

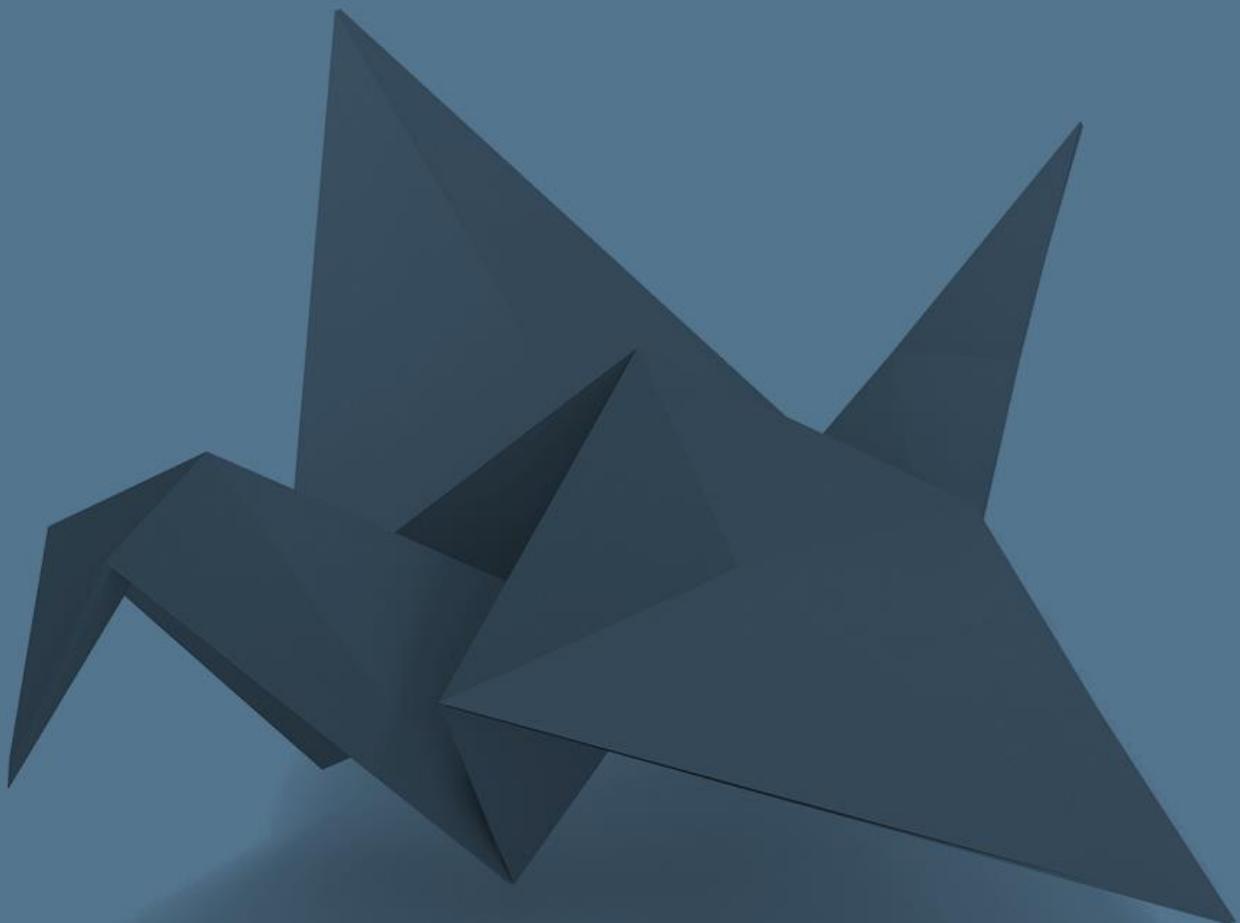


Centar za politike i upravljanje
Centre for Policy and Governance



BH Telecom Development Perspectives Between restructuring and privatization

Analysis drafted by Centre for Policy and Governance
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Introduction

The sale of the most profitable telecommunications operator in Bosnia and Herzegovina, BH Telecom JSC Sarajevo (BH Telecom), has for years been a matter of debate in BiH society. On the one hand, the Federation of BiH, whose government is the owner of over 90% of BH Telecom stock, needs a more liberal market, responsible investment, and rational business conduct – as well as capital investments which would also increase the quality of telecommunications services. On the other hand, those objecting privatization claim that the long-term ownership of BH Telecom by the state would be cost-effective, and it would contribute to financial liquidity.

