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SPANISH INVESTMENT STRATEGIES IN LATIN AMERICA'S TELECOMMUNICATIONS SECTOR: *CONQUISTADORES* REDUX?

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I. INTRODUCTION

Latin America possesses the most important and fastest-growing telecommunications market in the world. Although large US operators such as AT&T and MCI, and other European operators such as Italy's STET, have an important foothold in Latin America's telecommunications sector, Telefónica de España S.A. ("Telefónica") is, through its international subsidiary, TISA, the most important strategic investor and leading telecommunications provider in the region. A number of elements, such as privatization and liberalization of Latin America's telecommunications sector, internationalization of Multinational Telecommunications Operators ("MTOs"), Foreign Direct Investment ("FDI"), and international consortia, are involved in this *telecom cocktail* between the Spanish operator and the Latin American telecommunications sector. This article will discuss the manner in which all these elements interact.

Section II outlines, mainly from the perspective of the countries involved, the significance of the privatization process of the telecommunications sector in Latin America, the reasons behind the need for change, the general pattern used in this process, how investors were lured, and most important results and features. The strategic choice of

MTOs' internationalization is influenced not only by external opportunities such as those offered by the privatization process in Latin America, but also by MTOs' domestic, external and internal factors. As such, by focusing on Telefónica, Section III examines the process of internationalization of European MTOs, analyzes factors contributing to this process, examines what internationalization strategies are applied and how these can be implemented. Having established the suitability of MTOs' internationalization, Section IV analyzes factors such as country risk, potential relevant market, legal and regulatory framework, and sector and enterprise restructuring that have to be carefully assessed when considering entering new markets. Inasmuch as most international alliances in the telecommunications sector are carried out through international consortia, Section V is devoted to an examination of the main characteristics and elements involved in its formation, the factors to be carefully addressed during the acquisition procedure, and the aspects that are critical for a successful consortium. After examining the importance the globalization process and open schemes of regional integration have had in FDI flows toward Latin America's telecommunications sector, Section VI explores Telefónica's experiences regarding investment strategies and trends in Latin American privatized telecommunications companies, and draws a general framework of sector and country investment opportunities for the future. Finally, Section VII, focusing on Telefónica's experiences, lays down the most significant factors to be considered for a successful and profitable investment in the sector, and makes a link with Latin America's energy sector, which, following to some extent the path set up by telecommunications, can currently be described as a second wave of flourishing investment prospects in the region.

II. PRIVATIZATION OF THE TELECOMMUNICATIONS SECTOR IN LATIN AMERICA: PAVING THE WAY FOR PRIVATE SECTOR INVOLVEMENT

During the last several years, deregulation, privatization, liberalization, and re-regulation of the telecommunications sector in Latin America[1] has proved to be essential: (i) to attract the private sector and to exploit the advantages that the dismantling of natural monopoly entails for society and (ii) for the whole economic development of the region. In order to understand the significance that the whole process entails for governments,

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[1] Privatization may be an element of broader economic policy comprising deregulation and liberalization with the emphasis generally as much on improving the efficiency of retained state-owned enterprises as on efforts to divest. *See* CHARLES VUYLSTEKE, TECHNIQUES OF PRIVATIZATION OF STATE-OWNED ENTERPRISES: METHODS AND IMPLEMENTATION, 1-7 (World Bank Technical Paper No. 88, 1988) [hereinafter VUYLSTEKE].

it is necessary to examine, first, the reasons behind privatization, then, the manner in which the process took place and, finally, the most significant results and major features.

A. *The Rationale Behind Privatization*

1. OVERCOMING SECTOR AND COMPANY FAILURES

It was not until the late-1980s that Latin America became the developing world's laboratory for large-scale privatization in the telecommunications sector. Prior to a period of privatization, telecommunications monopolies[2] traditionally owned and operated the different national telecommunications networks.[3] The reasons for state control and ownership of telecommunications services included arguments of natural monopoly, universal service, the potential to generate revenues, and national security.[4] However, a number of factors called into question the deep state involvement in telecommunications. On the one hand, a wide-spread inefficiency[5] was reflected by long waiting lists for telephone

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> *Monopoly* loosely refers to firms with high market power, not necessarily those with 100 percent of the market. Also, it covers both natural and artificial monopolies. For instance, [in Latin America] state-owned telephone companies were sole providers of both local and long-distance telephone services, the first of which is still widely regarded as a natural monopoly, while the second is not . . . Thus, with long-distance service was no longer [considered] a natural monopoly, given the advent of microwave and satellite technology.

Ravi Ramamurti, *The New Frontier of Privatization*, *in* PRIVATIZING MONOPOLIES: LESSONS FROM THE TELECOMMUNICATIONS AND TRANSPORT SECTORS IN LATIN AMERICA 1, 7-8 (1996) [hereinafter Ramamurti 1].

3 Monopolies in local, national and international long-distance services were held, in Chile, by Compañia de Teléfonos de Chile ("CTC") and Empresa Nacional de Telecomunicaciones ("ENTEL"); in Argentina, by Empresa Nacional de Telecomunicaciones ("ENTel"); in Mexico, by Teléfonos de Mexico S.A. ("TELMEX"); in Venezuela, by Compañia Anónima Nacional de Teléfonos de Venezuela ("CANTV"); and in Peru, by Compañia Peruana de Teléfonos ("CPT") and ENTEL.

4 *See* WILLIAM W. AMBROSE, ET. AL., PRIVATIZING TELECOMMUNICATIONS SYSTEMS: BUSINESS OPPORTUNITIES IN DEVELOPING COUNTRIES, 3, 3-4 (International Finance Corporation, Discussion Paper No. 10, 1990) for a detailed analysis of these objectives of government ownership and control [hereinafter AMBROSE, ET AL.].

5 Before privatization the picture was, in general, distressing. In Chile, service penetration was low (about three telephone lines per 100 inhabitants), waiting lists for new lines reached 50% of the lines in service, and due to the coexistence between old and new technologies, service innovation was rather small. In Argentina, ENTel was in complete disarray with more than 8% of the 90% of all public network subscribers out of service, 8.8 telephone lines per 100 inhabitants, almost endless waiting lists, a very low quality of service (telephone calls were completed an estimated 49% for urban calls and 29% for long-distance), management widely perceived as corrupt, and its 45,000 employees, most of whom were

services, poor service, infrastructure problems, underutilized capacity, artificially low prices, and the capture of the firms by workers and unions;[6] on the other hand, the economic foundation supporting state control of telecommunications[7] was being eroded as a result of rapid technological changes, reduced production, installation and operation costs, and new possibilities of providing services. As the structure of the sector could neither respond efficiently to an increasing demand nor match the growing needs emerging from a new information era, the failure of state-operated enterprises to develop telecommunications networks which were able to meet even the minimal needs of the public produced a shift in economic and political reasoning that brought concern on governments to reform the sector. The inadequate telecommunications structure was perceived as an obstacle to economic and social development.

2. POLICY AND ECONOMIC REASONS

The impetus towards privatization[8] cannot be explained solely upon the grounds of sector and firm failure. There were also other factors beyond sector or specific firm conditions such as the will to improve performance of state firms by an improvement of regulation and management, a tougher handling of labor issues, or less political interference. On the one hand, in most of the countries privatization accelerated with the arrival of new and more pragmatic administrations;[9] at the same time, there were also

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unionized in state, on permanent strike. In Venezuela, although it was the fourth largest telecommunications sector in Latin America, as much as 55% of basic demand was not met, eight lines per 100 inhabitants, and waiting lists had an average of eight years. In Peru, waiting lists were three years and line density only 3%. Conversely, in the case of Mexico, although performance also deteriorated (waiting lists of about three years and service penetration still low), the picture was more optimistic for one reason: in comparison with the other state-owned telecommunications companies, TELMEX was a fairly well-run company. *See* Carlos Cassaus, *Privatizations of Telecommunications: The Case of Mexico*, *in* IMPLEMENTING REFORMS IN THE TELECOMMUNICATIONS SECTOR, 172 (Björn Wellenius and Peter A. Stern eds., 1996) [hereinafter Cassaus]; Hector A. Mairal, *The Argentine Telephone Privatization*, *in* IMPLEMENTING REFORMS IN THE TELECOMMUNICATIONS SECTOR, 161 (Björn Wellenius and Peter A. Stern eds., 1996) [hereinafter Mairal]; José Ricardo Melo, *Liberalization and Privatization in Chile*, *in* IMPLEMENTING REFORMS IN THE TELECOMMUNICATIONS SECTOR, 146 (Björn Wellenius and Peter A. Stern eds., 1996) [hereinafter Melo]; Aileen A. Pisciotta, *Privatizations of Telecommunications: The Case of Venezuela* *in* IMPLEMENTING REFORMS IN THE TELECOMMUNICATIONS SECTOR, 187 (Björn Wellenius and Peter A. Stern eds., 1996) [hereinafter Pisciotta]

6 IMPLEMENTING REFORMS IN THE TELECOMMUNICATIONS SECTOR, 1, 19-21 (Björn Wellenius and Peter A. Stern eds., 1996).

7 *See* Ramamurti, *supra* note 2, at 6; *see also* AMBROSE ET AL., *supra* note 4, at 5, 13.

8 *See* Ramamurti, *supra* note 2, at 7 (Privatization "covers mainly the divestment of state-owned enterprises . . . however, in the majority of cases, except in Chile, the government transferred management control over the firm to private hands rather than merely selling a few shares to private parties").

9 For instance, in Argentina, with the advent of the *Justicialista* government of Carlos Menem, in

international agencies such as the World Bank or the International Monetary Fund ("IMF") pushing towards this direction. On the other hand, privatization was also seen as a means of raising cash in order to reduce budget deficits and public debts.[10]

3. SENDING A SIGNAL TO INVESTORS

Privatization served not only to allow access to capital and technological know-how,[11] hence the focus on foreign telecommunications companies as investors and also as operators, but also to send a positive signal to local and foreign investors that governments were embarking on a new economic strategy. For that, "the privatizers had to make sure that the sale was a 'success.'"[12] Therefore, not only did companies' candidates for privatization have to be large, easily divested and attractive for foreign investors, but also had to be sold in the first attempt to one of several qualified bidders. Indeed, companies were desirable candidates for sale not because their past performance might have been poor, as it was in some cases, but because "their future growth and profit potential were excellent."[13]

The manner in which these factors were balanced varied from one privatization to another. In order to overcome a sector's and/or firm's failure to improve and expand services, it was critical that incentives and opportunities for private sector management be created for all, particularly for Chile[14] and Venezuela.[15] The use of sale proceeds to reduce fiscal

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1989, the government launched a vast privatization program which included all the commercial activities performed by the state such as telecommunications, electricity generation, water supply, gas, and transportation. Willing to push Argentina towards a stronger economic development, five main reasons, that can be applied in general to other countries, have been presented as Menem's ideas for privatization. Under this scheme, privitization: (i) maximizes the use of public resources; (ii) brings a large inflow of capital into the government; (iii) improves efficiency; (iv) stimulates investment and innovation; and (v) reduces government involvement in the economy, thereby allowing a free market to flourish and a private sector to develop. See Carla Davidovich, *The Selling of Argentina: Is the Path to the First World Privatized?*, 28 LAW & POL'Y ONT'L BUS. 151, at 151-65 (1996) [hereinafter Davidovich] for a discussion of these economic and other social and political arguments.

10 Indeed, this was an important factor not only because of the cash raised, but also for the political reason that a high selling price was presented to the public as a second-best solution counterbalancing the internal pressures against giving away "national patrimony to private investors." *See* Ramamurti, *supra* note 2, at 11.

11 Under a so-called "strategic partnership model," privatization aims at creating a modern infrastructure development. *See* Bessel Kok, *Privatization in Telecommunications-Empty Slogan or Strategic Tool?*, 16 TELECOMMUNICATIONS POL'Y 699, 702-03 (1992).

12 *See* Ramamurti, *supra* note 2, at 11.

13 *Id.* at 12.

14 *See* Melo, *supra* note 5, at 146-47.

15 *See* Pisciotta, *supra* note 5, at 187; *see also* Antonio Francés, *A Planned Approach to*

deficit and public debt was an important motivation in Argentina,[16] Mexico and Peru.[17] Mexico's goal was to "send a signal to local and foreign investors [that it] was embarking on a new economic strategy."[18]

B. *Setting the Pattern for Privatization*

Although the countries and the conditions in and under which companies were privatized are diverse, general patterns of similarity and difference can be established.

1. **PREPARING COMPANIES FOR PRIVATIZATION AND ATTRACTING INVESTORS**

Privatization not only means transferring ownership of state enterprises to the private sector, but also involves the politically sensitive task of freeing companies from the influence of beneficiaries, such as workers and unions, ministers and legislators, and customers. In addition, it also requires the technically complex tasks of restructuring a company, cleaning up company finances, redefining its regulatory environment, and marketing it to potential buyers. During this entire process, teams in charge of such tasks received valuable technical assistance from international agencies such as the World Bank, private consultants and financial advisers.

Although in most countries the general public's dissatisfaction with state enterprises made it easier to gather support for privatization, worker opposition proved to be a difficult problem to overcome in the case of Argentina, where, before privatization, ENTel had an important unionized workforce. In general, worker participation in company ownership under favorable terms played an important role in reducing the workforce and securing labor support for the reforms.[19] Willing to achieve the necessary reforms as soon as possible, there was a general tendency to centralize the privatization process and to minimize the involvement of the national

Telephone Privatization, *in* PRIVATIZING MONOPOLIES: LESSONS FROM THE TELECOMMUNICATIONS AND TRANSPORT SECTORS IN LATIN AMERICA, 147, 168-71 (Ravi Ramamurti ed., 1996) [hereinafter Francés].

16 *See* Ben Petrazzini, *Telephone Privatization in a Hurry*, *in* PRIVATIZING MONOPOLIES: LESSONS FROM THE TELECOMMUNICATIONS AND TRANSPORT SECTORS IN LATIN AMERICA 118, 137 (Ravi Ramamurti ed., 1996) [hereinafter Petrazzini].

17 Peter Hudson, *Sell Now, Pay Later*, BUS. LATIN AM., Mar. 25 1996, at 3.

18 Ravi Ramamurti, *Telephone Privatization in a Large Country: Mexico*, *in* PRIVATIZING MONOPOLIES: LESSONS FROM THE TELECOMMUNICATIONS AND TRANSPORT SECTORS IN LATIN AMERICA, 72, 101(1996) [hereinafter Ramamurti 2].

19 Björn Wellenius, *Telecommunications Restructuring in Latin America: An Overview in* IMPLEMENTING REFORMS IN THE TELECOMMUNICATIONS SECTOR 113, 129-30 (1996); *see also* Ramamurti, *supra* note 2, at 19 [hereinafter Wellenius].

legislature.[20] New regulatory institutions separated from operating entities were established to accompany privatization. Generally, important improvements were made in companies before privatization; in other cases, the companies were sold "as is," leaving internal changes to be made by new owners.

