with some official banks alone. The new companies will move to an active presence in the stock exchange and to a normal relationship with private and official banks.

High inflation in Argentina makes efficient billing and collection policies an essential component of a well-managed company. Today the entire billing cycle involves 90 days of exposure to inflation, from the moment the service is provided to collection.

The plan at this point is to reduce invoicing periods, from 90 days to 75 days at the end of 1991, and to 60 days at the end of 1992, by the introduction of new technology in the measurement equipments.

To conclude, I think that the financial restructuring process will also contribute to improve the company efficiency.

### 6.5 The Technology

Although the technical aspect today is mostly reduced to two or three standards worldwide, technology is still a sensitive issue. Telephone companies are

usually interested in participating in the privatization of their developing country counterparts because of their growing potential, their need for equipment and the equity participation some operators have in equipment manufacturing companies.

We have seen the list of mandatory conditions with which the companies need to comply. There is another condition concerning the minimum number of lines that should be added to the network per year. One of the new companies has prepared the following plan in order to obtain the required improvements in technology and to meet the specific service quality objectives:

6.5.1 <u>For the Domestic System</u>

1) Expansion of the network beyond the numerical requirements of the List of Conditions. They plan to install 815,000 telephone lines and disconnect 255,000 existing ones, with a net gain of 560,000 lines in the first five years, increasing today's installed capacity by over 28% during this period. Most new lines will be supported by digital switches.
2) Major revamping of the external plant. They expect to overhaul about 20% of its external plant during the first five years of operation. This effort will be concentrated in the most populated centers,

aiming at reducing drastically the number of lines out of service.

Most step by step and some crossbar switches will be replaced by stored program digital switches with access to direct dialing for long distance and international calls.

After five years, 43% of the lines in the region will be handled by digital switches, reaching 64% in the year 2000. First priority will be given to the switches in downtown Buenos Aires, where the bulk of the telephone traffic originates.

3) In step with the digitalization of the switches, the urban inter-switch trunk lines will be replaced by fiber optic trunk-lines.
4) Most analog long distance links will be replaced by digital microwave links, including the installation of alternative paths for some vital links to cope with congestion or breakdowns.
5) Existing analog capacity will be maintained for TV or backup service.
6) Power equipment for most switches will be modernized.
7) Portable, containerized switching capacity will be acquired to handle emergencies throughout the network.
8) Eleven thousand two hundred new coin or card

operated toll telephones will be installed during the first 5 years, and 4,800 more until the year 2,000. Also, 11,000 existing toll telephones will be replaced in the same period.

6.5.2 For the International System

1) Increase in the number of available satellite channels in accordance with the expected traffic growth (113% outgoing and incoming in 10 years).
2) Installation of high speed international data channels.
3) Replacement of some obsolete electromechanical switches.
4) Modernization of the Balcarce and Bosque Alegre antennas, transmitters and receivers. (These are the satellite facilities).
5) Installation of a teleport facility in the proximity of Buenos Aires.

The plan we are describing includes also improvements in the infrastructure network of SSEC. This will provide the value added services, and as in the case of SPSI (international services) is owned 50% by Telco Norte and 50% by Telco Sur. The plan for this company includes:

1) Telex network. There is still a demand for telex

services although there are expected to be replaced by alternative services. Thus a small increase in the number of lines is projected only for the first two years; there will be no further increases thereafter.

2) ARPAC. A major increase in the demand of packet switched lines is expected to occur during the first years, growing from 3,200 in 1991 to 16,000 in 1995 and 22,000 in the year 2000. This will imply a sizable investment in ARPAC equipment.

## 6.6 The Market

At the beginning, and maybe for several years the companies will work driven by demand. This means that any line available will be sold due to the enormous unfulfilled demand. Considering the high connection fee the companies can charge (stated in the "Pliego") and the fact that monthly charges should include lines amortization, the companies will have a profitable business for a while.

Once demand is satisfied, the only way to continue selling new lines, would be by decreasing prices. The situation will not be regularized till the market of new lines reached an equilibrium in which consumers will not be willing to pay more than a sensible connection fee for a new line.

When talking about equilibrium I am talking of a situation in which service growth is very small. Just to have an idea of some figures, for a developed country company, like one on the US eastern coast, the percentage of growth in basic services is around 3%. In an intermediate case, like the one of Puerto Rico, this value is around 8%. In the case of Argentina, this value will be around 10% in the next years.