Due to the lack of success during the existing privatization process in Bosnia and Herzegovina, society became skeptical towards this process which is highlighted as a cause for the currently poor economic state. Namely, up until 2014, privatization was marked, among other things, also by the attempts of misappropriation of the privatized assets, as well as by the incompetence of new owners to successfully restructure the companies and assure their growth, which is a consequence of the government's imposing of illogical and limiting conditions for new owners. All of that also stimulates the public's incredulity towards the privatization of the largest telecommunications operator in BiH. Thus, it is necessary to analyze available data which could illuminate a positive solution for BH Telecom.

Naturally, when the telecommunications market is spoken about anywhere in the world, internet telephony – which offers free-of-charge services and by that, imminently decreases the profit for traditional telecom operators – needs to be taken into consideration as well. Since the mobile internet industry is all the more developed in BiH, if it does not adjust to the development of modern technology, a drop in profits in BH Telecom can also be expected. Gathering the experiences of the more technologically advanced countries, the Centre for Policy and Governance has been warning against this trend as early as November 2014, through its research "Challenges of Privatizing Telecom Operators in FBiH"¹. Bearing all of that in mind, it is necessary, before anything else, to determine the Balance Sheet and Income Statement, and the current value of BH Telecom.

¹*Challenges of Privatizing Telecom Operators in FBiH*, November 2014, p. 5, Center for Policy and Governance, last visited: October 2017, <http://www.cpu.org.ba/media/26372/lzazovi-privatizacije-telekom-operatera-u-FBiH.pdf>.

A Golden Goose?

The opponents of privatization refer to Telecom as the “golden goose”, which will always be profitable. Data, however, points to BH Telecom’s decline of net profit in the last couple of years. According to data from financial reports available on the BH Telecom official webpage, in 2010, this enterprise has achieved the net profit of 154.11 million BAM, 150.22 million BAM in 2011, 147.48 million BAM in 2012, 133.15 million BAM in 2013, 78.59 million BAM in 2014, and 80.17 million BAM in 2015². Hence, while those opposing the sale of “golden goose” stocks have been claiming that the company must remain in the majority interest of the Government of FBiH because it will be profitable, its annual net profit can be seen to have nearly halved from 2010 to 2015.