Following a strategic partnership model of privatization, present with more or less importance in all countries, several measures were taken to make the state-enterprise more attractive to investors. Profitability was increased, for instance, by raising prices for regulated services in the range of 65% in Mexico to 95 in Argentina before privatization. The increase in prices for telephone services was necessary not only in order to find buyers but also to offset the risks of doing business in developing countries and to motivate investment in networks after privatization. Similarly, in Argentina, Mexico, and Venezuela, taxes on telephone users were sharply reduced to increase demand. In order to protect investors from the risks of inflation and price regulation, the use of price-cap regulation after privatization was widely adopted; such regulations lasted for periods varying from six years in Mexico, eight in Venezuela, and up to ten in Argentina. In addition, capital structures were modified before sale to allow minority owners to have administrative control. This was achieved by concentrating the voting power in a special class of stock later in the hands of the winning consortium. As a result, the strategic investors could control the company by buying minority percentages of equity.[21] The privatized companies also would be granted exclusivity privileges for a limited time in basic telephone services, one of two licenses for cellular service, and would not be prohibited from diversifying into services open to competition.

2. THE PRIVATIZATION PROCESS, SALE MECHANISM, OWNERSHIP AND PRICE

Privatization was realized mainly through international competitive bidding. The bidding and award processes were designed to enhance credibility and price competition. International investors were, in general,

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[20] In Argentina, for instance, privatization was made by Executive Decrees (basically decrees 731/89, outlining the government's new sector policies and structure; decree 62/90, setting forth the terms and conditions of the competitive bidding and including the terms of licenses to be granted to the new operators; and decree 1185/90, creating the Comisión Nacional de Telecomunicaciones) following broad laws passed by Congress (the State Reform Law 23,696 enacted in September 1989) to deal with the country's economic crisis. *See* Mairal, *supra* note 5, at 162, 164. In Mexico, the strategy deliberately avoided any component that required legislature's approval. *See* Melo, *supra* note 5, at 145-50. However in Venezuela, the privatizers had to maneuver through the obstacles set up by legislators. *See* Pisciotta, *supra* note 5, at 188-89.

[21] For instance, 20.4% in Mexico and 40% in Venezuela.

ready to invest in these attractive privatized sectors by relying upon factors such as market growth prospects, country risks and the level of tariffs and other business factors prior to privatization.[22]

Governments chose to sell to consortia led by well-established foreign operating companies capable of providing expert management, large investment plans and access to the latest technologies.[23] Ownership structure was widely distributed among company employees, domestic and foreign investors and the public at large. Turning over controlling interest to private owners placed administrative control and management responsibility on a single owner group, and within it, on the strategic investor, who or which was responsible for operating the company. This foreign participation was balanced by including in the consortium local partners contributing in local management and supplies, as well as in government, financial, and labor relations.[24]

A brief summarization of the bidding process, awards and distribution of shares was as follows:

> Argentina was a model of fast privatization. In Argentina, ENTel was divided into two regional companies,[25] Telco Norte and Telco Sur (each including about half of the lucrative Buenos Aires market).[26] After overcoming a number of problems related to domestic opposition,[27] ENTel's structural problems[28] and the

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22 A reflect of the interest raised among foreign operators and investors may be exemplified by the following facts: seven consortia of foreign operators and banks associated with domestic investors prequalified to bid for ENTel in Argentina, the sale of shares in Argentina were several times oversubscribed, and Chilean CTC's first international issue of stock was also oversubscribed.

23 For instance in Venezuela, in order to prequalify for the international bidding, companies were required to have more than 6 million installed lines, over 25% digitalization of local exchanges, over 65% in completion of international calls, one month average waiting time for new lines, and 16 hour average time for line repair. *See* Pisciotta, *supra* note 5, at 187.

24 For instance, in TELMEX, the local partner assumed control of finance, administration, and purchasing, while France Télécom became involved in expanding and modernizing the network, and Southwestern Bell was responsible for strengthening systems and marketing. *See* Ramamurti, *supra* note 2, at 42.

25 Two main reasons were considered for this division: first, the government would stimulate a sort of "competition by comparison" between natural monopolies obtaining thereafter valuable comparative information; second, the basis for effective competition would be set for when monopoly status ended and each Telco, as well as any newcomer, were free to enter into other Telco's region. *See* Mairal, *supra* note 5, at 164.

26 International service and telecommunications services not subject to an exclusive license were turned over to two separate companies, Telintar and Startel, respectively. Each was jointly owned by the regional companies.

27 *See* Petrazzini, *supra* note 16, at 120-21.

28 *See* Mairal, *supra* note 5, at 164-68.

bidding process,[29] the government sold 60% of each new regional company to foreign telecommunications companies responsible for managing the new entities. In November 1990, Telco Norte, re-named "Telecom Argentine Stet-France Télécom S.A.," was awarded to the consortium headed by STET, an Italian operator, and France Télécom in partnership with J.P. Morgan and a big Argentine industrial group. Telco Sur, re-named "Telefónica de Argentina S.A.," was awarded to a consortium led by Telefónica de España S.A. in partnership with Citibank and two major Argentine groups. The remaining 40% of shares were sold in December 1991 and February 1992 to employees and, successfully, to the public at large in the domestic and international markets.

Mexico served as a model of privatization in a large country. In Mexico,[30] the privatization of TELMEX was completed in three stages. First, stock was offered for sale to company employees; then, a controlling interest was offered for sale to Mexican domestic investment groups, with strict limits on the participation of foreign investors as partners; finally, shares were offered for sale in world capital markets. In December 1990, a consortium of Mexican investors joined by Southwestern Bell and France Télécom, purchased the controlling interest in the company.

Generally, privatized companies were granted operating concessions with monopoly privileges for the provision of basic telephone services and local and long distance (accounting for 90% or more of the sector's revenues) services for periods ranging from six years in Mexico, to eight in Venezuela, and up to ten in Argentina. At the same time, competition was immediately open in important non-basic services such as cellular telephony[31] and value-added services.[32] At the end of the exclusivity

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[29] Bell Atlantic, which was one of an original three bidding consortiums, did not qualify because the "pliegos" required that foreign telephone companies contribute at least 10% to the bidding consortium's equity, and Bell Atlantic was barred under United States rules from investing more than 4.9%. The government, desperate to accommodate an American company, reduced the threshold from 10 to 4.9%. Despite this, Bell Atlantic withdrew its bid at the last minute when its financial partner was unable to acquire the required amount of Argentine debt. *See* Petrazzini, *supra* note 16, at 128-29.

[30] *See* Cassaus, *supra* note 5, at 182.

[31] For instance, in Argentina, in November 1989, the first private cellular network entered in service in Buenos Aires. The network was built, owned and operated by a consortium, Compañia de Radiocomunicaciones Móviles, controlled by Bell South, Motorola, Citicorp Argentina, and the local Socma and BGH. *See* AMBROSE ET AL., *supra* note 4, at 40.

[32] In Venezuela, by attempting to encourage competition, not only in value-added services, but also in private network services (which in some respects are substitutes for basic services) the privatization process was perceived as being more aggressive than others. *See* Pisciotta, *supra* note 5, at 188-89; *see also*

periods, competition would be introduced in all segments of the sector. In addition, as set forth in concession contracts, extension and existence of monopoly rights were made contingent upon meeting strong investment plans and high performance targets regarding digitalization and improvement of quality of services, management and expansion of services in urban and rural areas. Depending on the different strategies followed by the countries to carry out privatization, the prices paid and the conditions of sale varied considerably from one country to another: from $700 per line in the case of ENTel, to $3200 in the case of CANTV.

C. *Evaluating Results and Features from Experiences*

Because the strategies[33] and the pace of privatization have differed, the results and the lessons obtained also have been different. A general framework and one major exemplifying feature from each process can be drawn.

In general terms, the various results of privatization have been very positive for the countries involved. Under private ownership, companies have adopted aggressive strategies to increase the volume, variety, and quality of telecommunications services. Investments have been accelerated[34], the number of lines has significantly grown,[35] new technology has been incorporated,[36] waiting lists have been reduced,[37] and

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Francés, *supra* note 15, at 167-69.

[33] Among the different possibilities available to privatize national telecommunications companies, governments have, among others, the following options: negotiated sale of 100% of the company to a single buyer, sale of a minority stake to a single buyer or group of buyers, public offerings in the domestic market or international markets or both, sale of a minority stake to a single purchaser combined with a public offering, and breakup and sale of components. *See e.g.* Dean Lewis, *Options for Selling a Telecommunications Company*, *in* IMPLEMENTING REFORMS IN THE TELECOMMUNICATIONS SECTOR at 425, 425-31(Björn Wellenius and Peter A. Stern eds., 1996); *See* VUYLSTEKE, *supra* note 1, at 7-71 for an in-depth analysis of these and other methods.

[34] For instance, in Argentina, since two regional companies started operating, they have made investments of more than $5.5 billion. In Venezuela, between 1991 and 1995 more than $2 billion was invested in CANTV, accounting for about 10% of the total gross investment. *Telecommunications & Technology in Latin America 1995*, LATIN FIN., Sept. 1995, at 33 [hereinafter LATIN FIN].

[35] In Chile, whereas before privatization the number of lines were growing at about 5%, they expanded at over 20% per annum in 1990 and 1991; in 1995, telephone density was 11.8 lines per 100 inhabitants, exceeding the Latin American average of nine. In Argentina, the number of total lines installed grew by 65% totaling, in 1995, more than 5.5 million. In Venezuela, basic service expanded to cover 11% of the population. In Peru, line density raised from 3% to 8.26 lines per 100 inhabitants. *Id.* at 34-35, 42, 66, 72; *see also* Wellenius, *supra* note 19, at 115.

[36] By 1993, Chile had completed digitization of 99.8% of its telephone network; In Argentina in 1990, only 13% of its network was digital compared to 65% at the end of 1995. *See* LATIN FIN, *supra* note 34, at 34-35.

[37] In Chile, from eight months to 30 days. In Argentina, from five to 10 years before privatization

the sector is in constant growth, significantly contributing to the respective countries' economy.[38] Likewise, more efficient use of human and capital resources have resulted in increasingly efficient enterprises.[39] Major stakeholders also have benefited largely.[40]

Inasmuch as the privatization of the telecommunications sector represented the first and longest major privatization program of government telecommunications assets in developing countries generally, and in Latin America particularly, several paradigms are established. Chile's experience, for instance, provides valuable lessons for other countries and serves as a model of international competitive bidding.[41] Argentina's privatization process is a vivid example of the rush to divest the telecommunications sector under conditions of high economic and political instability that resulted in a sub-optimal transition.[42] Mexico shows not

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to averages between three days and three months after privatization. In Peru, from 3 years to 1 year. *Id.* at 34, 65.

38 In Chile, since privatization began, the telecommunications sector has become one of the most dynamic industries, growing at an average annual rate of more than 19.5% over the last five years. The dynamic telecommunications sector has strongly contributed to Gross Domestic Product with increases of more than 100%. CTC alone, has contributed 67%. In Mexico, the sector has grown 15% annually over the last five years. In Venezuela, telecom-related investments provided 2% of the Gross Domestic Product. *Id.* at 41-42, 58, 71-72.

39 During the period 1982-'90 Chile's CTC workforce was reduced from 15 to nine employees per 1000 lines, and the average cost of installing a new line steadily fell from $130 in 1986 to $110 in 1990. *See* Dominique Hachette, et. al., *Five Cases of Privatization in Chile*, *in* PRIVATIZATION IN LATIN AMERICA 77, 81-82 (M. Sánchez & R. Corona eds., 1993) [hereinafter Hachette]. In Argentina, the cost of a new line fell to about $250, the labor force, which was largely de-unionized, shrunk by 25%, and the number of installed lines per employee raised from 75.7 in 1990 to 154.5 in 1994; *see also* Mairal, *supra* note 5, at 172; *see also* AMBROSE ET AL., *supra* note 4, at 39-40. Peru's workforce was reduced from 12,051 to 8894, and ratio lines per worker improved from 55.8 to 86.8. *See* LATIN FIN., *supra* note 34, at 34-36, 65-66.

40 For instance, in 1992, TASA, the southern regional company earned $293 million (81% higher than the precedent year), and was able to finance 80% of its investment program from retained earnings. *See* FIN. TIMES, May 18, 1993, at 6.

41 *See* Hachette, et al., *supra* note 39, at 74.

42 Although the general outcome can be described as successful, it is more as a consequence of what was achieved given the situation and reduced schedule, rather than as compared to what could have been achieved should the privatization process have been properly managed. As the unprecedented economic and fiscal crisis of 1989 pushed the Argentine government to implement privatization quickly, ENTel never underwent the kind of restructuring that was carried out on such firms in Mexico, for instance. As a result, the failure to prepare ENTel adequately affected its sale price, which was among the lowest paid for a telecommunications firm in a developing country. The planned liberalization process of the local telecommunications market was affected by the lack of transparency and predictability of the bidding process. As the list of competing bidders diminished, demands of the government increased. The government was caught in a dilemma: to comply with the announced timetable, the government had to deal with the only remaining bidders and their costly demands. As a result, the level of initial tariffs had to be raised above original targets, and the lack of effective regulation immediately after privatization had a negative impact on sector development and placed the regulatory agency, CNT, at odds with the technical

only an example of how to privatize the second largest telecommunications sector in Latin America, but also of how ownership, competition, and regulation are not only independent policy variables but a set of loosely connected tools with important interactions.[43] Venezuela benefited from prior experiences and took a planned approach that showed the importance of the regulatory process, before and after privatization, to foster market developments.[44] Conversely, Peruvian privatization is to some extent, an example of how consumers pay the price for and because of poor regulation and governments desperately needing to raise cash.[45]

III. INTERNATIONALIZATION OF MULTINATIONAL TELECOMMUNICATIONS OPERATORS

The telecommunications sector is not only one of the fastest growing sectors in the world but also one of the most rapidly changing ones. This holds for the regulatory framework, which is leading to more liberalized national markets, as well as for the national and international market structure, characterized by market entry of newcomers, mergers of monopoly powers at national levels and the creation of new international and global strategic alliances. The strategic choice of MTOs' internationalization is thus influenced not only by external opportunities offered by privatization but also by domestic, external and internal factors.

This section focuses on how deregulation at the European and national level have led Telefónica to reinforce and expand its international strategy. Then, internal and external MTO's factors and strategies determining internationalization will be explored. Finally, the most important methods to implement internationalization will be discussed.

A. *Deregulation as a Driving Force Behind the Internationalization of European Telecommunications Operators*

The importance of efficient telecommunications networks for the European Union ("EU") cannot be measured merely in terms of income generated (more than $140 billion) or in terms of its direct and indirect employment (more than 1.5 million jobs); efficient telecommunications are also vital for the purpose of achieving social cohesion throughout the EU.[46]

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and political tasks assigned to it. *See* Petrazzini, *supra* note 16, at 137-38; Wellenius, *supra* note 19, at 117-18; *see also* Davidovich, *supra* note 9, at 169-70.

43 *See* Ramamurti 2, *supra* note 18, at 103.

44 *See* Pisciotta, *supra* note 5, at 192-93; *see also* Francés, *supra* note 15, at 148, 170-71.

45 *See* BUSINESS LATIN AMERICA, June 3, 1996, at 3.