The market to be served by Telco Norte, Telco Sur, SPSI and SSEC can be divided into two main user segments: residential and business.

The residential segment includes residential, small business and professional users of telecommunication services. The business segment includes both major private sector enterprises and government. Current network usage measured in number of pulses is 82% by the residential segment and 18% by the business segment. These percentages are expected to be 86% and 14% by the year 2000.

A substantial growth in revenue is expected through the implementation of a marketing strategy targeted to each of these major segments as well as specific sub-segments within them.

The marketing issue will have a strong correlation with the tariff issue mentioned above. The operator intends to employ differentiated pricing policies and

develop new services to best serve each specific market segment.

## Chapter 7 - Conclusions

### 7.1 General Considerations

The Argentine government, as many other governments in the world, took the decision to get rid of as many state-owned companies as it could. In the Argentine case, the ones not subject to privatization should be restructured. In the case of the privatized companies clear rules for the new owners would be incorporated through regulatory agencies.

At the beginning of 1991, the national telephone company and the national airline company were already sold. The hydrocarbons sector has been deregulated, and 38 minor oil producing areas has been sold too. Also has been given in concession the operation of a railway cargo line.

Other countries have started their privatization processes with the telecommunications sector.

> It is not surprising that the telecommunications sector of national economies is the first selected for the "showcase" of privatization. Telecommunications is the infraestructural base which will allow the other industrial sectors to develop and flourish, and without which domestic functioning suffers and foreign investment is unavailable. Indeed, the issue now that privatization as a concept and a word is out of the closet is to control its use so that its application is meaningful for the particular country looking at it as a restructuring option. (O'Neil, 1991).

In the case of Argentina, other reasons for choosing

telecommunications first were: ENTel poor performance, the necessity of substantial infrastructure investments and also the necessity to attract foreign investments with a reliable and modern telecommunications system.

## 7.2 Lessons for the Future

Several points should be taken into account in future privatization in Argentina or in other countries with similar characteristics. I will talk briefly about each of those.

The Process: Considering all the political, economic and social constraints, the process was a clear and well managed one. The tight schedule imposed by the government, although responsible for many of the untidy points described in this work, was necessary from a political perspective.

It is important to recognize that there are few companies willing to participate in new businesses in Argentina. In fact, in this privatization although three groups participated in the bid, only two showed a real interest. One of the people interviewed suggested having a first step in which local and international consultants prepare all the contract conditions, and after that, call the companies interested in competing so they could discuss the conditions they are really interested in having. (Baglietto, 3/1991).

Regulatory Agency: One of the things to be done while privatizing a state monopoly that could not be demonopolized is to create the necessary regulatory mechanisms.

As noted by Bjorn Wellenius:

> ...as traditional telecommunications monopolies yield to more complex structures and growing number of participants, the government's role in encouraging and regulating sector activity becomes distinct and increasingly important. This role includes the regulation of tariffs and financial flows among operating companies to ensure the sector's viability as a hole, its responsiveness to broader development objectives, and the containment of monopoly power; the regulation of financial flows between the sector and government to meet resource mobilization objectives; the setting of technical interconnection standards to ensure the integrity of the network; the licensing and monitoring of use of radio spectrum, a scarce natural resource; and representation of the sector in international technical and administrative negotiations. (Wellenius, 1987).

One of the criticisms that the Argentine process has received is that although a regulatory agency was stated as part of this process it was not operating at transfer time.

Contract Negotiations: The government negotiated important issues, like the tariffs, once the winners had been announced. This situation weakened the government position, because at the time it was negotiating, the other participants (the losers) left the country. The

advice here is to negotiate almost all the points with all the participants in an early stage before the winners have been decided. Thus, strengthening the government position.

Guarantee: At the beginning of this process there was a concern about the attraction this privatization would have to possible buyers. In fact, we have seen that there is almost no cash investment. This concern was a reason for not asking participants for a guarantee that was high enough to ensure that everybody would comply with all the requirements. The result was the failure of Manufacturers Hannover in collecting all the debt titles.

The advice in this case is to set a high guarantee, and a clear cross responsibility from all the partners.

Tariffs: This is a difficult point and has been criticized from many people. The real situation is that there were not many companies interested in taking the risk to invest in Argentina, and few financial institutions were willing to lend, so, the government had no other alternative but to allow the new owners to finance the necessary investments through the internal cash flow.