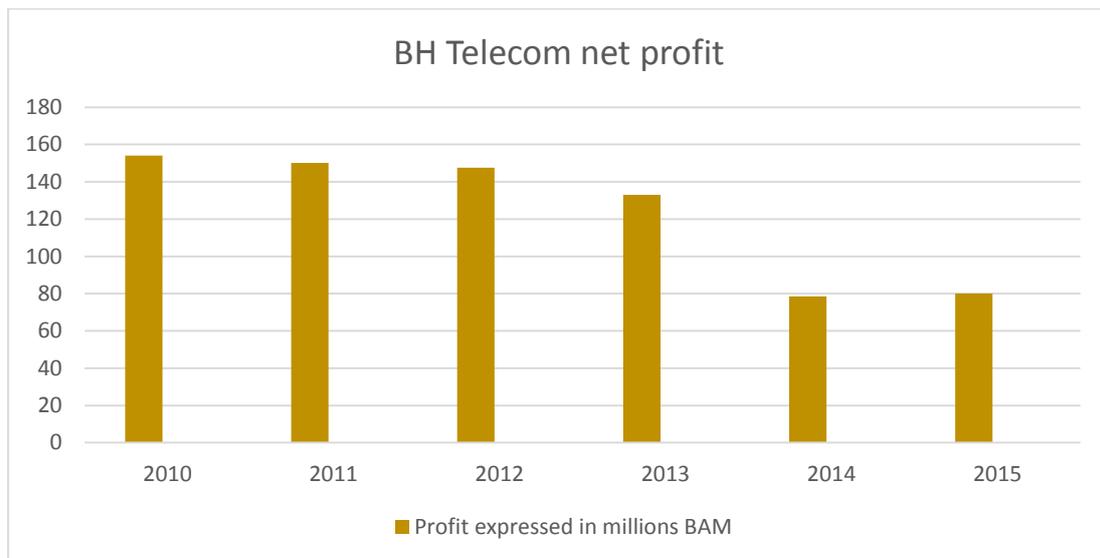


Chart 1: BH Telecom net profit overview for the period 2010 – 2015

Therefore, the stock value has also been declining, so BH Telecom is worth all the less as years go by. In 2011, the value of one BH Telecom stock amounted to 17.55 BAM, in order for it to decline to 16.82 BAM in 2016³. Quite naturally, via enterprise profit declining, the figure which is given back to the Government by the enterprise via taxes, decreases too. In 2013, BH Telecom disbursed 13.3 million BAM via income tax, in order for that figure to amount to 9.7 million in 2015. Even on the occasion of selling, the question is whether a purchaser for a block of BH Telecom stocks could be found. It must be emphasized here that the stock’s sales value can significantly be distinguished from its book value, as was the case with the Sarajevo Tobacco Factory.

²Annual Business Report for 2013, <https://www.bhtelecom.ba/6808.html>; Annual Business Report for 2014, <https://www.bhtelecom.ba/6806.html>; Annual Business Report for 2015, <https://www.bhtelecom.ba/7183.html>; Challenges of Privatizing FBiH Telecom Operators, November 2014, p. 5, Center for Policy and Governance, last visited: October 2017, <http://www.cpu.org.ba/media/26372/lzazovi-privatizacije-telekom-operatera-u-FBiH.pdf>. Note: As the data for 2010, 2011, and 2012 are not available on the official BH Telecom website, these are taken from the analysis of Centre for Policy and Governance.

³ Issuer Profile, BH Telecom JSC Sarajevo, The Sarajevo Stock Exchange, last visited: October 2017, <http://www.sase.ba/v1/Tr%C5%BEi%C5%A1te/Emitenti/Profil-emitenta/symbol/BHTSR>.

The Government of FBiH's shares in Sarajevo Tobacco Factory were sold in September 2016. Namely, 511,478 of stocks were sold at a price of 83.50 BAM per stock, while the book value per stock amounted to 174.5 BAM. Apart from that, other illogicalities were noticed too. It is unknown who did the value assessment, and the purchasing of stocks was not widely attainable exactly because of the amount of money necessary for the purchasing of a block of stocks. All of that could represent an obstacle also on the occasion of possible stocks exchange for BH Telecom.

The Citizens' Gain

The abovementioned data, however, is not necessarily of interest to the final consumer: the user of BH Telecom services, i.e. a citizen of Bosnia and Herzegovina. Rather, what interests average consumer are the service costs and quality. If the product is of an affordable price, with its quality ensured as well, whether the service comes from a public or private telecom operator is of less importance to the consumer. The dismantling of monopoly, as well as market liberalization (i.e. bigger offer to consumers) should lead to the advancement of service and price reductions.

Comparing the BH Telecom quality and service prices with those of other operators in the BiH market which are not in public ownership of BiH, we can verify the exactitude of this presumption. The most inexpensive BH Telecom package which includes cable television with 140 television and 30 radio channels, a landline phone, and internet with 10+/1 Mbps of speed and 200 MB of mailbox space, amounts to 49 BAM. On the other hand, the most inexpensive packages from other telecommunications operators which are not part of the BiH public ownership, and which do business within its territory, by way of illustration, amount to 42.9 BAM for cable television with 161 television and 75 radio channels, landline telephony, internet with 40/4 Mb/s of speed and 500 MB of mailbox space, and to 38.25 BAM for cable television with 188 TV channels, fixed telephony, and internet with 5/0.5 Mbps of speed (*Table 1*). The given data implies that service prices and volume in FBiH are more favorable among the competitors.

TELECOM OPERATOR	BH TELECOM	COMPETITOR 1	COMPETITOR 2
Number of cable television channels	140 TV and 30 radio	161 TV and 75 radio	188 TV
Landline telephony (free calls included)	YES (unlimited)	YES (unlimited)	YES (300 minutes)
Internet speed (Mb/s)	10+/1	40/4	5/0.5
Mailbox (in MB)	200	500	/
Price	49 BAM	42.9	38.25

Table1: Comparison of service packages between BH Telecom and a part of market competitor

According to the Communications Regulatory Agency (RAK) data from June 2007, BH Telecom occupies 41.08% in market shares in landline telephony in the first quarter of 2017, Mtel JSC Banja Luka (m:tel) occupies 32.74%, Hrvatske telekomunikacije JSC Mostar (HT Eronet) 12.63%, while “new operators” occupy 13.54%. In the first quarter of 2014, BH Telecom had occupied 46.63%, HT Eronet 12.81%, and m:tel 34.78%.