46 *See* European Commission, White Paper, *Growth, Competitiveness, Employment: the Challenges and Ways Forward into the 21st Century*, COM (93) 700, 1993; The Bangeman Report,

Efficient telecommunications networks for the EU would, moreover, improve the competitiveness of the European industry in world markets.[47] The United States and Japan, both main trading rivals of the EU were perceived as possessing an important competitive advantage after introducing competition in the sector. The challenge facing the EU was therefore, achieving a balance between employment restructuring and social cohesion while simultaneously allowing business and society to obtain the benefits of technology, the internal market, and competition, without sacrificing any one of them.[48] The solution applied was granting the application of EU competition law a central role to ensure that liberalization was speedy and effective.[49] Liberalization and introduction of competition at European and national levels has been critical in shaping internationalization strategies of European MTOs.

1. DEVELOPMENTS AT THE EUROPEAN LEVEL

From the first liberalization efforts in the mid-1980s,[50] the progress toward liberalization within the EU became considerable in the early 1990s. Once a general political framework was established and a political

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Europe and the Global Information Society. Report of the High Level Group on the Information Society, Brussels, May 1994.

[47] *See* European Commission, *XXIVth Report on Competition Policy*, 1995, at 2.

[48] *See* Europe Documents, *Van Miert's Recommendations for the Liberalization of Telephone Services in the Community*, AGENCE EUROPE, April 22, 1993.

[49] European Commission, *Europe's way to the Information Society. An Action Plan*, COM (94) 347, 1994.

[50] It was not until 1984 that the first initiatives in telecommunications were launched. Following the first action program, some factors contributed to the rapid development of the European telecommunications policy. First, the growing digitization began to transform the telecommunication networks into multi-purpose information infrastructures extending service opportunities far beyond the traditional telephone services. As a result, a growing conviction arose among Member States that if traditional monopoly rights were not reduced it could not be assured either that new markets could be developed, or that the new technologies and service offerings could be incorporated rapidly enough. In addition, the impact of two important processes leading to the introduction of liberalization and competition in the sector began to be felt in Europe making Member States become more receptive to the concept of market deregulation: one was the 1982 AT&T divestiture agreement; the other was the progressive deregulation and privatization of British Telecommunications in the United Kingdom. Finally the European Court of Justice also had a pivotal role as it confirmed, in its 1985 BT judgment that European competition rules were fully applicable to the telecommunications sector. *See* Gonzalo García Jiménez, *Towards Full Liberalization of the Telecommunications Sector in the European Union Trough the Application of Competition Laws*, on file, *Centre de documentation européenne*, Institute of European Legal Studies, Faculty of Law, University of Liège, June 1996, at 9-11 [hereinafter García 1]; *see also* Gonzalo García Jiménez, *Overview of International Telecommunications Regulations: The European Union*, *in* BEYOND THE TELECOMMUNICATIONS ACT: A DOMESTIC AND INTERNATIONAL REFERENCE FOR BUSINESS, 215-40, (T. Knuer, et al. eds., 1998) [hereinafter García 2];

consensus among member states ("Member States") of the EU developed that full liberalization was a priority,[51] a strong liberalization impetus came from the European Commission ("EC") imposing Article 90 directives[52] on Member States to open up the telecommunications markets to competition. The aim of EC legislation creating a framework for effective competition is realized through a complementary role between liberalization and harmonization.[53] This process of liberalization and introduction of

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[51] The development of the telecommunications policy framework was, from the start, based on comprehensive EC consultative documents called the "Green Papers." The Green Papers established basic policy goals for public debate, thereby setting out the proposed overall concept and leading to broad consultations and subsequent adoption by resolutions of the EU Council of Ministers and the European Parliament. These resolutions set a framework with regard to general competitive conditions required in order to achieve liberalization in the sector. This method of proposing comprehensive policy preliminary plans, broad consultations and transparency was the emblem in the development of the policy framework. The 1987 telecommunications Green Paper (concluding that reserved services should be narrowly defined and new services open to competition) and the 1992 Review of the Situation in the Telecommunications Service Sector (concluding that monopoly rights were hindering the development of the sector and ultimately leading to a consensus on the inevitability and desirability of full liberalization) were essential pieces in the process. *See* Gonzalo García Jiménez, *Towards Full Liberalization of the Telecommunications Sector in the European Union Trough the Application of Competition Laws*, on file, *Centre de documentation européenne*, Institute of European Legal Studies, Faculty of Law, University of Liège, June 1996, at 11-14. For a brief but clear-cut analysis see Reinaldo Rodriguez Illera, *La liberalización de las telecomunicaciones en la Unión Europea*, *in* DERECHO DE LAS TELECOMUNICACIONES, 279-85 (Javier Cremades ed., 1997) [hereinafter Illera]; *see also* H. Ungerer, *EU Competition Law in the Telecommunications, Media and Information Technology Sectors*, Fordham Corporate Law Institute, 22nd Annual Conference on International Antitrust Law & Policy, Fordham University, New York, October 1995.

[52] From the issuing of the 1987 Green Paper, Article 90 has developed into a cornerstone of the Commission's telecommunications policy. Article 90 (3) provides the Commission with the power to adopt directives and decisions binding on Member States in order to ensure compliance of state monopolies with Article 90 (1) and 90 (2). The basic principle of Article 90 (1) is that Member States must respect the underlying rule that the undertakings granted monopoly rights must, in principle, comply with the Treaty's rules, and must not, therefore, act to undermine this. In other case, Article 90 requires the removal of special and exclusive rights. Article 90 (2) limits the application of the Treaty rules, and the competition rules in particular, where they threaten to obstruct the performance of public service duties by undertakings entrusted with such duties (in the case, security of supply and universal service provided by national TOs). For an analysis of ECJ's interpretation of these principles *see* García 1, *supra* note 50, at 4-9, 19-21, 27-31; *see also* S. Taylor, *Article 90 and Telecommunications Monopolies*, 15 EUROPEAN COMPETITION L. REV. 6, 322-34 (1994); *see also* Jaime Folguera Crespo and Edurne Navarro Varona, *Aplicación de los artículos 30, 59, 85, 86 y 90 del Tratado CE a los mercados de telecomunicaciones*, *in* DERECHO DE LAS TELECOMUNICACIONES 210, 210-43 (Javier Cremades ed., 1997).

[53] This is so because abolishing monopolies did not mean that competition would emerge straight away, as TOs that have enjoyed this monopoly for a long time would continue to hold sizable chunks of the market and key rights. Therefore, introducing competition through Article 90 directives was not enough. Harmonization directives under Article 100A were also essential in order to establish a genuine common market in telecommunications, in which competition rules are properly applied. Harmonization Council directives were also necessary to ensure that newly liberalized markets were not fragmented along national

competition has also heavily relied upon the European Court of Justice's judgments.[54]

However, whereas several market telecommunications segments were soon exposed to competition,[55] the core fields of national TOs, namely voice telephony services and public switched telecommunications networks, were still dominated by highly protected national monopolies.[56] As revenues from these key segments amounted up to 85% of total revenues, effective competition in the telecommunications sector could not effectively be achieved until they were liberalized. The 1993 Council Telecommunications Development Resolution[57] agreed to proposals by the Commission to fully liberalize telephony services within the EU by January 1, 1998.[58]

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lines by, for instance, diverse licensing and type approval procedures or interface specifications. The Open Network Provisions directives aimed, therefore, to guarantee that access by all service providers and users is harmonized, objective, transparent and non-discriminatory across the EU. *See* García 1, *supra* note 50, at 18-19, 26.

54 On the one hand, by upgrading the introductory paragraph of Article 3g of the Treaty of the EU (which lists the introduction of a system of undistorted competition among the activities of the EU) to become a fundamental principle of Community law, has turned Community law into a basically monopoly-unfriendly legal system. On the other hand, by interpreting in a narrow manner the derogation given under Article 90 (2) and by interpreting the provisions of Article 90 (3) as confirming the Commission's competence to break down state monopolies, the ECJ gave the Commission the confidence to "tackle" telecommunications monopolies in the EU and accelerate the liberalization process with the required impetus. *Id.* at 50-51.

55 First, competition was introduced in terminal equipment, including *inter alia* telephone sets, modems and terminal telex. *See* EC Commission Directive 88/301/EEC, *Official Journal of the European Communities* (O.J.) L131/73, May 16, 1988. Then, the services directive opened to competition telecommunication services (data transmission and value-added). In addition by defining very narrowly the term voice telephony (reserved service excluded from competition) the directive also liberalized telephony services other than those provided for the general public such as private corporate networks and closed user groups. *See* EC Commission Directive 90/388/EEC, O.J. L192/10, July 24, 1990. Finally, satellite communications equipment and services, cable TV networks telecommunications services and mobile and personal communications were liberalized and fair competition was ensured. *See* respectively, EC Commission Directives 94/46/EC, O.J. L268/15, Oct. 19, 1994; 95/51/EC, O.J. L256/49, Oct. 18, 1995; 96/2/EC, L20/59, Jan. 16, 1996. *See* García 1, *supra* note 50, at 22-35.

56 In fact, the 1987 Green Paper provided for the temporary reservation of non-competition in basic voice in order to allow the TOs to receive protected revenues to maintain their universal service obligation, a principle that the Commission did not want to sacrifice. The TOs could therefore use this breathing space to adjust and modernize in order to meet the challenges of the emerging market place. García 1, *supra* note 50, at 12.

57 Council Resolution of July 22, 1993, on the review of the situation in the telecommunications sector and the need for further development in that market. O.J. C213/1 (1993).

58 EC Commission Directive 96/19/EC, O.J. L75/13, Mar. 22, 1996.

2. DEVELOPMENTS AT NATIONAL LEVEL

Though EC directives are binding for Member States, they leave a certain degree of freedom to national legislatures to make national law commensurate with EC legislation. It is therefore clear that progress in liberalizing telecommunications markets[59] depends ultimately on how Member States implement and enforce EC directives. Delays in adapting national legislation in order to comply with the directives can create practical difficulties for business ventures. In order to cope with this situations EC law provides procedures for eliminating such obstacles.[60] The majority of Member States must liberalize basic vocal telephony from

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[59] The legal telecommunications framework in Spain is established basically by the *Ley de Ordenación de las Telecomunicaciones* ("LOT") 31/1987 of December 18. This law meant progress in the regulation in the sector because, before this law, the sector lacked specific laws except for the concession contract between the State and Telefónica and a series of provisions inferior in rank to law. Liberalization of terminals was developed in 1989 by Royal Decree 1066/1989, and award of a second mobile telephony service was fulfilled by Order of December 24, 1994. Since publication, LOT has been partially reformed three times: the first one by Law 32/1992 of December 3, to conform to Community developments after the issuing of the 1987 Green Paper (mainly the Services Directive and the Council Open Network Provision Directive, a framework directive providing for harmonization; the second by Law 42/1995 of December 22, and Law 37/1995 of December 12, respectively, the Cable Telecommunications Law and Satellite Telecommunications Law; the third one by Royal Decree 6/1996 of June 7 of Liberalization of Telecommunications. This last reform is of capital importance since, first, it provides for the creation of the *Comisión del Mercado de las Telecomunicaciones*, an independent body attached to the Ministerio de Fomento, the Ministry responsible for Public Works, Transportation and Telecommunications- which is mainly assigned to safeguard the competition rules in the sector, to arbitrate when conflicts arise between operators and to advise the Ministry in the development of rules), and second, it creates a second global telecommunications operator in Spain, Retevision (which is in process of privatization), putting an end to Telefonica's monopoly in basic services and networks, thereby providing for the transition from monopoly to duopoly in preparation for a close-at-hand full competition environment. Currently under way is the discussion of the draft bill that will replace the LOT and regulate the Spanish telecommunications sector once fully liberalized. During the liberalization process the *Tribunal de Defensa de la Competencia* has also played an important role by securing a fair level playing field. *See* Javier Cremades García, *El Derecho de las telecomunicaciones en Europa y en España, in* DERECHO DE LAS TELECOMUNICACIONES, 7-93 (Javier Cremades ed., 1997); Rodrigo Uría Meruéndano, *El Derecho y las telecomunicaciones, in* DERECHO DE LAS TELECOMUNICACIONES, 108-10 (Javier Cremades ed., 1997); Marcos Araujo Boyd, *El Derecho de la competencia y las telecomunicaciones, in* DERECHO DE LAS TELECOMUNICACIONES, 784-85 (Javier Cremades ed., 1997).

[60] Under Treaty Article 90 procedure, when a Member State has not amended the offending regulation, or justified or compensated for them after receiving a letter of formal notice of the Commission, the latter may adopt a formal Article 90 (3) decision requiring the government to end the infringement within a set time period. If it does not comply, proceedings under the Treaty Article 169, which confers the Commission with the power to ensure that EC law is enforced over the national law of Member States, may be launched which result in a judgment from the ECJ. Failure to implement a subsequent Court judgment will ultimately result in fines. In addition, as recognized by the ECJ, national governments are even liable to compensate companies in case of infringement of Treaty provisions conferring rights on the latter. *See* García, *supra* note 50, at 43-44.

January 1, 1998; Spain, however, as a peripheral region within the EU, has an additional transition period of five years to do so. Despite Spain's right to postpone full liberalization until the year 2003 at the latest[61] it will, eventually, be effective from 1999.[62]

Although European TOs are currently concluding preparations for the single European telecommunications market, their strategies for becoming competitive in the international arena are quite different. This is a result of different national regulatory frameworks and national telecommunications structures.[63] Such differences play a decisive role in establishing MTOs' defensive or offensive strategy of internationalization. Losing a monopoly in a portion of telecommunication services forces operators to recover abroad the market share they lose[64] or anticipate losing. By the same token, national TOs paying little attention to the outside world are in danger of losing their ability to compete and hence of losing national and international markets. Telefónica[65] has been a pristine representative[66] of

[61] European Report, *Spain to liberalize telecommunications by 2003 at the latest, European Report*, n. 2149, July 17 (1996), Section III at 1.

[62] Although full liberalization is scheduled for January 1998, it will not be effective until 1999. This compromise reached with the Commission allows the second global Spanish operator a fundamental two-year period of breathing space before other European TO competitors enter the Spanish market. During this time, as European standards make no provision for the principle of reciprocity, Telefónica and Retevision are allowed to access deregulated European basic telephony markets from January 1998 forward without permitting TOs in these Member States to get a foothold on the Spanish market until late 1999. At the same time the compromise also allowed the Commission to present a more homogeneous, liberalized and competitive packet to be better positioned to negotiate market access during the negotiations leading to the new WTO Telecommunications Agreement reached in February 15, 1997. *See* Illera, *supra* note 51, at 88-89.

[63] Cornelius Graack, *Telecoms Operators in the European Union. Internationalization Strategies and Network Alliances*, 20 TELECOMMUNICATIONS POL'Y 5, 343 (1996) [hereinafter Graack].

[64] Finnish Telecom, British Telecom and Swedish Telia are representatives of this defensive approach, by which they expand their activities into foreign markets aiming to compensate losses in liberalized home markets. *Id.* at 349-51.