7.3 Final Comment.

Only a few months after the privatization took place, the Argentine government introduced several laws that in effect modified the telephone company contracts. The sales tax has been increased from 16% to 25%. It is clear what impact this measure will have on consumers usage. Also a new law introduced important changes in the whole economy, one of which forbids any future use of escalation mechanism, a mechanism clearly established in the contracts.

It is not my intention to analyze the reasons for these modifications or their justifications from a government perspective. But these are good examples of what kind of situations an investor should be prepared to face when investing in risky countries. I do not want to discourage people thinking of investing or participating in concession processes in countries like Argentina. On the contrary I think that there are great opportunities for the investors ready to try. I just want to show that the processes are much more dynamic than in more developed countries, and that companies should be prepared to have continuous negotiations. The benefits are obviously the chance of higher profits.

From a government perspective there are clear benefits. An example will be very helpful. When ENTel was a state-owned company, the government had continuous

problems with Foetra (ENTel's biggest union). These problems were national issues that required, in many cases, the attention of high government officials, and sometimes even the president. Now, for the government, Foetra does not exist anymore, it is only an issue for a private company. (Baglietto, 3/1991)

For society, long term benefits will be seen in future years. However, there are some actions already taken that will help society fight against corruption. Another example will illustrate this. The first month, when Telco Sur paid salaries, they required that each employee be present with his or her national document. The result, the company discovered that 500 people who were receiving a monthly salary had died.

Only the future will witness Argentina's economic and social recovery. So far, I think that the way chosen is the most likely to succeed.

# ECONOMIC INDICATORS

## 1972 - 1988 (BILLION DOLLARS)

| | Inflation (%) | Account Balance | Gross Fixed Investment | Growth (% - GNP) |
|---|---|---|---|---|
| 1972 | 64.1 | (0.2) | 2.0 | 2.1 |
| 1973 | 43.6 | 0.7 | 2.0 | 3.7 |
| 1974 | 40.1 | 0.1 | 1.9 | 5.4 |
| 1975 | 335.7 | (1.3) | 2.0 | (0.6) |
| 1976 | 347.5 | 0.7 | 2.0 | NA |
| 1977 | 160.4 | 1.3 | 2.2 | 6.4 |
| 1978 | 169.8 | 1.8 | 2.6 | (3.2) |
| 1979 | 139.7 | (0.6) | 2.3 | 7.0 |
| 1980 | 187.6 | (4.7) | 2.4 | 1.6 |
| 1981 | 131.3 | (4.7) | 2.6 | (6.7) |
| 1982 | 209.7 | (2.4) | 2.1 | (5.0) |
| 1983 | 433.7 | (2.5) | 1.5 | 3.0 |
| 1984 | 688.0 | (2.4) | 1.3 | 2.6 |
| 1985 | 358.4 | (0.9) | 1.2 | (4.5) |
| 1986 | 81.9 | (2.9) | 1.3 | 5.5 |
| 1987 | 174.8 | (4.2) | 1.4 | 2.0 |
| 1988 | 387.7 | NA | 1.3 | (0.4) |

Exhibit I

# ARGENTINE FOREIGN DEBT COMPOSITION

1983 - 1988 (BILLION OF DOLLARS)

| | 1983 | 1984 | 1985 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|---|
| 1-International Organism of Credit | 2.9 | 2.8 | 4.6 | 5.6 | 8.3 | 8.9 |
| 2-Paris Club | 0 | 0 | 2.1 | 4.5 | 5.3 | 5.2 |
| 3-Commercial Banks | 31.8 | 32.7 | 33.8 | 33.7 | 36.8 | 38.5 |
| 4-Others | 10.4 | 10.6 | 8.9 | 7.6 | 7.8 | 7.4 |
| Total | 45.1 | 46.2 | 49.3 | 51.4 | 58.3 | 60.0 |

| Estimated delays as of 6/89 | |
|---|---|
| 1-Int Org Credit | 0.29 |
| 2-Paris Club | 0.56 |
| 3-Com Banks | 3.41 |
| 4-Others | 0.23 |
| Total | 4.50 |