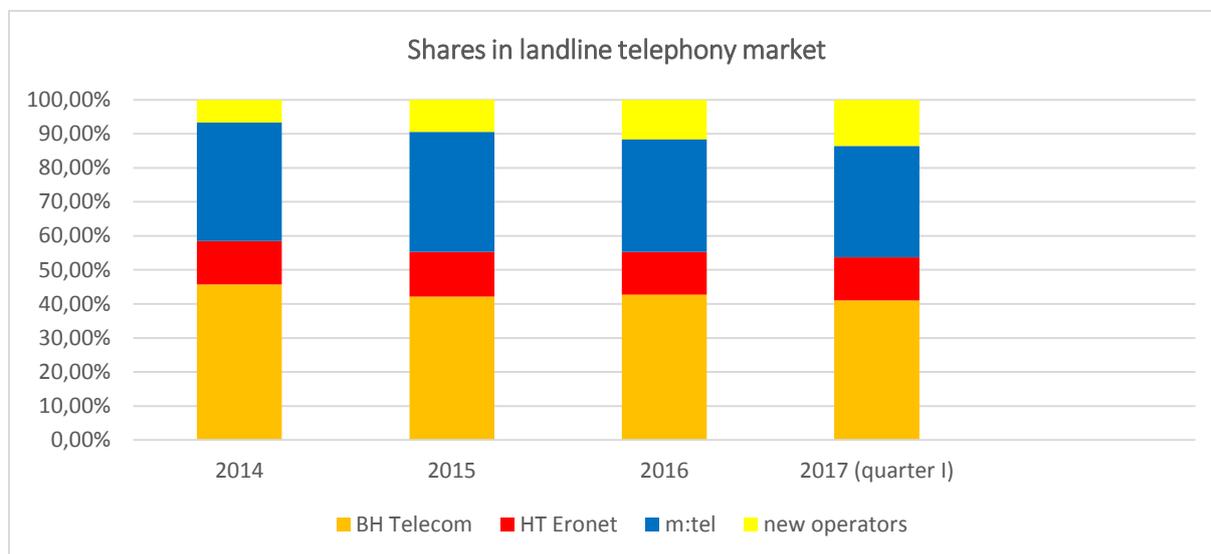


Chart 2: Overview of shares of telecommunications operators in landline telephony market

Hence, differences in market shares of the three largest telecom operators in BiH throughout the past three years are not the same, yet lack grander deviation. On the other hand, from the first quarter of 2014 until the first quarter of 2017, and in spite of obstacles upon the market, new operators have increased their market share from 5.79% to 13.54%. When it comes to mobile telephony, in the first quarter of 2017, BH Telecom occupies 47.31%, m:tel 38.53%, HT Eronet 14.09%, and new operators occupy 0.18% of market shares. In the first quarter of 2014, BH Telecom had occupied 44.87% of the market, with HT Eronet holding 12.55%, and m:tel 42.32% of market shares. In 2014, new operators had a market share of 0.27%. However, it is necessary to stress that this figure was then divided between total of two operators, while today five new operators are active.

According to the RAK⁴ analysis, BH Telecom, m:tel and HT Eronet represent operators with a significant market strength within the market of call termination in its own mobile phone network. On the other hand, while entering the market, new operators come across those obstacles across which the leading operators or those active for a longer period of time did not. Call termination is separate for BH Telecom, the HT Eronet, and m:tel networks and it represent separate relevant markets under the exclusive control of those operators. It is concluded in the analysis of RAK⁵ that there is no possibility for a greater share of new operators onto those markets.

⁴Quarterly Comparative Electronic Communications Market Data 1/1/17 – 31/3/17 [Kvartalni uporedni podaci tržišta elektronskih komunikacija 01.01.2017. – 31.03.2017.], p. 2 and 4, Communications Regulatory Agency BH, last visited: October 2017, <http://www.rak.ba/bos/index.php?uid=1374157315>.

⁵Analysis of market calls which terminate in individual mobile networks – wholesale level [Analiza tržišta poziva koji završavaju u individualnim mobilnim mrežama - veleprodajni nivo], November 2016, Sarajevo, p. 35, Communications Regulatory Agency BH, Telecommunications Section, last visited: October 2017, <http://www.rak.ba/bos/index.php?uid=1369662926>.