[65] Almudena Arpón de Mendívil y Aldama, *Telcommunications Regulation in Spain*, 2 COMPUTER AND TELECOMMUNICATIONS L. REV., 112 (1996) [hereinafter A. De Mendívil] ("The fundamental point of the LOT . . . [was] the consideration of telecommunications as essential state-owned services reserved for the public sector"). Telefónica has traditionally been a private company in which the state held an important share. However, after the liberalization efforts imposed by the Commission, privatization was progressively achieved. Nowadays, after resolution of the Council of Minister of December 20, 1996, Telefónica has been fully privatized in the first semester of 1997 by selling the remaining third of state control. *See* José Luis Albácar Rodriguez, *El plan nacional de telecomunicaciones. El contrato del Estado con Telefónica S.A.*, *in* DERECHO DE LAS TELECOMUNICACIONES 643, 643-60 (Javier Cremades ed., 1997).

[66] Other monopolies following the same strategy are France Télécom, Deutsche Telekom, Telecom Italia, and Dutch Telecom. *See* Graack, *supra* note 63, at 343-46.

monopolies pursuing international expansion while national markets were still protected from competition.

Protection has not meant stagnation in the Spanish telecommunications market. Conversely, the liberalization of the sector, by allowing for progressive competition, either total or restricted, with regard to the number of operators in accordance with the different affected services has brought the incorporation of technological developments in networks and services. Such innovations in networks and services have, in turn, allowed companies to improve competitiveness and to be better prepared for internationalization of the sector. Ultimately, the competitiveness of Spanish companies in general is improved.[67]

As a result, since the beginning of the 1990s, Telefónica has been reinforcing its international expansion strategy. Such expansion is due, in part, to the opening up of new, mainly Latin American, markets and profitable growth opportunities. By late 1996 Telefónica had a stake in telecommunications operators in Argentina, Chile, Colombia, Mexico, Peru, Puerto Rico, Portugal, Romania, and Venezuela.[68]

B. *Factors and Strategies Determining MTOs' Internationalization*

The new framework of privatization and liberalization in the telecommunications sector encouraged operators to devise opportunistic internationalization strategies, both of defensive and offensive nature. In addition, the increased degree of internationalization and integration of worldwide economies had produced a demand for global telecommunications services that hardly can be satisfied by operators on their own. Therefore, a policy of international and global alliances plays a leading role in the strategic plans of major operators.

1. FACTORS DETERMINING THE STRATEGY

A MTO can begin an internationalization process[69] if it enjoys certain specific advantages not possessed by the recipient country. Internationalization must make it possible to maintain, and if possible improve, a company's competitive advantage. In this regard, an internationalization process is possible if there are corporate capabilities and ownership-specific advantages to carry it through, as well as the will to exploit them on a transnational scale. Proprietary comparative advantages

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67 *See* A. De Mendívil, *supra* note 65, at 113.

68 TELEFÓNICA, 1995 ANNUAL REPORT 34-39 (1995); Telefónica Internacional: Presentación a AT&T, New York, November 1996 at 11 [hereinafter Telefónica Internacional].

69 *See generally*, John H. Dunning, *Dunning's Eclectic Paradigm in* MULTINATIONAL ENTERPRISES AND THE GLOBAL ECONOMY, 75, 75-85 (1993).

are embodied in intangible assets such as know-how, expertise, and management capability, and are evidenced by leadership in service costs and differentiation[70] as well as by the capability to enter new markets and to cooperate with others. On the other hand, as will be analyzed later on, the economies of location[71] (market size, structure and degree of integration, country risks, factor productivity, investment climate) will determine the geographical setting of the chosen internationalization process. In addition to all of these factors, companies were ready to gain the maximum profit from internationalization in order to achieve a balance between Latin American countries' need to create a desired infrastructure and MTO's own process of expansion.

In broad terms, company internationalization can be defined as the course of action of pursuing new markets outside the country. A fundamental issue is that internationalization strategy must be addressed from within a company's general strategy, accounting for the growing integration and globalization of the economy.[72] In this context, MTO internationalization can respond both to offensive strategies to take advantage of opportunities that did not previously exist, and to defensive strategies to stand up to new competition. Although both strategies have played an important role in Telefónica's internationalization, offensive strategies have proved to be determinant.

2. DEFENSIVE AND OFFENSIVE STRATEGIES

As previously examined, in pursuing a strategy of international expansion Telefónica has reacted, to some extent, to its domestic regulatory environment brought about by the acceleration of European integration in the telecommunications sector. The prospects for introducing competition in its domestic market made Telefónica react to ensure its survival and growth in the face of aggressive strategies from other competitors. The purpose was to gain elsewhere the space which was to be worn away in the domestic market.[73]

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70 For instance, high level of quality and service penetration, market management, forecasting and restructuring skills.

71 John H. Dunning, *International Direct Investment Patterns*, *in* THE GLOBAL RACE FOR FOREIGN DIRECT INVESTMENT 127-30 (Lars Oxelheim ed., 1993) [hereinafter Dunning].

72 Juan José Durán Herrera and Fernando Gallardo Olmedo, *La estrategia de internacionalización de las operadoras de telecomunicaciones*, 735 INFORMACIÓN COMERCIAL ESPAÑOLA 3, 93 (1994) [hereinafter Durán and Gallardo].

73 Franco Masari, *Internationalizing Telecommunications Operations: STET and the Argentina Experience*, *in* IMPLEMENTING REFORMS IN THE TELECOMMUNICATIONS SECTOR, 406 (Björn Wellenius and Peter A. Stern eds., 1996).

However, Telefónica's strategy of entering foreign markets while home markets were still protected by regulation can be best characterized as offensive in nature, whereby the wish to expand came before the need to survive. In this sense, apart from the inherent nature and dynamics of the telecommunications sector, changes in the environment such as liberalization and privatization coupled with significant improvements in the foreign investment climates, provide sufficient motives for considering the viability of internationalizing a competitive advantage. Therefore, Telefónica has, in addition to seeking out new markets, strengthened its competitive advantage on an international scale and advanced in a global competitive position.

Cultural affinities, language, and EU-Latin American political and institutional relations have also facilitated Telefónica's adaptation and responses to the environment of Latin American countries. As a result, in comparison with other companies which come from environments culturally and socially more distant, Telefónica has not only reduced transaction costs but also diminish the impact of country risk.[74]

C. *Methods to Implement Internationalization: MTOs Acting Alone or as Part of International and Global Alliances*

Once the advisability of internationalizing was established, Telefónica faced the dilemma of doing so alone or in alliance with other MTOs. The internationalization method depended on the potential associated transaction costs[75] such as the degree of asset specificity (related to resources and technological and managerial capabilities) and uncertainty (e.g., risks associated with the supply of services) surrounding the transaction. While there are a number of economic reasons[76] favoring

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[74] Juan José Durán, *General Trends of Foreign Direct Investment in Latin America: Special Reference to Spain*, *in* OECD Proceedings, INVESTMENT POLICIES IN LATIN AMERICA AND MULTILATERAL RULES ON INVESTMENT 35 (1997) [hereinafter Durán].

[75] John H. Dunning, *The Global Economy, Domestic Governance strategies and Transnational Corporations: Interactions and Policy Implications*, 1 TRANSNAT'L CORPORATIONS 6, 13-17 (1992).

[76] When trying to determine the optimal size of a firm's strategic alliances five main reasons have to be taken into account: first, the alliance may help to penetrate markets that the operator cannot possibly approach on its own (in this case economic valuation is based on income generated in the new market thanks to the alliance); second, the alliance helps to learn an activity in which the operator does not overwhelmingly enjoy proprietary competitive advantages; third, the possible generation of know-how as a result of collaboration between the alliance's agents, which materializes in net income in the future; fourth, if an operator succeeds in forming a stable alliance with another operator that could compete with it in its natural market, it could thus avoid this danger and keep income not lost to the competition; and fifth, given that the telecommunications sector is characterized by fast, frequent technological changes, be ready to give prompt answer to new services and variants of others already in existence. *See generally* P. Llerena and S. Wolff, *Inter-Firm Agreements in Telecommunications: Elements of an Analytical Framework*, *in* GLOBAL

internationalizing through alliances, the essential reason operators decide to do so is, generally, to attenuate risk[77] and to spread the financial requirements[78] of the investment. Telefónica acted alone, for instance, in only two cases, Chile and Puerto Rico. With respect to Chile, Telefónica was attracted to a low country risk and a strong market-oriented economy which favored private enterprise and foreign investment. In Puerto Rico, a private deal between the government and Telefónica resulted because of an unrealistic minimum bid-price that scared away potential bidders. Outside of these two isolated investments, Telefónica has acted as a member of a consortium, the most important instrument to carry out an alliance in the telecommunications sector.

As will be analyzed below, a consortium may be characterized as a strategic tool for MTOs because it generates organizational capabilities that are enshrined in specific knowledge of inter-organizational relations and environment. Specific knowledge acquired through strategic cooperation through a consortium cuts off adaptation costs to new environments and costs of transferring organizational abilities from one context (home domestic country, or host regional market) to other (host regional market, or international or global markets). In addition, the participation of MTOs in several consortia provides intangible assets for the MTOs concerned as they acquire experience in managing this kind of business organization that can be exploited in future collaborative operations. Ultimately, the MTO generates or improves a new competitive advantage against its competitors.

From a broader perspective, the relevant market for telecommunications operators has changed over time from a purely national to a cross-border market where international cooperation is necessary. As a result, cooperation between operators is intensifying in the form of global alliances in order to serve new service requirements of multinational enterprises such as one-stop-shopping[79] and to provide global services. One example of this development is Unisource, a pan-European telecommunications company originally formed by Dutch Telecom, Swiss Telecom,

TELECOMMUNICATIONS STRATEGIES AND TECHNOLOGICAL CHANGES 257-73 (G. Pogorel ed., 1994).

[77] J. Durán and F. Gallardo, *Foreign Direct Investment of Telecommunications Operators in Less Developed Countries: Application to the Telefónica Experience*, *in* THE RACE TO EUROPEAN EMINENCE: WHO ARE THE COMING TELE-SERVICE MULTINATIONALS? 444 (Erik Bohlin & Ove Granstrand eds., 1994) [hereinafter Durán and Gallardo].

[78] Mabelle G. Sonnenschein and Patricia A. Yokopenic, *Multinational Enterprises and Telecommunications Privatization*, *in* PRIVATIZING MONOPOLIES: LESSONS FROM THE TELECOMMUNICATIONS AND TRANSPORT SECTORS IN LATIN AMERICA 359 (Ravi Ramamurti ed., 1996) [hereinafter Sonnenschein and Yokopenic].

[79] One-stop-shopping allows enterprises and other customers to contact only the telecommunications operator to order and manage all leased international links.

Swedish Telia, which was joined in 1995 by Telefónica.[80] Of paramount importance has been the creation of a so-called Uniworld joint venture between Unisorce and AT&T, the largest United States telecommunications company.[81]

In today's globalized telecommunications industry, globalization of MTOs is not only a strategy for moving forward but a necessity to surviving. The creation of dynamic competitive forces capable of bringing the benefits of competition to all customers and all markets on a global basis has triggered a dynamic globalization process with and among the largest American MTOs with Latin America as one of the most important battlefields.[82] Given the wide range of international and global alliances among major MTOs, this dynamic multiplication of takeovers offers,[83] alliances and mergers have implications for all major MTOs:[84] if they are not *in* they are *out*.

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80 Unisorce's main goals are the deployment of a pan-European network and the coordination of national's TOs to provide global services. *See* Telefónica, *supra* note 68, at 25-26. By the same token it also provides for easier cooperation between the global alliance and large telecommunications operators such as AT&T. Cooperation between Unisorce and AT&T seems to be much more stable that cooperation between AT&T and each single member of Unisorce. *See* Graack, *supra* note 63, at 341, 354.

81 *See* Telefónica, *supra* note 68, at 27.

82 In April 1997 TISA formed an alliance with Concert, the network system operated by MCI and BT. Under the terms of the deal, MCI would gain a 10% share in TISA and Telefónica would own 33% of Avantel, the Mexican long-distance operator controlled by MCI. In July 1997, another major alliance took place among AT&T, STET and Unisorce NV, with a primary goal of increasing Latin American service. *See* Sally Bowen and Adam Thomson, *Telecom Boom*, LATIN TRADE, Oct. 1997, at 48, 52.

83 On October 1, WorldCom, the fourth largest US long-distance operator that has expanded rapidly into local services, announced a $30 billion takeover offer of MCI (the second largest long-distance operator). Soon after, on October 16, GTE (the largest US-based local telephone company), after contemplating a combination with Sprint AT&T, announced $28 billion all-cash bid for MCI. *See generally*, FIN. TIMES, October 2, 1997, at 5; William Lewis, *Worldcom*, FIN. TIMES, October 16, 1997, at 1, 16, 19 [hereinafter Lewis].

84 After announcing a $28 billion for MCI, British Telecom (BT) acquired 20% stake in MCI and formed the global strategic alliance Concert. WorldCom's bid would leave BT with about 10% of the newly merged company and thus throw into disarray BT's international strategy. By the same token, as Telefónica had recently entered in alliance with BT and MCI and, in addition, was negotiating the participation with MCI in Avantel, WorldCom's bid put into question these developments and produced, at first, a sharp fall of Telefonica's share prices that was only curbed after BT and MCI's issuing soothing statements. Conversely, it seems, however, that GTE's bid for MCI offers a potential alliance with BT and Telefónica. The combination of all four would strengthen their position in the US, Europe, Latin America and Asia (the latter mainly because if NTT, the largest Japanese operator, showed reluctance to enter in concert, having two potential US groups would eventually attract it, and also because of Telefonica's participation, since 1991, in the consortium Joint Network Initiatives, formed by AT&T, BT, France Télécom and the Japanese KDD). *See generally*, FIN. TIMES, Oct. 2, 1997, at 5; *See* Lewis, *supra* note 83, at 19; *see also* EL PAIS, Oct. 8, 1997, at 9.

IV. MTOs AND FOREIGN DIRECT INVESTMENT ASSESSMENT OF PRIVATIZED LATIN AMERICAN TOs

Once the suitability of the internationalization process is established, the MTO will initiate the formation of a consortium. Importantly, however, a MTO will do so only after identifying positive signals regarding their chances of entering new markets. A MTO will assess several elements in contemplation of a direct investment[85]: the existence of a potentially relevant market and a suitable investment climate to conduct business in a given country, the potential risks involved, the presence of a privatization and/or liberalization process, and the degree of sector and enterprise restructuring and regulatory framework.

A. *Country and Market Considerations*

The long periods required to recover the costs of large investments associated with telecommunication privatizations make it indispensable for MTOs to analyze country and market potentialities and conditions and risks.

1. COUNTRY CONSIDERATIONS

Evaluating a country's stability is critical if a strategic investor is to accurately appreciate the investment opportunities privatization entails. The investment opportunities of a country are important to the same extent that the historical, economic, and political developments of a country add to or detract from a privatization opportunity.[86] Attributes of great interest to a foreign strategic investor include the stability of a country's political institutions, the state of the national economy, the stability and convertibility of its currency, its legal system and tax structure, and its demographic, social, historical, and cultural conditions.[87] Instability

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85 Direct investment is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise in another country . . . The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise. [In addition,] direct investment comprises not only the initial transactions establishing the relationship between investor and the enterprise but also all subsequent transactions between them and among affiliated enterprises, both incorporated and unincorporated. FOREIGN DIRECT INVESTMENT IN LATIN AMERICA IN THE 1990s, 74 (Institute for European-Latin American Relations ed., 1996) *quoting* INT'L MONETARY FUND, BALANCE OF PAYMENTS MANUAL 5 (1986).