Exhibit II

# TELEPHONE COMPANIES' PRODUCTIVITY

## LINES ON SERVICE PER EMPLOYEE

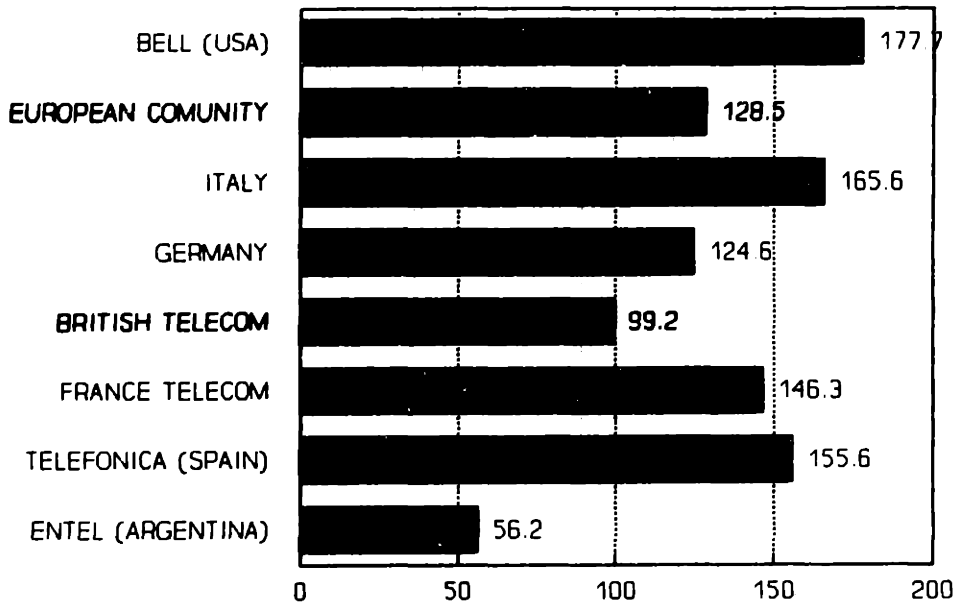


EXHIBIT III

# ENTEL - INCOME STATEMENT INFORMATION

(1946 - 1987) - PAGE 1

| | 46-50 | 51-55 | 56-60 | 61-65 | 66-70 |
|---|---|---|---|---|---|
| REVENUE | 442 | 627 | 695 | 930 | 1066 |
| EXPENSES | 246 | 299 | 373 | 473 | 559 |
| Operative | 145 | 160 | 189 | 213 | 225 |
| Maintenance | 79 | 106 | 153 | 216 | 264 |
| Administrative | 22 | 33 | 31 | 44 | 70 |
| GROSS MARGIN | 196 | 328 | 345 | 464 | 548 |
| DEPRECIATION | 51 | 93 | 117 | 149 | 199 |
| INTERESTS | 0 | 0 | 21 | 25 | 16 |
| EXCHANGE DIFFERENCE | 0 | 0 | 0 | 5 | -9 |
| TAXES | 0 | 0 | 0 | 0 | 0 |
| OTHER EXPENSES | 0 | 0 | 0 | 0 | 0 |
| PROFIT | 145 | 235 | 207 | 285 | 342 |

EXHIBIT IV

## ENTEL - INCOME STATEMENT INFORMATION

(1946 - 1987) - PAGE 2

| | 71-75 | 76-80 | 81-85 | 86 | 87 |
|---|---|---|---|---|---|
| REVENUE | 1434 | 1874 | 1969 | 2348 | 1984 |
| EXPENSES | 935 | 824 | 1019 | 1752 | 1142 |
| **Operative** | **358** | **258** | **305** | **348** | **270** |
| Maintenance | 438 | 389 | 397 | 513 | 470 |
| Administrative | 139 | 177 | 317 | 891 | 402 |
| GROSS MARGIN | 537 | 1134 | 1468 | 991 | 1653 |
| DEPRECIATION | 186 | 479 | 776 | 864 | 537 |
| **INTERESTS** | **62** | **35** | **277** | **144** | **149** |
| **EXCHANGE DIFFERENCE** | **162** | **116** | **1682** | **393** | **987** |
| TAXES | 0 | 101 | 515 | 154 | 112 |
| OTHER EXPENSES | 0 | 10 | 122 | 108 | 685 |
| PROFIT | 127 | 393 | -1904 | -672 | -817 |

EXHIBIT IV

Latin American weekly report

ISSN 0143-5280

29 November 1990. WR-90-46

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DEWEY

# Unions everywhere are resisting the region's privatisation policies

Mid-November headlines throughout much of Latin America bore an uncanny resemblance. In Argentina, Bolivia, Brazil, Colombia, Peru, the Dominican Republic, Uruguay and Panama, the unions were on the front pages —in most cases attempting to mount major protests against the economic policies pursued by their governments.

Wages failing to keep up with high inflation rates were a common motivation. But in most cases there was another: government attempts to slim down the state apparatus through large-scale dismissals and the privatisation of state enterprises.