Further, new operators have managed to increase their shares, which favors the market and brings about an increase in quality and a decrease in service prices. It is clear from the afore-stated that, in the case of greater market liberalization, that trend would logically mount. Also, technological advancement, i.e. the development of internet applications which offer free calls, undoubtedly cuts down service prices of traditional operators.

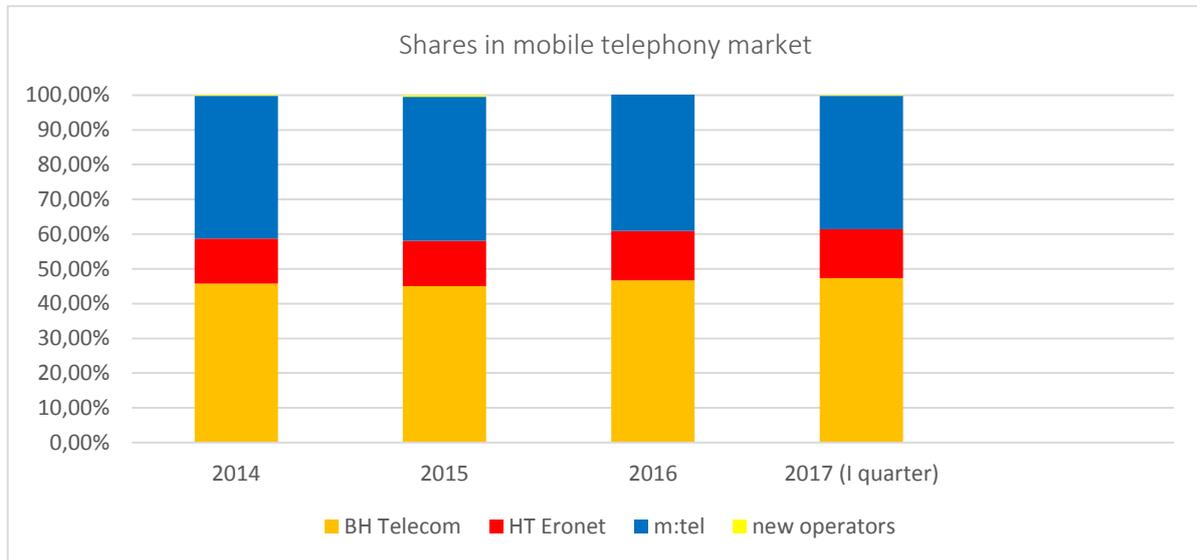


Chart 3: Overview of shares of telecommunications operators in mobile telephony market

Market Privatization and Liberalization – Illustrations from the Region

As can be concluded from the above-mentioned, even though Bosnia and Herzegovina *de jure* has a liberal telecommunications market where private operators do business too, in general, the market is an oligopoly in which three largest operators – BH Telecom, HT Eronet, and m:tel – have a monopoly over certain parts of the state. It is conditioned by the application of infrastructure, i.e. by the availability in a wider area. Therefore, even the liberalization of telecommunications market is essential in order to reach the ultimate goal – quality and available services. When it comes to regional countries, they mainly conducted the privatization process of telecommunications operators but also show how privatization **cannot** be successful without market liberalization.

Croatia

Hrvatski Telekom was established in 1999 by dividing "Croatian Post and Telecommunications" into two companies. The Republic of Croatia sold 35% of HT stocks to DTAG Company the same year, and in 2001, this company bought the additional 16% of stocks. However, even though the private network in Croatia, VipNet received the second license already in 1999, the duopoly in Croatia has been ruling for far too long. In 2004, the Croatian Telecommunications Agency (HAT) conferred the mobile telephony concession to Tele2, which started operating in November 2005. The work of Tele2 led to a large drop in prices in mobile telecommunications, which, up until 2014, according to the Croatian Telecommunications Agency, cumulatively saved the citizens of Croatia two billion Euros.

Montenegro

Crnogorski Telekom is under the ownership of Hrvatski Telekom, which has purchased 76.5% of stocks from M-Tele, i.e. Magyar Telekom. As the Crnogorski Telekom does not yet have a true competitor, and currently holds a monopoly in the domain of the fixed network, that has led to low quality service, i.e.

reduced speeds within the offers of internet packages, and large prepayment prices for landline telephony and internet. On the other hand, competitiveness in the domain of mobile telecommunications (Telenor, m:tel), has resulted in affordable prices of calls via mobile phones, SMS messaging, and mobile internet with decent surfing speeds.