86 Judith D. O'Neill, *Privatization of Telecommunications Enterprises: The Viewpoints of Foreign Operators*, *in* IMPLEMENTING REFORMS IN THE TELECOMMUNICATIONS SECTOR, 385 (Björn Wellenius and Peter A. Stern eds., 1996) [hereinafter O'Neill].

87 *See* Sonneschein and Yokopenic, supra note 78, at 345-46; *see also* O'neill, *supra* note 86, at 386.

decreases the attractiveness of an investment and may deter large investors from entering unstable countries inasmuch as it can mean higher risks for investment returns and limits on an investor's ability to raise capital.[88]

The strategic investor must review country-risk rankings offered by private consultants and research organizations when evaluating a particular telecommunications investment and when formulating an appropriate strategy.[89] These rankings show the political, economic, and financial risks of doing business in a targeted country. Factors analyzed to determine the general country risk are as various as the present and prospective political situation; economic factor include such as gross domestic product ("GDP") growth, inflation, exchange fluctuation, the degree of competition in the market, the pace of change to a market economy, the management of relations with the government, and labor and socially-related risks.[90]

Paramount attention must also be paid to how well local capital markets function,[91] how firm the general legal and constitutional framework is, and what precisely the country's foreign investment laws are.[92] The viability of long-range investment may rely heavily upon how authorities ensure transparency of market transactions, appropriate levels of taxation on capital gains and dividend incomes, how the general legal framework protects property rights, how the constitution guarantees foreign investors against nationalization, and how foreign investment laws allow repatriation of dividends and foreign legal control of the privatized company.[93]

To the extent that country risk varies throughout the operator's lifetime, it must be carefully assessed and covered. In order to attenuate

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[88] For instance, in Argentina the division of ENTEL in two regional companies helped to some extent to cover the country risk, since if the government decided to expropriate or block funds, it would antagonized two different investment groups including local partners, and would jeopardize the country's telecommunications development.

[89] *See* Sonneschein and Yokopenic, *supra* note 78, at 351.

[90] For an updated evaluation of Latin America's economic, political and social risk rating and other indicators see *Political Risk in Latin America: How Safe is Investment?*, LATIN AM. SPECIAL REPORTS, Oct. 1996.

[91] For instance, in Argentina one aspect that limits country risk is the weight of TASA's shares on the Buenos Aires stock exchange. An expropriation of fund blocking operation against the MTO would be detrimental to the country's stock market.

[92] François J. Grossas, *Privatization of Telecommunications Enterprises: The Viewpoints of Investors*, *in* IMPLEMENTING EEFORMS IN THE TELECOMMUNICATIONS SECTOR, 416-17 (Björn Wellenius and Peter A. Stern eds., 1996) [hereinafter Grossas].

[93] For an updated framework of foreign investment regulations and brief analysis of basic rules, restricted sectors, prevailing attitude, remittance limits and other restrictions, incentives for new investments, and approval process see for instance, BUS. LATIN AM., The Economist Intelligence Unit, March 10, 1997, at 4-5. *See generally*, Roberto Mayorga Lorca, *Foreign Investment Regimes in the Americas: Legal Challenges*, *in* OECD Proceedings, 45-59; Isabella Soares Micali, *Legal Environment for Investment in Latin America: Corporate Law and Bankruptcy*, *in* OECD Proceedings, 69-81

country risk, several techniques are available to MTOs. Insurance policies covering country risk can be provided by either private or public companies such as the Spanish firm Compañia Española de Seguro y Crédito a la Exportación ("CESCE")[94] or by supranational organizations such as the World Bank's Multilateral Investment Guarantee Agency ("MIGA")[95] aiming at improving investor confidence and promoting the flow of investments to developing member countries. In addition, the very configuration of a consortium contributes to cover this risk by diversifying the risk among the partners and, also, by including local partners.[96]

2. MARKET CONSIDERATIONS

Among the first factors, or entry signals, to be evaluated are privatization of basic telephone services, liberalization of mobile communications, and existence of advanced corporate communications markets. Similarly, local demographic and economic trends also have to be evaluated in order to determine if they ensure sufficient demand[97] so as to allow improved quality of services and growth of business.[98]

Broader market considerations also are critical for strategic investors. Provided they have long-term interests in the sector, strategic investors may be prepared to pay a higher price and to accept lower initial returns on their investments in exchange for building up a regional or global market presence. In the case of most Latin American countries, it was also clear that prospects of strong, open integration would lead to important economic growth in the region. The liberalization of cross-border markets, implying an important rise of intra-regional trade, would likely lead to a substantial rise in cross-border activities of firms and, hence, in the demand of improved and expanded telecommunications services.[99] The strategic value of the privatized companies was, therefore, enhanced. The expected growth of the telecommunications business would allow, in the long run, the strategic investor not only to gain profits but also to achieve economies of scale, lower prices, quality of services, digitization, and strong penetration rates. All of these realizations would allow the privatized company to be

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94 *See* Durán, *supra* note 74, at 452.

95 MIGA, 1996 ANNUAL REPORT 8-13 (1996). MIGA issues guarantees against non-commercial risks for investments in its developing member countries that originate in any of its member countries. In general it covers currency transfer restriction, expropriation, war and civil disturbance, and breach of contract.

96 *See* Durán, *supra* note 74, at 453.

97 *Id.* at 444. In this regard, a study of demand based on the ratio lines in service per 100 inhabitants can provides clues about what countries are suitable investments.

98 *See* Sonnenschein and Yokopenic, *supra* note 78, at 346.

99 *See* Dunning, *supra* note 71, at 125.

well positioned for a future time when the exclusivity period expired and basic telecommunication services would be open to competition. In addition, by primarily focusing in the Latin American market, entities such as Telefónica were building on regional and global networks[100] and strengthening their position as a global MTOs.

B. *Legal and Regulatory Framework*

The investor's evaluation of the privatization process depends heavily upon: (i) how a particular government plans to restructure its telecommunications sector; (ii) what legislative and regulatory efforts are implemented to accomplish such objectives; and (iii) what regulatory framework under which the company will operate will ultimately exist.[101]

1. SECTOR CONSIDERATIONS

A successful privatization can occur only if necessary restructuring of the telecommunications sector and separation between regulatory and operating functions have been achieved before privatization. For this purpose, and in order to assure purchasers of the government's commitments, it is necessary to draft and enact legislation to change telecommunications and foreign investments laws, to create an independent regulatory body,[102] to create a proper budgetary infrastructure to ensure that a private company will be paid for services rendered,[103] and to create some mechanism to solve conflicts when competition is introduced.[104]

Usually, representatives of interested MTOs will meet at an early stage with a particular government to discuss and negotiate regulatory rules. If a regulatory scheme focuses on the carrier rather than on the service, the government is better able to encourage growth of the sector, whilst achieving universality, quality of service and reasonable price; at the same time, the investor is better able to picture the future and make more accurate financial projections.[105]

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[100] Maurice Odle, *Foreign Direct Investments as Part of the Privatization Process*, 2 TRANSNATIONAL CORPORATIONS 23, at 23-34 (1993) [hereinafter Odle].

[101] *See* O'Neill, *supra* note 86, at 385.

[102] For instance in Chile was created the Subsecretaría de Telecommunicaciones with tasks relating mainly to technical regulations and licenses to new suppliers, in Argentina these tasks were carried out by the Comisión Nacional de Telecomunicaciones.

[103] This is necessary because in a natural monopoly environment, budgetary cross-subsidies usually prevail. As the State needs to ensure universal service, the profits from one service (i.e., long distance) cover losses in other (i.e., local, rural), in cases of general deficit it is covered by national budget.

[104] For instance in Peru, arbitration allows the company to resolve conflicts without going to the local courts. *See* Sonnenschein and Yokopenic, *supra* note 78, at 347.

[105] *See* O'Neill, *supra* note 86, at 389.

Also of paramount importance, investors must be acutely aware of future operating conditions. A government needs to balance two competing objectives. On the one hand, a government may grant a strategic investor exclusivity for a limited number of years as a means of reducing investment risk and ensuring a stable flow of revenues. On the other hand, a government needs to shorten, as much as possible, any period of exclusivity so as to promote greater efficiency and higher quality of services that competitive entry would carry. In order to project the capital required, an investor must acquire clear and detailed information about how much growth and the scope of services will be required by a government. Given that capital required during the expansion and modernization is typically huge, the investor may require that funds for further investments be internally generated or borrowed from national or international capital markets. To be sure, special attention must be paid to regulatory restrictions, such as treatment of tariffs, that may affect the profitability of a privatized company.[106]

As the prospective investor requires prompt and detailed information, a small and well organized team can ensure success in managing the privatization process. In addition, factors that may contribute to enhancing the interest of the investor: (i) transparency, a process free from contingent political intervention; and (ii) the establishment of proper procedures, ranging from invitations to prequalify to the ultimate selection of an operator.[107]

2. ENTERPRISE CONSIDERATIONS

As investors pay close attention to the financial situations and perspectives of the state-owned telecommunications enterprises, governments usually will have to turn companies into viable businesses and make them as attractive as possible[108] before they are offered to investors. Therefore, in addition to reorganizing the companies and restructuring the capital, reforms must be made with respect to finances and operations and debts must be rescheduled or assumed by the government.[109] Moreover, as company viability will depend, to a large extent, upon the support of labor forces, reforms also must be made to pension plans, employee benefits, the

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106 *See* Grossas, *supra* note 92, at 415.

107 This procedures in general include: provision of sufficient data room information and analysis, analysis of the salient laws of the country, reasonable timetable and criteria to prequalify, statement of terms and conditions of the sale, offering statements, deadline and bidder proposal, bidder selection, negotiation and execution of a concession agreement. *See* O'neill, *supra* note 86, at 390.

108 *See* Sonneschein and Yokopenic, *supra* note 78, at 347-48.

109 *See* Grossas, *supra* note 92, at 414.

quality and attitude of the labor force, and organizational structures in general.[110]

A fair and competitive valuation of the company is essential for the success of the privatization. As investments in the telecommunications sector imply long-term commitments, valuation must be appropriate with the risk of operating in a foreign developing country. The capital structure established by the government must be clearly assessed by the investor to know how much investment will be required, when and in what form,[111] what amount of control the investors will have over the operation of the company, and how the balance of the company's stock will be distributed.[112]

V. THE STRATEGIC TOOL OF TELEFONICA IN PRIVATIZED LATIN AMERICAN TOS: THE INTERNATIONAL CONSORTIUM

Once the suitability of making a FDI within the framework of a consortium is accepted, a MTO must begin the search for adequate partners. The consortium formalizes its relationship in a manner parallel to the due diligence and negotiations involved during the bidding process. A number of issues regarding inter-partner relationships and consortium-government negotiations are critical for a successful consortium. Throughout this process, as during the evaluation of the FDI assessment, appropriate local counsel is critical to enhance the chances of success.

A. *Main Characteristics of the Formation of a Consortium*

An international consortium in the telecommunications sector may be defined as a business cooperation process regulated by a contractual relationship between the parties. In principle, an international consortium is established for an unlimited time span. During such time, at least one of the agents involved with or for the consortium is a telecommunications operator. The agent's aim is to undertake a far-reaching business telecommunications project requiring important financial and technological contributions and resources to be provided by partners of the consortium. The consortium must be governed by a joint organization established

110 *See* Sonnenschein and Yokopenic, *supra* note 78, at 348.

111 Debt-equity swaps arrangements can facilitate the investment, as they result on an indirect price discount on the assets. This low-cost investment approach was successfully used for instance in Argentina, together with an additional cash payment. The rules established by the government were essentially: a minimum of $214 million in cash, $380 million in Argentine foreign debt payable over a three-year period, plus additional debt subject to a floor. *See* Odle, *supra* note 100, at 25; *see also* Petrazzini, *supra* note 16, at 127.

112 *See* O'neill, *supra* note 86, at 389.

beforehand by the parties that is differentiated from the parties themselves.[113] Given that many parties are involved in the formation of a consortium, what follows is a discussion focusing on the importance of partner selection and contract formation.

1. SELECTING ADEQUATE PARTNERS

It is essential that the goals of all partners coincide or complement each other.[114] Usually, five main parties are involved in the setting up of a consortium in a basic telephone network or mobile telecommunications: (i) a telecommunications operator leading the consortium; (ii) another operator(s); (iii) financial partners; (iv) local partners; and (v) the local government.[115] While only the first four are members of the consortium, the non-member government usually plays a decisive role.

The leading operator will carry the weight in forming the consortium. This operator will be responsible for managing the business of the local operator and will provide financial resources, technology, human resources,[116] and business capability. In addition, as the principal partner of the consortium, the leading operator will assume responsibility for financial control and management, for carrying out negotiations with local political authorities and for settling possible conflicts that may arise between the alliance's partners.

The role that other operators, if any, will play in the consortium is similar to that of the leading operator, though some important differences exist. These other operators search for new markets, gain experience in operating certain services, and collaborate with leading operators in business management.[117] They also must contribute resources, provide

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113 *See* Durán and Gallardo, *supra* note 72, at 97.

114 For instance, in Venezuela, GTE formed a consortium that included Telefónica, AT&T and two local partners (Banco Mercantil and Electricidad de Caracas). Telefónica's experience in managing both sophisticated data networks in rural communities was very valuable, especially during the period of intense network developing. AT&T gave its experience in the development of the international traffic sector. The local partners brought knowledge of the local financial and labor markets. Banco Mercantil, one of the largest banks in Venezuela, brought knowledge of local cash flow management, local capital and consumer markets, and advertising. Electricidad de Caracas, the private power company, brought its experience in outside plant construction, local subcontractors, subcontract arrangements, and the local labor market. These areas of knowledge were critical to GTE in meeting the expansion requirements of CANTV during the first year. *See* Sonnesnchein and Yokopenic, *supra* note 78, at 359; *see also*, Durán and Gallardo, *supra* note 72, at 98.

115 *See* Durán and Gallardo, *supra* note 72, at 98-99.

116 In 1995, Telefónica had 153 employees in Latin America: 45.1% in Argentina, 35% in Peru, 13% in Venezuela, 5.2% in Chile, and 1.7% in other countries. *See* Telefónica Internacional, *supra* note 68, at 16.

117 ROB FRIEDEN, INTERNATIONAL TELECOMMUNICATIONS HANDBOOK, 280, 285 (1996).

access for their own customers or know-how that compensates for the principal operator's weaknesses, and exercise some lesser control.

If there are local or non-local financial partners,[118] their priority will be to obtain an acceptable financial return against capital costs. A financial partner does not participate in running the local operator's business, but may collaborate in providing access to financial markets. To be sure, the control exercised by non-local financial partners stems from the relationship within the consortium.

