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Deconstructing 3G and reconstructing telecoms

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Abstract

After heated debate in Hong Kong, the Government and the regulator adopted suggestions (May 2000)² to assign third generation (3G) mobile telecommunications licences by royalty auction to avoid the use of upfront cash auctions as in Europe, now widely regarded as a disaster. Uncertainty has replaced the former certainties of the 2G world, an issue that raises fundamental questions about what exactly is 3G, while rendering much business forecasting futile. This paper examines the debacle, casts a critical eye over the use of auctions, and summarizes the Hong Kong debate and the business modelling that accompanied it. It concludes with a warning on uncertainty.

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1. Introduction

It is hard to credit the telecommunications industry with getting things so wrong as the third generation (3G) mobile licence fiasco in Europe during the summer of 2000. European governments may have been culpable of shortsighted policies of gouging the industry, but ultimately, high auction prices were the responsibility of those who bid for them. ‘Nobody but a fool bids more in an auction than he thinks the licence is worth’ was how one of the UK’s principal advisors Professor Binmore (2001) (Leverhulme research professor of economics at University College London) described it. The story would be a cautionary tale at the best of times, but it has added significance owing to two factors. It comes at a time when the industry as a whole is suffering due to the decline of revenues from international and mobile services, and it adds risk

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²See http://www.trp.hku.hk/papers/2000/3g_response.pdf.

to the already high degree of uncertainty within the industry as it steers towards broadband. The result has been an involuntary restructuring of some of the major names in the industry, and their withdrawal from markets.³

The outstanding example is British Telecom (BT). In the mid-1990s, BT was promoting itself as a world telecommunications company, forging a joint venture named Concert with AT&T to provide worldwide services, and investing heavily in companies in the fast-growing Asia-Pacific region. The millennium has seen a complete reversal of fortune. Concert has been dissolved, although for reasons not directly connected with 3G, BT is selling its investments across Asia,⁴ the UK mobile operations have been divested, and BT's chairman and CEO have both resigned following the 3G disaster. As Sir Bonfield (2001), BT's CEO frankly admitted, 'We spent £10 billion too much'.

In Hong Kong the allocation of 3G licences has avoided the mistakes of Europe and their consequences. After heated local debate, Hong Kong adopted an innovative approach to auctioning to avoid burdening the industry with large debt.⁵ The method used was an auction based upon the royalty payment operators would commit themselves to paying on the relevant turnover of their licensed business.⁶ A reserve auction price was fixed at 5 per cent, or HK\$50 million whichever was the larger, for each of the first 5 years, rising gradually over the remaining 10 years of the licence. In the event, the investment climate dictated that there were only four bidders for four licences and the spectrum was assigned at the reserve price.

This paper considers the issue of restructuring in the context of uncertainty as the industry moves into the world of broadband Internet, and in particular the unanticipated implications of the 3G auctions for the largely involuntary restructuring that followed. The case of Hong Kong is used to illustrate a royalty-based auction.

2. Restructuring

What exactly do we mean by the term 'restructuring'? In the most general sense any kind of reorganization is a kind of restructuring, so the first delineation that makes sense is to distinguish between 'internal' and 'external' restructuring, where 'internal' can refer to any reorganization within a company's setup. This is an entirely usual event unless it reflects a significant shift of power within an organization and/or of the external focus of the company. The abandonment of a major project or opportunity would be one such example. In Hong Kong there were only four bidders for four 3G licences, yet six licensed local mobile operators. Of the two that did not bid,

³Restructuring was forced upon the industry in Europe even ahead of the bidding as regulators demanded the unraveling of cross-ownership. For example, when Vodafone bid for Germany's Mannesmann it was required to divest its holding of its subsidiary Orange.

⁴For example, BT has sold off interests in Japan Telecom, Maxis (Malaysia), Bharti Cellular (India), Clear Communications (New Zealand), Mobile One (Singapore) and is looking for a buyer of its stake in Smartone (Hong Kong).

⁵Described as 'an exemplary licensing process' by ITU Internet Reports (2002): *The Internet for a Mobile Generation*. See http://www.itu.int/osg/spu/publications/sales/mobileinternet/exec_summary.html.

⁶A method emanating from 'Response to OFTA's Consultation Paper on 3G' John Ure, May 2000 at: www.trp.hku.hk/trp-papers.html and www.ofta.gov.hk.

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