In Argentina, where the anti-government CGT-Azopardo managed to assemble a crowd of 25,000 (by their own reckoning; 12,000 by the government's), the effort was very close to being a last-ditch stand. Privatisations are well under way, and soon the hitherto strong public-sector unions will find themselves dealing with private employers.

In Colombia, Bolivia, Brazil, the Dominican Republic, Peru and Panama, organised labour is trying to nip in the bud the privatisation and streamlining drives. In most cases the governments are hanging tough —with some success.

In Argentina, the offer of a number of government concessions on the timing and manner of mass dismissals led to the defection of the CGT-Azopardo's most powerful supporter: the Unión Obrera Metalúrgica headed by Lorenzo Miguel. The government went ahead and announced that it would be shedding 127,000 public-sector jobs over the coming two years.

In Peru, though the guerrillas of Sendero Luminoso and the MRTA did their utmost to turn strike actions and protest demonstrations into an uprising, the public-sector unions suffered the defection of the state enterprise unions —apparently convinced that they stand a better chance than their peers in the central administration.

In Colombia, a general strike fizzled out (*see* Page 8) and the government went on to cancel the legal status of striking telephone workers.

In Brazil, the more radical of the labour confederations, CUT, surprised everyone by announcing that it would be negotiating a new wages policy jointly with the São Paulo industrialists (*see* Page 3).

But things are not going the governments' way everywhere. In Bolivia the unions have joined forces with civic movements and have enjoyed some success in slowing down the moves to hand over the mining and oil industries to private operators (*see* Page 5). Watch for more.■

Exhibit V

THE NEW YORK TIMES **INTERNATIONAL** SUNDAY, NOVEMBER 25, 1990

# Argentine Union Leader Blunt About Payoffs

By SHIRLEY CHRISTIAN
Special to The New York Times

BUENOS AIRES, Nov. 24 — A labor leader's recent public admission that he saw nothing wrong with taking his cut from business deals has caused embarrassment even in this country where payoffs and other corruption are considered common practice.

Luis Barrionuevo, a leader of the restaurant workers' union who also directs a social benefits fund for all trade unions, said in a radio interview that he had "made a lot of money" by channeling union business to lawyers and accountants, who, in turn, paid him and other union leaders.

Mr. Barrionuevo made the comment in the process of claiming he had never "put the hand in the cookie jar" because this availability of money "from the other side" made it unnecessary for union leaders to enrich themselves at union expense.

Asked by one caller to the radio program where he got the money to buy the luxurious residence listed in his wife's name, Mr. Barrionuevo said, "I didn't make it working because it is very difficult to make money by working."

Mr. Barrionuevo's comments caused an uproar, in part because he is one of the few labor leaders supporting President Carlos Saúl Menem, whose free-market economic policies are opposed by many other labor leaders.

In addition, as head of the National Administration of Health Insurance, Mr. Barrionuevo manages about $900 million a year in contributions from individual workers, a job that has traditionally been considered a prime opportunity for personal enrichment.

Two legal actions charging illicit enrichment were initiated against Mr. Barrionuevo in the aftermath of his remarks, one by a federal prosecutor and the other by a group of opposition congressmen. On Thursday, court authorities seized the tape made at the radio station, where the interview was given on Nov. 16.

On Friday, the president of the National Conference of Catholic Bishops, Msgr. Antonio Quarraccino, complained that Argentina had become "the paradise of swindlers and opportunists, who take shelter under the rumpled mantle of liberty and democracy."

While calling on Mr. Barrionuevo to explain the origin of the money used to buy the house, the church leader warned that corruption could cause the public to lose faith in the democracy to which Argentina returned just seven years ago.

Suggesting that the situation described by Mr. Barrionuevo was representative of a wider problem, the monsignor said he thought "this gentlemen is someone who, apparently, always faces up to things, and others take advantage of that to throw stones at him."

Indeed, Mr. Barrionuevo has defended himself by claiming that there was nothing wrong in what he did because that is the way things are done here. He said union leaders were not behaving any worse than private business people and Government workers.

Much of the legal and accounting work to which Mr. Barrionuevo referred apparently has to do with legal actions for disputed wages filed against restaurant owners by their employees or former employees.

Such legal actions are standard practice in Argentina, against both state and private employers. In fact, a concurrent scandal here has to do with the tens of thousands of lawsuits pending against the Government by dismissed

Exhibit VI

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