Selection of local non-financial partners[119] capable of contributing to the management of a company is essential. In most cases, the main goal of non-financial partners is to pursue profit from their own business. This profit-seeking role exists either because non-financial partners have interests in the supply of goods or services available to the operator or because they are needy consumers of telecommunications services. Special care must be taken in selecting local partners because, apart from financial resources, local partners can help the operator provide internal contacts and knowledge of critically important local markets.[120]

Though it does not participate as a partner, the government plays a fundamental role in a consortium's operation. Typically, when an international consortium takes out a share in a basic network operator, this involves at least partial privatization of the local operator. As a result, the principal agent negotiating with the consortium will be the local government. Given the strategic nature of the telecommunications sector, the Government's negotiating position will be to defend national interests related to the country's economic development. As for consortiums whose

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[118] In fact, large firms operating in the cash-rich telecommunications sector, have usually little problem finding long-term financing, and often 50% or more of the required financing comes through retained earnings. Usually a number of local and/or non-local banks provide further financing by being part of the consortium. Having local financial partners ensures access to the local financial markets. A well established consortium with a strong leading operator, by enhancing the credibility of the privatized companies, also ensures the confidence of lenders in the international financial markets where otherwise unfavorable credit risk would have made them more reluctant. For instance, Argentina's TASA and Chile's CTC have recently, subscribed syndicated loans, with very favorable interest rates, for a total amount of $375 million from banks such as Deutsche Bank Argentina, Société Générale and Santander Investment Bank. *See* José Luis Guasch, *Infrastructure Concession Design and Financing Issues*, *in* PRIVATIZING MONOPOLIES: LESSONS FROM THE TELECOMMUNICATIONS AND TRANSPORT SECTORS IN LATIN AMERICA 374-75 (Ravi Ramamurti ed., 1996); *see also* Christopher J. Sozzi, *Project Finance and Facilitating Telecommunications Infrastructure Development in Newly-Industrializing Countries*, 12 COMPUTER & HIGH TECH. L. J. 447 (1996); *see also* LATIN FIN., June 1995, at 75; *see also* Telefónica Internacional, *supra* note 68, at 47.

[119] In Mexico, for instance, the government required that local partners were included in the consortium.

[120] *See* Telefónica, *La Experiencia de Telefónica en América Latina*, Nov. 1996, at 7-8 [hereinafter Telefónica].

aim is to participate in mobile communications networks, the Government similarly plays a relevant role because it must grant the license for operating mobile service, either on a monopoly basis or with limited competition.

2. FORMALIZATION OF THE CONSORTIUM CONTRACT

A partnership agreement[121] should be established before a shareholders agreement. Establishment of a partnership agreement helps to produce an association of different members of the consortium in negotiation. Such an association or agreement resolves important aspects of consortium formation such as the percentage of each member's participation, mechanisms for the decision-making, capital contributions and the covering of expenses until consortium formalization, and the prospective and potential distribution of functions of each participant. The consortium, once established, must submit a specific tender to the local Government's bid request on the basis of a share package that will entitle it to manage the operator.[122]

The definitive consortium often takes shape after the license is obtained.[123] Once the partners are assembled, the consortium's organizational structure must be defined clearly and must be provided with a personality independent of its component parts.

Almost all alliances are created with unlimited time span. However, as problems may arise among the consortium members regarding, among other reasons, operating inflexibility, managerial conflicts, politicization, reluctance by some partners to reinvest profits, and/or changes in the political atmosphere, one or more of the partners may be willing to withdraw from the consortium.[124] It is therefore advisable that the contract regulating the consortium include an implicit sales option covering the

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[121] *See* Luis López-van Dam Lorenzo, *Aspectos jurídicos de las privatizaciones y adquisiciones de empresas de telecomunicaciones en el exterior, in* Cremades at 1105 [hereinafter López-van Dam].

[122] For the government's considerations on this issue *see* for instance, Hector A. Mairal, *Legal and Other Issues in Privatizations: the Argentine Experience, in* OECD, PRIVATIZATION IN ASIA, EUROPE AND LATIN AMERICA, (1996), at 138-39.

[123] For instance, in Argentina, the consortium was initially composed by Telefónica, Citicorp and Technint (an Argentine investment group). Once the tender was awarded, the structure of the consortium was completed and new financial partners entered (Banco Hispanoamericano, Banco Río, Banco Comercial de la Plata, Aresbank, Banco Central, Chemical Bank, etc.).

[124] For instance, in Argentina, after buying participations of other financial partners in the consortium Cointel, Telefónica increased its participation from 10% to 29% in 1993. In August 1994 another increase on Telefonica's participation took place through the exchange of 20% of Chile's ENTEL by 4.3% participation of Chemical Bank in Cointel. *See* Durán and Gallardo, *La internacionalización de Telefónica de España. Una estrategia multidoméstica con orientación global, in* MULTINACIONALES ESPAÑOLAS I. ALGUNOS CASOS RELEVANTES 113-14 (Juan José Durán ed., 1996).

negotiated departure of one of the partners,[125] and stipulate that the operator acting as leader (the MTO) be first in line to make the purchase.

The degree of participation in the management of the consortium's capital is also a matter of great importance.[126] Obtaining management control can be critical for the purpose of complying with concession mandates. When participation in the capital is majority in absolute terms, the lead investor will have guaranteed majority in the organs of representation (shareholders assembly) and in the administrative organs (board of directors), thereby ensuring management and administration control. If participation is not majority in absolute terms it might nevertheless be *de facto* by demanding to change the percentage of shares necessary to obtain majority control. Although minority participation and atomized capital is usually the rule in Latin American telecommunications privatization processes,[127] the lead investor usually can have in practice a relative majority to control the consortium. It is therefore important in this latter case to establish legal mechanism through which the lead investor, although holding a minority of shares, could retain control. A formula commonly used is the establishment of series of shares conferring different powers upon each of them.[128]

Other covenants to be carefully assessed and also included in the shareholders agreement or statutes deal with the powers exercised in the different organs of the consortium, mainly regarding the shareholders assembly, the collegiate organs of administration, and the management posts.[129] In this regard it is important to carefully provide for clear and detailed procedures with respect to the requirements for regular meetings (method of notice, quorum, and right to appoint substitutes), matters requiring majority or super-majority votes, and nomination and revocation of the managerial posts.[130]

Management contracts, linked to the position of shareholder, can also be a critical element for strategic investors to obtain share control not

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125 *See* Durán, *supra* note 72, at 100. For an analysis of clauses usually found in partnership agreements and sample clauses see generally RONALD F. SULLIVAN, FINANCING TRANSNATIONAL PROJECTS, § 8.02 (1993) [hereinafter SULLIVAN].

126 *See* López-van Dam, *supra* note 121, at 1105-06.

127 *See* VUYLSTEKE, *supra* note 1, at 121-22.

128 *See* López-van Dam, *supra* note 121, at 1106. For instance, in Venezuela four categories of shares were established: class A belonging to the consortium, class B belonging to the State, class C targeted on employees, and class D sold to the general public. Until January 2001, the CANTV's president and four directors, as well as their deputies, were to be named by the owners of class A shares, and two directors and their deputies were to be named by the owners of the majority of class B shares. *See* Francés, *supra* note 15, at 161.

129 *See* López-van Dam, *supra* note 121, at 1107.

130 *See* Sullivan, *supra* note 125, at § 8.02(3).

obtainable by means of capital outlay.[131] This formula is commonly used in some privatization process and is of special importance in privatization models where share capital is widely distributed. As in practice, the strategic investor (the MTO) gives more input to the management of the company than the rest of the shareholders, in the absence of a management contract all shareholders would obtain, on the basis of participation, the same return by means of dividends.

By the same token, the existence of legal limitations derived from either privatization or business laws applicable disable in occasions that operational control of the privatized entity could remain, by statutory means, in the hands of the strategic investor. To overcome this potential caveat, a management contract confers the strategic investor the possibility of obtaining a greater return compared with the return which would result from its participation in the privatized company.[132]

B. *Acquisition Procedure: The Bidding Process*

Just as a successful consortium depends on good selection of the partners, so too does it depend on a transparent and fair bidding process as well as managed negotiations with the government.

1. TRANSPARENCY AND NEGOTIATIONS

As already seen, most Latin American privatization processes follow the strategic partnership model. To the extent that the goal is the acquisition of capital and management capability, governments usually impose prequalification requirements[133] in order for MTOs to submit a specific tender. The bidding process therefore should provide for enough time for comprehensive due diligence visits, outline clear criteria for evaluating the bids, and provide disclosure of the final purchase price and the buyer. Successful biddings must be transparent and competitive and contain realistic deadlines and prices.[134] A single authorized government representative or, better, the creation of a professional regulatory agency

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131 *See* López-van Dam, *supra* note 121, at 1108.

132 Most of management contracts are linked, in return, to the maintaining of the title of concession and are dependent upon the accomplishment of certain operational and financial conditions. *Id.* at 1108.

133 The elaboration of appropriated documentation regarding operational and financial capability and other formalities required to prequalify need special consideration and thus requires local counsel to ensure that all documents accomplish the required specifications. In the case of Spain, for every private or public document to be valid and fully applicable in other country, it has to be legalize by notary public and be authenticated by the consulate of the concerned country in Spain. In addition, some further formalities may be also usually carried out in the concerned country, normally before the Foreign Affairs Ministry. *Id.* at 1103.

134 *See* Sonneschein and Yokopenic, *supra* note 78, at 351-53.

vested with authority (but separated from the political process) helps to eliminate incertitude and enhance investor confidence in the process.

Various documents negotiated during the privatization process explain in detail the terms, schedules and conditions of future operations. These documents usually include a charter ("pliegos"), a license or concession agreement, and the regulatory rules. The concession establishes the right of a company to conduct a specific business, the terms and conditions under which a company will operate, the terms and conditions for interconnection requirements, and a company's obligations with respect to the networks and to customer service. In comparison, the regulatory rules establish the extent to which a business will be subject to competition, outline the period of exclusivity, and present the methods for determining future rates and rate increases. As the concession can change an investor's perception of a company's value, bidders must discuss and negotiate these issues while conducting due diligence review. In addition, any changes in it must be agreed upon by a company and the government as stability in the concession is critical for the investor.

Competition and exclusivity (e.g., investor's protection from open competition) are critically important in allowing an investor to develop basic network infrastructure and to provide services at reasonable prices.[135] Similarly, the ability to negotiate the local rate and the flexibility to make price changes ensures a company's financial viability, provides for economic incentives to increase operational productivity, and promotes greater competition.[136]

Finally, as the costs associated with service requirements mandated in a concession have a considerable impact on an investor's valuation of the company, the bidders must check whether these services are realistic.

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135 For instance, the concession contract of Telefónica in CTC will expire by 2031, in Telefónica del Perú in 2013 (with possibility of extension), in CANTV by 2026 (with possible extension), and in TASA is with unlimited time. Whereas local and long-distance services are already in competition in CTC, the exclusivity period for both services expires in TASA in November 1997 (plus automatic extension of three years if concession mandates are accomplished), in Telefónica del Perú in June 1999 (plus possible extension of five years), and in CANTV in September 2000 (plus possible extension of nine years). *See* Telefónica Internacional, *supra* note 68, at 18.

136 A price ceiling regulation, providing for service baskets, adjustments for inflation and the rule of maximum price adjustments, allows rationalization of prices in alignment with costs. Under this framework, the growth of gross revenues will depend on the growth of subscribers base, productivity increases, and the price elasticity of demand. Therefore, allowing the company operators to benefit by productivity increases, which will be shared with consumers, will provide economic incentives and financial viability, which is necessary to prepare for open competition. *See* Sonnenschein and Yokopenic, *supra* note 78, at 355. The inflation adjustment are made every six months in TASA and every three months in Telefónica Peru and CANTV, and tariff revision are carried out each five years in CTC, annually in TASA and CANTV, and freely readjusted by the consortium until 1998 in Telefónica del Peru. *See* Telefónica Internacional, *supra* note 68, at 18.

2. DUE DILIGENCE AND CONTROL

Before making any offer to a government's bid request, an investor must evaluate the changes required in a targeted privatizing company and the cost of making such changes. This process, called due diligence, entails a review of the information memorandum provided to all qualified bidders and a thoughtful legal audit of the company.[137] Several important aspects to be considered include: records of lines and subscribers, operation records and service indicators, financial records, systems, billing and customer service operations and access to business offices, supply and inventory systems and access to warehouses, operation systems and access to operation facilities, and the labor force situation.[138] Special attention must be paid to any aspect subject to modification due to changes in the ownership of a privatized company, such as loans and credits.[139] To ensure that the process is fair and open to all bidders, the process is usually monitored either by the government or by a special office created for this purpose;[140] even an engaged investment banker can act as the government's agent.[141]

Once a government makes official the winning bidder consortium (a fact that usually will depend not only on the financial contribution but also on the prestige of the MTO and the combination of partners within the consortium),[142] a MTO's management of the local operator is ensured through a variety of controls.[143] On the one hand, a MTO's own management will control thoroughly the management procedures implemented in the local operator with respect to obtaining financial returns, managing ethics, and fulfilling other strategic objectives. On the other hand, the other consortium partners will make sure that they obtain financial returns on their investments. Finally, the local government will be more interested in political control and compliance with market regulations in order to improve constantly the country's economic and social conditions.

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137 *See* López-van Dam, *supra* note 121, at 1102-03.

138 *See* Sonnenschein and Yokopenic, *supra* note 78, at 356-57.

139 Although it is advisable to make the bidding offer dependable on government's settling of these issues, in the case the procedure did not provide for a conditioned offer, a government's commitment to resolve these contingencies before the deadline to present the bid or before the taking over of the privatized company should be obtained. *See* López-van Dam, *supra* note 121, at 1104.

140 As in Argentina.

141 As in Mexico and Venezuela.

142 *See* Durán and Gallardo, *supra* note 72, at 98.

143 *Id.* at 99.

C. *Critical Factors of Success*

In addition to selecting adequate partners and running a business properly, the successful formation of a consortium among a number of firms depends upon the relations and interests of various parties and upon a number of issues the partners must approach during the alliance establishment and negotiation stage.

The business conducted by an alliance must permit the exploitation of the dominant partner's proprietary competitive advantages,[144] which in essence are technological or managerial skills and know-how. Similarly, the business must allow for a fluid flow of communication between and among partners, a clearly defined framework of committed resources, a definite mechanism for recovering them, and a profit sharing scheme or formula. It is, moreover, indispensable that services be provided with acceptable quality; otherwise expulsion from the market would result and the global strategy of a MTO jeopardized.[145] In addition, it is essential to carry out good negotiations with the government. Although it will require commitments in terms of service extension and quality and speed in addressing demand, it will ensure private control of the company. Negotiation also will enable a MTO to obtain commitments from a government regarding, for instance, subsidizing of unprofitable activities (such as extending the telephone service to rural areas),[146] extension of tax exemptions, construction of a stable billing framework, and limitation of country risk.

Inasmuch as profitable business is heavily reliant upon the level of operating costs, it is important to eliminate managerial inefficiencies in areas such as purchasing, personnel, and investment policies.[147] To this end, appropriate local partners are, once more, of great importance. Also, for the purpose of eliminating incertitude, it would be very useful for a consortium to have previously established a telecommunications plan covering the longest possible time span.

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[144] *See* Durán and Gallardo 2, *supra* note 77, at 449.

[145] It also can be a springboard to gain government's confidence when bidding for licenses in cellular communications, as was the case in Argentina and the awarding of the second cellular telephone license for the Buenos Aires area.

[146] Such a subsidies for rural services are currently under-way, for instance in Peru, Paraguay and Bolivia.