Serbia

Even today, the Telekom Srbija is predominantly under state ownership. Following a restructuring of Mobtel into Mobi in 2005, the Government of Serbia has 70% of ownership. In 2006, Mobi 63 was sold at an international public auction for 1.513 billion of Euros to the Norwegian Telenor, and not long after that, the government in Serbia sold the third license for mobile operators to the Austrian Mobilcom (VIP) for 320 million Euros. Thus, the market was liberalized, and in the field of mobile communication, citizens have accessible services, while the almost complete monopoly over fixed network is held solely by the Telekom Srbija, as a state company, and in that way, it determines the prices and quality of service.

Technology Development

One of the problems the scarcity of liberalized market carries is certainly the delayed development of new technologies in relation to global, but also regional trends. While only the 3G network is available in Bosnia and Herzegovina, the 4G network was introduced in Serbia in August 2015, by Vip Mobile, a private operator. In September 2017, this network was accessible to 95% of the population of the Republic of Serbia. In Croatia, the 4G network is offered by three operators – Tele2, Vipnet, and the Hrvatski telekom. Thereby, Hrvatski telekom has the largest coverage amounting to 92% of population. According to OpenSignal data, Croatia is in place number 43 in relation to the availability of 4G network, Albania in 46, Serbia in 47, while BiH is not on the list of the first 75 countries⁶.



Image 1: 4G network availability⁷

⁶The State of LTE (November 2016), Open signal, last visited: October 2017.

<https://opensignal.com/reports/2016/11/state-of-lte>.

⁷Coverage maps you can trust, Sarajevo BA, Open signal, last visited: October 2017.

<https://opensignal.com/?z=6&minLat=38.9&maxLat=48.4&minLng=7.0&maxLng=29.8&s=all&t=4>.



Due diligence

Using the figures available at the time, whose trend mainly continued also in the following two years, and applying the mentioned examples from the region, it was concluded in the research of the Centre for Policy and Governance from November 2014, that the introduction of private equity in BH Telecom would advance the company's business, improve effectiveness and productivity, and rationalize expenditures⁸. According to the research, the above would lead to an increase in technological competitiveness. Of course, in order to bring a final conclusion to the best solution for the issue of BH Telecom's future, a more comprehensive analysis would have been necessary. Exactly such an analysis is what the Government of FBiH pledged for within the loan arrangement with the International Monetary Fund (IMF), agreed upon in September 2016.

Namely, according to the Letter of Intent to the IMF from July 2016, the Government of FBiH should have had, in consultation with the World Bank, finished "the financial and operative value assessment" of BH Telecom, i.e. the so-called due diligence. "Value assessment", however, has not been made until the mentioned deadline, and today it represents one of seven preconditions for receiving the second credit tranche from the Fund.

Based upon data presented earlier, it can, however, be concluded that there remains a possibility for such an analysis to show the need for changes in the business conduct of BH Telecom. The Prime Minister of FBiH, Fikret Odžvić, was explicit that during his mandate there would not be any sale of BH Telecom, and how the company should not be sold, but restructured. **No matter the destiny of the IMF arrangement, for the final finding of the solution when it comes to BH Telecom, it is necessary to conduct the due diligence analysis and to agree upon a plan of future work of BH Telecom as soon as possible.**

Money Expenditure from Eventual Sale

Except for the issue of the condition of BH Telecom and the telecommunications market in case of BH Telecom sale, a question that arises is that of spending the money from the sale. If low level of responsibility and transparency of work of governments in BiH is taken into consideration, a concern that the money will be spent without a concrete plan is completely justified. The sale of BH Telecom nowadays would probably not assure a high enough amount in order to fully resolve infrastructural and energetics projects. Also, money for the continuation of highway construction is trying to be raised via excise increase on petroleum products. Nevertheless, the resources could be invested in solving other problems which hinder the development of economy of BiH, such as exorbitant contributions and employer hindering. Therefore, transparency and a clearly designated sale plan are of key importance and it is necessary to strive towards determining the expenditure of earned money before the possible sale of (parts of) BH Telecom stocks.

⁸*Challenges of Telecom Operators Privatization*, November 2014, p. 5, Centre for Policy and Governance, last visited: October 2017. <http://www.cpu.org.ba/media/26372/lzazovi-privatizacije-telekom-operatera-u-FBiH.pdf>.



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