[147] *See* Durán and Gallardo 2, *supra* note 77, at 449.

VI. FOREIGN DIRECT INVESTMENT AND TELECOMMUNICATIONS IN LATIN AMERICA

A. *Globalization, Regional Integration and Direct Investment Flows Toward Latin America's Telecommunications Sector*

One of the most important illustrations of globalization in recent years is the growing number of business internationalizations.[148] Multilateral liberalization efforts carried out under the GATT/WTO framework[149] combined with complementary efforts under regional integration agreements have shot up the figures of international trade[150] and FDI.[151] The combination of improved records of economic and political stability, the success of open schemes of integration yielding a dynamic liberalization of cross-border markets, and the continued growth of FDI during the last decade,[152] collectively, have made Latin America the second-fastest growing region in the world. The more integrated Latin American economies become,[153] the more FDI they attract and the more intra-region FDI rises,

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148 The degree of economic globalization and inter-dependence is determined by advances in factors such as: international trade, capital and investments flow, and technology transfers; patterns of production and labor migration; the level of international economic cooperation; and intra-firm organizational structures. *See* IRELA/IDB, *supra* note 85, at 4. For an analysis of FDI and globalization see e.g. Richard J. Sweeney, *The International Competition for Investment*, *in* Oxelheim, 71-107.

149 In addition to providing a framework to reducing tariff and non-tariff barriers to trade, of paramount importance is the new WTO Telecommunications Agreement reached in February 15, 1997. This agreement will accelerate the global trend toward increased market access, competition, and deregulation. For a brief analysis of its significance see e.g., Peter Sisson, *The New WTO Telecom Agreement: Opportunities and Challenges*, TELECOMMUNICATIONS, Sept. 1997, at 24-33. In this regard, of no less importance is also the work developed under the framework of the OECD to establish an agreement on multilateral rules on investment. *See* Durán, *supra* note 74.

150 During 1995, the increase in terms of international trade was three times quicker than that of production. See THE ECON. RESEARCH AND ANALYSIS DIV. AND THE STATISTICS AND INFO. SYS. DIV., WTO, INTERNATIONAL TRADE: TRENDS AND STATISTICS, 2 (1995).

151 In the last ten years the estimated value of annual global FDI outflows has increased from $60 billion to $315 billion, and during 1995 FDI outflows grew more rapidly than world trade. WTO, TRADE AND FOREIGN DIRECT INVESTMENT 52 (1996).

152 FDI has continued to grow steadily from $8 billion in the late-1980 to $25 billion in the mid-1990s. *See* LATIN FIN., June 1995, at 24. For instance, in 1994, Peru had a GDP growth of 12.7%, the highest in the world.

153 Through a well established economic cooperation and the long-standing political dialogue with Latin America, the EU has played a very important role, first, in the process of integration among Latin American countries and, then, on the setting up of a new bi-regional context between the EU and the most dynamic, integrated and performing economies of the region, namely, Mercosur, Chile and Mexico. For an analysis of the new commercial policy of the EU toward Latin America, the reasons, the targets, the instruments, and trade and investment trends see Gonzalo García Jiménez, *New EU Trade Agreements With Emerging Regions. The New Commercial Strategy of the EU Toward Latin America: In Search of Market*

the more intra-regional trade increases, the more the region's GDP grows,[154] the greater consumer demand becomes, and, as a result, the greater the expansion of business is. As a natural consequence of this trend, advanced telecommunications services are in greater need. How well and how fast Latin America adapts its telecommunications sector plays a pivotal role in how quickly it will become competitive in the global marketplace.

There is a close relationship between economic development, in terms of GDP per capita, and telecommunications development, in terms of lines per 100 inhabitants (i.e., coverage).[155] The GDP per capita of certain developing countries in Latin America reflects potential development in the telecommunications sector and highlights a need and capacity to absorb investment. When comparing the fastest growing regions in the world in terms of GDP in recent years, vast differences appear between southeast Asia and Latin America in terms of telecommunications coverage. Whereas all southeast Asian countries are mature markets with acceptable levels of demand in terms of coverage (e.g., over 30%),[156] Latin American countries have coverage levels below 10%. This low coverage is, nevertheless, a positive indicator inasmuch it reflects a potential telecommunications market that must be served.

B. *Spanish Investment Strategies and Trends in Privatized Telecommunications Companies*

From early efforts of privatization of state-owned TOs in Latin American countries begun in the late-1980s, Telefónica has made important investments in privatized telecommunications companies. All these investments are made through a Telefónica subsidiary, Telefónica Internacional Sociedad Anónima ("TISA"). TISA controls participation in TOs and acts abroad with Latin America as a priority area for its long-term expansion plans.[157] The goal of Telefónica's internationalization strategy in

Access Trough a Regional and Specific Approach, in REGIONALISM AND MULTILATERALISM AFTER THE URUGUAY ROUND: CONVERGENCE, DIVERGENCE AND INTERACTION, 265-95 (Paul Demaret, Jean-François Bellis & Gonzalo García Jiménez eds., 1997).

154 Of an average 4.6 for the next years. *See* Latin Trade, Oct. 1997, at 46.

155 *See* Ignacio Santillana, *Investing in Major New Infrastructure Projects, in* IDB and International Herald Tribune, LATIN AMERICA: A NEW INVESTMENT PARTNER HOW TO REAP THE DIVIDENDS OF THE REGION'S ECONOMIC REVIVAL, 75 (1994).

156 *See generally* Stephen McClelland et al., *Asia: The Global Telecom Dynamo,* TELECOMMUNICATIONS, Sept. 1997, at 42-60.

157 Today fully privatized, at the beginning of 1996 Telefónica owned 75% of the capital ($980 million) , and the Spanish State 23.8%. *See* Telefónica Internacional, *supra* note 68, at 14. TISA also operates cellular licenses in Romania (60% of Telefónica Romania) and Portugal (15% of CONTACTEL). *See* Telefónica, *supra* note 68, at 37.

Latin America is twofold: (i) to develop a multidomestic model through its investments in the Latin American area; and (ii) to establish a presence in those international projects aimed at providing global services to multinationalized customers.

1. MULTI-DOMESTIC STRATEGY

Taking as a general framework geographic distribution, the general pattern followed for purposes of analyzing Telefonica's investment experience in Latin America will be share participation and area of business.

Telefónica's presence in Chile dates back to 1989 when it acquired 10% of Entel Chile, which provides international and long-distance services. The investment was made, rather than through a consortium, through a holding ("Inversiones Hispano Chilenas") fully owned by Telefónica.[158] By 1990 Telefónica increased its share in Entel to 20%, but had, later on, divested its interest in the company due to potential anti-competitive practices.[159] In the same year, Telefónica acquired 43.6% of CTC from the Bond Corporation and held the shares in the holding Telefónica Internacional de Chile. Through CTC,[160] Telefónica now operated 95% of all Chile's basic telephone services.[161] By 1994, CTC entered, through its subsidiary CTC Mundo, the liberalized long-distance and international services market. In the same year, CTC acquired 80% of Intercom, a Chilean enterprise operating cable television.[162] Telefónica also participated in mobile[163] and data transmission services. Finally, Telefónica also participated in the yellow pages business through a 51% interest in a company called Publiguias.[164]

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158 *See* Durán and Gallardo, *supra* note 125, at 111.

159 By mid-1991, Chile's National Treasury Office pronounced sentence against the increase of Telefónica's share in ENTEL to 20%. The reason being that Telefónica's dual share in both telecommunications operators, CTC and ENTEL, would entail monopolistic practices in the fully liberalized environment that the legislator was about to introduce. As a result, by mid-1994, Telefónica relinquished from ENTEL.

160 Other partners are: Fondos de Pensiones Chilenos (21.6%), ADR'S (16.7%).

161 The other 5% corresponds to five regional companies.

162 Intercom merged in 1995 with Metropolis, a Chilean competitor in this market. The actual share of Telefónica in Intercom-Metropolis amounts to 30%. *See* Telefónica Internacional, *supra* note 68, at 19.

163 This is achieved through a 45% participation in CTC-VTR Cellular (merged in mid-1996).

164 Other partners are: CTC (9%), Cochrane (20.4%), Publicar (19.6%).

Tisa's Participations: Countries And Business

ARGENTINA	*All telecommunications services in the southern region through TASA. Cable TV throughout country provided by Multicanal.
BRAZIL	*All telecommunications services in the State of Riogrande do Sul, except interstate and international long distance.
CHILE	*All telecommunications services trough CTC and Publiguías.
COLOMBIA	*Cellular and value-added services through COCELCO.
MEXICO	*Value-added services.
PERU	*All telecommunications services through Telefónica del Perú.
PUERTO RICO	*Domestic and international long distance through TLD.
VENEZUELA	*All telecommunications services through CANTV.

In Argentina, a consortium led by Telefónica, Cointel, was awarded a seven-year (extendible for another three years) concession to exploit as a monopoly the telecommunications operator in Southern Argentina. With a 22% stake in TASA,[165] Telefónica operated basic telephone services in the South of Argentina and in half of the area of Buenos Aires. International and data transmission services were provided by Telintar and Startel, respectively; both companies were equally half-owned by both by TASA and Telecom Argentina (the Northern operator). Mobile communications in the south were provided by the subsidiary TCP Cellular. In 1993, the second cellular telephone license for Buenos Aires was awarded to Movistar, a company equally half-owned by both TASA and Telecom Argentina. Telefónica also participated with a 25% stake in Sintelar,[166] a company dedicated to external plant equipment, provided services to big customers through its participation in TYSSA,[167] and yellow pages services through Páginas Doradas. In 1995, Telefónica also acquired a 25% of Multicanal[168] to provide cable television services.

[165] Other actual partners are: Citicorp (15.5%), Techint (4.6%), Bco. Rio de la Plata (8.9%). *See supra* notes 124 and 125.

[166] Together, mainly, with the Spanish company Sintel.

[167] Owned by Telefónica (20%) and by TASA (80%).

[168] Other partners are Citicorp Equity Investment (22.5%) and Grupo Clarín (52.5%).

*Tisa: Main Partners**

COMPANY	% OWNERSHIP	OTHER PARTNERS
CTC (Chile)	43.6%	Fondos de Pensiones Chilenos, Grupo Luksic, grupo Claro (23.4%)
TASA (Arg.)	18.05%	Citicorp (14.1%), Techint (4.2%), Bco. Río de la Plata (8.9%)
Telef. del Perú	31.5%	Peruvian State (29.3%), Graña y Montero (1.75%), Bco. Weisse (1.75%)
CANTV (Ven.)	6.4%	GTE (20.4%), AT&T (2%), Electric. de Caracas (6.4%), Venezuelan State (49%)
TLD (Puerto Rico)	79%	Autoridad de Teléfonos de Puerto Rico (PRTA) (19%)
COCELCO (Col.)	30.8%	Grupo Sarmiento (50%), Grupo Ardilla Lülle (9.9%), CTC (9%)
Publiguias (Chile)	51%	CTC (9%), Cochrane (20.4%), Publicar (19.6%)
Alestra (Mexico)	14.5%	AT&T(20%), Alfa(25.6%), GTE (14.5%)
Multicanal (Arg.)	25%	Grupo Clarín (52.5%), Citicorp Equity Investment (22.5%)

* At XII/31/96

In Venezuela, the consortium Venworld acquired 40% of the capital of CANTV. With a 20.4% ownership in the partially privatized company, GTE, and to a lesser extent, Telefónica (6.4%) and AT&T (2%), was in charge of running basic telephone services, and local, national, and international long-distance calls.[169] The consortium also provided value-added services through CANTV Servicios, and has, since 1992, a second cellular license by which services have been provided through Movilnet. It also operated yellow pages business through Caveguias, and cable television through CATV.[170]

In December 1992, Telefónica acquired 79% of Telefónica Larga Distancia ("TLD") of Puerto Rico. It provided international service to more than 40% of the country.[171] With TLD, Telefónica gained access to the advanced and dynamic North American market, and has been able, since 1996, to provide international services from the United States toward the Latin American region.

169 Other partners in the consortium were: Electricidad de Caracas (6.4%), and the State (49%).

170 After some delay due to the limitation of 20% on the foreign capital participation fixed by the Cable TV law, the license was recently granted.

171 The rest of the international traffic is provided by the US operators: AT&T, Sprint, and MCI.

In 1994, through a consortium mainly composed of local partners,[172] Telefónica acquired 31.5% of Peruvian operators CPT and ENTEL, which, in January 1995, became Telefónica del Perú. Telefónica provided basic services, local, national, and international services, data transmission, and mobile communications services. Cable television services were provided through Cable Mágico. As in Argentina, it also participated in SINTEL Peru which was devoted to external plant equipment, a key activity in order to accomplish the required extension of services.

In January 1994, Telefónica obtained in Colombia, through a 30.8% interest in the consortium COCELCO,[173] a license to operate mobile communications in the highly-populated northwest of Colombia, and a license to provide value-added services.

In Mexico, in October 1995, Telefónica reached an agreement with GTE whereby the Spanish company acquired control of 25% of the consortium Unicom.[174] As a result, Telefónica, in addition to providing value-added services in January 1996, entered the important Latin American market of long-distance services,[175] currently undergoing a period of liberalization.[176] Indicative of the importance of the Mexican market, Unicom and Alestra (composed by AT&T and the Mexican Grupo Alfa) merged at the end of 1996.[177] Not willing to lose an opportunity to enter the Mexican market, Telefónica negotiated its participation in Avantel, a consortium composed by MCI and Banamex, a local financial group.

In January 1997, following the first attempts of Brazil's de-monopolization of the telecommunications sector, Telefónica acquired

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172 Graña y Montero (1.75%), Banco Weisse (1.75%) and the State (29.3%).

173 Other partners in the latter are: Grupo Sarmiento (50.01%), Grupo Ardila Lülle (9.9%) and CTC Perú (9%).

174 Once Telefónica entered the composition of Unicom is as follows: GTE (25%), Telefónica (25%), and the local financial group Bancomer and Valores Industriales (50%).

175 It accounts for half of international traffic between Latin America and the US, and amounted to $4 billion in 1996.

176 The newcomers, will enter the market in two stages. The first, in 1997, is the core triangle formed by Mexico city-Puebla, Guadalajara and Monterrey, the area which accounts for about 70% of all telephone traffic. Second, the rest (some 50 cities), for which they must provide services by the year 2001. *See Telecommunications in Latin America: How the Region is Wiring Up?*, LATIN AMERICAN SPECIAL REPORTS, August 1997, at 9 [*see* LATIN AMERICAN SPECIAL REPORTS].

177 By merging, Alestra and Unicom will avoid the need to build to competing national fibre-optic networks (each 3,600-mile network would have cost an average of $300 millions to build). Therefore, by joining forces, the companies have saved at least that much, while allowing the consortiums to invest in other telecommunications opportunities, such as wireless local telephone service (which, although the radio frequencies required to operate the systems have to be yet auctioned by the government, the service is not under exclusive concession to Telmex), and the communication satellite sector which will be soon privatized. *See generally*, BUS. LATIN AM., Apr. 29, 1996, at 3.

control of Companhia Riograndense de Telecomunicações ("CRT") in the State of Rio Grande do Sul.[178] The importance of the CRT acquisition for Telefónica was clearly reflected in the price it paid for it: some $681 million for a 35% stake (55% higher that the minimum price).[179] However exaggerated the price may seem, it was barely sufficient to beat the best bid of Italy's STET.[180]

2. GLOBAL STRATEGY

Telefónica is the leading strategic investor of Latin American telecommunications operators. It manages more than 9 million fixed lines in service, more than 700,000 cellular subscribers, has a million cable television customers, and globally, has more than 11 million customers.[181] The company intends to expend $7 billion in expanding throughout Latin America and, by the beginning of the next century, expects TISA's acquisitions to account for half of its total earnings.[182]

With its stake in Chile's CTC, Telefónica Argentina, plus the Peruvian and Brazilian acquisitions, the company now has a core structure from which to launch its so-called "Pan-American Telecommunications Network,"[183] a scheme to provide a single-window service for international traffic, cellular, data transmission, and cable television-multimedia first within the axis Lima, Santiago, Buenos Aires and Porto Alegre, and then expanded in the near future to the rest of Latin America. For this purpose, the company intensified its actions on gaining the maximum profit from the existent synergy's among the different affiliated companies. Mechanisms for profit maximization include: favoring coordination and integration of operations, setting up common purchase policies, establishing management and information systems, and reducing financial operational costs.[184]

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178 CRT is the only company controlled by a state rather than the federal government. *See* BUS. LATIN AM., Jan. 20, 1997, at 2.

179 Or $6,000 per line. Compare to $3,300 per lines of Chile's CTC.

180 *See* LATIN AMERICAN SPECIAL REPORTS, *supra* note 176, at 11-12.

181 *See* Telefónica, *supra* note 120, at 6.

182 *Cf.* with the current 15%. *See* Latin American Special Reports, *supra* note 177, at 12.

183 The infrastructure for this regional network began to grow with the establishment of a land connection between the Peruvian and Chilean telephone systems in 1995. The next important phase will be the inauguration, expected for mid-1998, of the Americas I cable link running from Miami to Santiago, passing through Brazil and Argentina. Apart from having affiliates along the cable's line, Telefónica also has a 12% stake in the cable link itself. *Id.* at 12.

184 For instance, for the period 1996-2000, through a coordinated purchase policy of Telefonica's TOs in Chile, Argentina and Peru has an estimated cut expenses equivalent to $390 million. Likewise, an integrated policy on services, information systems and products will represent savings in investments and maintenance costs amounting up to $200 million. Finally, by being part of the Grupo Telefónica Internacional, the affiliated companies have better access to international capital markets (i.e., NYSE) and

As a result, if Telefónica's presence in the United States, through TLD-Puerto Rico, represents a strategic link among Latin America, the United States and Europe, penetration into Mexico's long-distance market, and the recent expansion in Brazil's key market reinforce and consolidate Telefonica's position as a global operator in Latin America. This combination of factors makes the company become a strong, unique interlocutor face to the large MTOs and consortia involved in the region.[185]

C. *Prospects for the Future: Existing Opportunities in the Region*

In addition to recent strong growth resulting from a number of large countries deregulating and privatizing, there is little doubt that the demand in Latin America's telecommunication sector will continue to expand.[186] Of an estimated $60 billion needed annually to fund necessary worldwide telecom investments through 1999, one-sixth is reserved for Latin America.[187] Setting aside Brazil, an estimated $80 billion in telecommunications-related investment in the region will be needed over the next five years.[188]

Infrastructure growth will require an estimated $16 billion a year for the next five years. Brazil alone is estimated to require $40 billion worthy of growth over the next three years. Although service penetration has sharply increased it still requires a significant gap to fill: penetration averages 9% for a 450 million population.[189] Cellular telephony is another

improve credit ratings (CTC and TASA have recently subscribed syndicated loans amounting to $375 million with very favorable interest rates). *See* Telefónica Internacional, *supra* note 68, at 47-50; LATIN FIN., Sept. 1995, at 75; *see also* Telefónica Internacional, *supra* note 68, at 27; *see* Telefónica Internacional, *supra* note 68, at 39.

185 *See* Telefónica Internacional, *supra* note 68, at 28.

186 Deregulation, privatization and demand for cellular phones are boosting Latin America's telecommunications sector. Brazil, Bolivia, Panama, Colombia, Ecuador, Nicaragua, Honduras, El Salvador, Guatemala, Paraguay, and Uruguay are already carrying out privatization of their telecommunications sectors. Others such as Mexico, Peru and Venezuela are further in the process of liberalization. *See* Adam Thomson and Sally Bowen, *Telecom Boom*, LATIN TRADE, Oct. 1997, at 48-52.

187 Norman C. Lerner, *Surveying the Market in Latin America*, TELECOMMUNICATIONS, Feb. 1997, at 25.

188 *See* Jorge Perez Cantu and Leonardo Turolla, *Getting Through to Latin America: What to Expect in the Telecommunications Sector*, LATIN FIN., at 12 [hereinafter Cantu and Turolla]. Likewise, the value of the market will increase from $28 billion in 1996, to more than $40 billion by the year 2000; a leap of almost 43%. *See* LATIN AMERICAN SPECIAL REPORTS, *supra* note 176, at 2.

189 Compare to a 56% penetration level in the EU and Canada and 52% in the US, for a 250 million population in the EU and a combined 300 million for the US and Canada. Thus, whereas for instance Mexico, with an 8.6% penetration level and a population of 90 million, has only 8 million lines, Brazil, with 150 million, has only 12 million lines and even lower penetration rate. *See* Cantu and Turolla, *supra* note 188, at 13. In absolute terms (number of lines installed) predictions of expansion in 1996-2000 are of 43% in Peru, 38% in Colombia and Mexico, 37% in Venezuela, 33% in Chile, 26% in Brazil, and 21% in

fast-expanding area of the market:[190] in the near future teledensity in the seven largest economies is expected to increase from 1.5 to 4.2%.[191] Plans to double the network of communications satellites serving Latin America are also under-way.[192] Expansion in the value-added services market[193] and the emergence of new telecommunications technologies, such as wireless communications[194] (e.g., personal communications services and pagers), Internet,[195] and video-conferencing,[196] will require large high-technology investments to address general and business consumer demand. As markets liberalize, convergence of technologies such as telephony and cable, and multimedia and wireless communications will present new challenges to telecommunications companies throughout the region.

Although Brazil is the last major market in Latin America to embrace reform of its huge telecommunications sector, the expectations and

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Argentina. In relative terms (lines per population) predictions for the year 2000 implies expansion rates of 51% in Chile, 40% in Colombia, 21% in Peru, 20% in Brazil and 9% in Mexico and Venezuela. *See* LATIN AMERICAN SPECIAL REPORTS, *supra* note 177, at 2.

190 For instance, by the end of 1994 there were approximately 2 million cellular subscribers, compared to about 39,000 in 1990. *See* Arely Castellón, *Tapping the Market: Existing Opportunities in the Region*, LATIN FIN. *supra* note 34, at 17.

191 Chile, Argentina, Venezuela, Peru, and Brazil have already or are offering cellular licenses. Although some times cellular systems are used to skip building digital line networks and thereby create an artificial wireless growth rate due to cellulars' shorter start up time and lower initial costs, they should not be seen as a quick fix for lack of penetration, as a fiber optic land system will be eventually be needed. *See* Cantu and Turolla, *supra* note 188, at 14.

192 Private satellites service provision complement the capabilities of the basic wireline network and provide additional transmission capabilities for other applications (such as very small aperture terminal ("VSAT"), and public switched network ("PSN") services). Satellites now carry out half of the region's international telephone traffic, and grows at an annual rate of about 30%. Worldwide projects such as those of Globalstar (a consortium formed by France Télécom, Alcatel and Hyundai) and Iridium (a group led by Motorola) are also under strong competition to capture cellular telephone bands in the region. *See* LATIN AMERICAN SPECIAL REPORTS, *supra* note 177, at 4; Mohsen Khalil, *Argentine Company Launches Satellite*, INT'L FIN. CORP. REV., 15, 15-71 (1994).

193 Because the majority of telephone companies concentrated on extending the number of lines available to consumers, only large multinational corporations that had created their own private networks gained access to value-added services such as voice mail, "800" numbers, call forwarding and call waiting. Thus the lack of services available to the general public, has created unique opportunities in this market. *See* Cantu and Turolla, supra note 188, at 12.

194 *See* in general, Motorola, *Frequencies of the Future. Wireless Communications Keep Latin America in Touch*, BUS. LATIN AM., at 18-23 .

195 In Brazil, for instance, although there are about 500,000 users, market penetration is still low (3%). Although some constraints still exist a fast expansion is under way: competition is already being promoted to establish inter-linked cross-border networks, and connection costs will be eased through the Américas I fibre-optic cable. *See* LATIN AMERICAN SPECIAL REPORTS, *supra* note 177, at 5; José L. Barletta, *New Waves. Improved Technology Expands Internet*, LATIN FIN., *supra* note 34, at 24-27.

196 On this issue see Picture Tel Corporation, *Meeting the World Face-to-Face. Videoconferencing Helps Latin Firms Conduct Business Globally*, LATIN FIN., *supra* note 34, at 28-30.

business prospects that privatization and liberalization entail are unmatched. Brazil offers the most attractive telecommunications market in the region because of its size (160 million people) and economic potential (expected 4 to 6% growth through the end of the decade). Furthermore, Brazil is also an attractive market because of the inadequacy, poor performance and low penetration of the sector, whose improvement yields to large profitable businesses for private investors.[197] The core telephone business alone will require about $70 billion worth of investment; before the year 2003, the whole privatization process is expected to attract about $100 billion.[198]

Major players such as Telefónica, STET, France Télécom, GTE, AT&T, Bell operating companies, as well as smaller investors groups are already forming consortia with local partners[199] to compete for Band 'B'[200] cellular concessions and for the privatization of Telebrás[201] (the state holding company that is to be split up into six units: five "Baby-Brás" providing local services, and Embratel providing domestic long-distance and international services). With its foothold in Brazil, Telefónica has ensured its role in the key to future Latin American telecommunications markets.

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197 The government's eight year plan for substantial growth by 2003 includes: increase in fixed access lines from 14.3 million in 1995 to 40 million; increase in line density from under 9% to more than 24%; increase in cellular subscribers from 1.3 million in 1995 to 17.2 million; increase in pay TV subscribers from 700,000 to 16.5 million. *See* Lerner, *supra* note 188, at 27-28.

198 *See* LATIN AMERICAN SPECIAL REPORTS, *supra* note 176, at 10-11.

199 There is a limitation of 49% maximum ownership by foreign investors. For a description of investment laws regarding the telecommunications sector see Walter D. Stuber and María C. Semionato, *Investments in Telecommunications in Brazil*, 1 TELECOMMUNICATIONS AND SPACE J, 257-88 (1994).

200 Telebrás has separated the cellular telephony market into Band "A" services (accounting for 60% of market growth), offered by the public sector, and Band "B" services (accounting for 40% of market growth), to be offered to private investment under ten region-concessions. Bell South won the concession for the city of São Paulo at more than four times the minimum price and the concession for the Northeastern region (covering six states). In August, a consortium led by Swedish Telia won the bidding for a 15-year concession of the interior of the State of São Paulo. *See* LATIN AMERICAN COUNTRY REPORTS: BRAZIL, Sept. 1997, at 17.

201 The Brazilian Constitution was amended in 1995 to allow for the breakup of the state telecommunications monopoly, Telebrás, and the first set of regulations were enacted in November 1995. Telebrás is responsible for 92% of the local traffic and 100% of long-distance traffic in Brazil. The federal government has 52.2% of Telebrás' voting capital and 3.76 of its non-voting capital, foreign investors own 28% of the capital. *See* Ian Katz, *No More Busy Signals*, LATIN TRADE, May/June 1996, at 77; Antonio C. Mazzuco, *Brazil Telecommunications Regulation*, 2 COMPUTER AND TELECOMMUNICATIONS L. REV. T-67 (1996).

VII. CONCLUDING REMARKS

With the reforms undertaken in Latin America's telecommunications sector and successful privatization of telephone companies every one wins: the government, the customer, the employees, the investors, and the economy. Although governments, in order to attract investors, did not transform state monopolies immediately after privatization into competitive, privately-owned sectors in one swift step, they will achieve the same final result via an intermediate stage of regulated private monopoly. Potential investors will continue to be attracted by, among other elements: popular and labor support, political and economic stability, liberal foreign investment laws, constant economic growth, appropriate sector and enterprise restructuring, clear regulatory frameworks, and a transparent and fair process.

Telefónica's experience in Latin America's telecommunications sector serves as a model in that it presents a number of factors largely contributing to MTOs' successful and profitable investments. Specifically, several considerations or activities must be appreciated when considering the alluring prospects the region offers. Preliminary evaluations of political and economic risks and prospects of growth in telecommunications demand should be conducted. An investor may also want to engage local legal advisors with deep knowledge about the political, economic and legal environments. An investor must be prepared to manage in a different cultural environment. Potential investors also must identify positive signals for entering the market, make suitable selection of partners and make special considerations in gaining support of prestigious local partners. Ultimately, an investor must select an activity that exploits the competitive advantage of each operator and allow for the fluid and trustworthy flow of communication between and among partners. At last, an investor must conduct effective and continuous negotiation with the partners and with the government, ensure appropriate human resources and relations with unions, and provide high quality services. At a more general level, internationalization has to be one of the essential strategies of a MTO. A strong multidomestic strategy can enhance a global strategy and allow a company to become a world leading telecommunications operator and to gain access to otherwise closed markets.

Just as Spain's Telefónica has become, through a multidomestic and global strategy, the Latin America's leading telecommunications provider, so too is another Spanish company, Empresa Nacional de Electricidad Sociedad Anómina ("ENDESA"), well on its way to becoming the most important strategic investor in the Latin American energy sector and the leading provider, distributor, transporter, and generator of electricity in the region. The pattern of behavior analyzed in this paper in the context of the telecommunications sector is, to some extent, similar to that currently under way in both the European Union's and Latin America's energy sector. On the one hand, liberalization of the EU's energy sector, introduction of competition into the European market and privatization of major Member States' national monopolies is opening the gate for them to apply diversification strategies in other sectors (gas, water, telecommunications) and international strategies to expand through investments in emerging foreign markets. On the other hand, Latin America's energy sector not only presents outstanding prospects for the future (e.g., investment needs in the sector range from $10 billion to $25 billion annually, and electric demand is expected to grow 3% annually), but also offers a market in which privatization is gaining momentum. As a result, acquisitions of privatized state-owned energy companies, biddings, strategic alliances and international consortia with important local technological and financial partners will be multiplied in the upcoming years. Recent investments of ENDESA, which began privatization of half of the remaining state-owned 60% in October 1998 and devotes 60% of its foreign investments to Latin America in Enersis of Chile, Colombia, Peru, and Central America (through the Siepac project), evidence a process to consolidate ENDESA's position as the leading strategic investor in the region. ENDESA, moreover, maintains a view toward the creation of a proposed large pan-American electric network. Doubtless, the Spanish experience in the telecommunications sector will enhance the confidence and the chances to consolidate its presence in Latin America's energy sector.