Investor confidence and economic growth

Some speculative thoughts from Supercomm 2002

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Speakers at Supercomm 2002 forecast a bright future for telecommunications as a key basic driver towards industrial and socio-economic development. Yet investors seem unable to move forward with confidence. If the open market doesn't fund telecom developments who will?

Strange times persist, in this telecommunications business. I am hard pressed to find a comparable situation in other industries, or other eras. There is strong demand for services, major new markets are largely untapped, exciting new technologies are available to support innovative revenue generating services – yet investor confidence is non-existent.

Much has been written about the irrational exuberance that created the bubble, and the reality check that burst it. We should all be well-versed in the factors that contributed to the debacle, and well able to understand what to really look for to find viable opportunities. Yet investors seem unable to move forward with confidence. Every small bump in performance results in a disproportionate slashing of stock values.

The message delivered by the captains of the telecommunications industry at Supercomm 2002 last week in Atlanta, Georgia, USA, was clearly focused on a bright future for the foundation of industrial and socio-economic development: telecommunications. Each noted the need to get back to stable relationships with the investment community to be able to achieve the vision:

- John Chambers described how new technologies, new applications and new business processes can generate significant productivity gains – in all industries, for all countries. He noted that great things come to those who have a plan and stick to it - Cisco has achieved internal productivity gains of 3 to 5% annually, but achieving those gains came after some 18 to 24 months of investments in the right tools and process changes.
- Lawrence Babbio clearly linked Verizon's plans for a strong future with a willingness to buy new technologies to get there – but only within a supportive regulatory environment.
- Bill Esrey offered perhaps the most direct attack on those who seem surprised that only the strong, well-funded, and tenacious will survive in the capital-intensive world of telecommunications. He laid out a compelling story about Sprint's unique ability to leverage its national fiber network and leading edge wireless network to drive new services and new revenues in the near term.
- A panel of senior executives from Cisco, Siemens, Tekelec and Microsoft tackled the issue of service provider profitability, demonstrating that everyone "gets it" now - customer and revenue growth must include a planned path to profitability.

In the face of this well-supported optimism, with all facts pointing toward continued global growth in consumer, corporate and government demand for more telecommunications services, we note that attendance at SuperCom was down 30% over last year. We talked with many vendors who were worried about their ability to survive long enough to participate in the up-turn. The service providers we spoke with are still leery about their ability to realize profits from new technologies and applications. And most importantly, many of the investors we met with are not at all confident about investing in telecommunications any time soon.

So, here we are: major requirement for infrastructure improvement to drive economic growth; major reluctance by the capital markets to invest in the future. What are we to make of this? In fact, investors are probably acting quite rationally from their perspective. What investors seem to be telling us is this:

- The returns on investment in telecommunications infrastructure are too small, too long-term and too uncertain to interest investors, who after all base decisions on what is financially worthwhile for them, not what is good for the economy in general.
- Even where short-term profit opportunities might be available, investors do not have much confidence in their ability to differentiate between tomorrow's winners and losers.

Now if this is true, it signals a return to the sort of economic environment for telecommunications that existed in most of the countries in the world for most of the twentieth century – telecommunications growth funded by governments and communities to provide an amenity for the citizens. We should recall that telecommunications came to many places in the US not as the result of entrepreneurial investment, but because people joined together in rural cooperatives and municipalities to obtain the benefits of phone service. In many European countries, telecom companies were taken into state ownership not for purely ideological reasons but because the private sector didn't do a great job of providing universal service at affordable prices. In the early days, the volumes were simply too small. The return of state telecom companies to the private sector, and the introduction of competitive carriers in many developed countries around the world, only became economically possible in the closing decades of the twentieth century once very large volumes of POTS customers were already in service.

Is this scenario going to be repeated for the next generation of telecommunications services? We have seen all of the governments of the G8 (with the exception of the USA) take firm positions on encouraging, supporting or sponsoring broadband infrastructure deployment. We have seen the results of direct government investment in broadband rollout in South Korea, where significant industrial growth rapidly followed to take advantage of robust infrastructure. Other governments have taken note. We have all been made clearly aware of the impact that the "Digital Divide" has on education, industry and social expansion. In the USA some municipalities have decided not to wait for private sector broadband deployment and they are doing it themselves.

It is normal now, in the developed world to bemoan the heavy hand of bureaucratic government involvement in almost anything. There is good reason for this, as government-run enterprises do not have an unblemished track record of excellence. (On the other hand examples of management ineptitude in private sector telecommunications have not been totally absent in recent years.)

Free market enthusiasts are faced with a dilemma right now. If bigger returns are available elsewhere, no one can force investors to put their money into telecommunications. But if the short-term drivers that determine private investment strategies fail to deliver the investment capital the telecommunications industry really needs, then they shouldn't be surprised if the public sector steps in.

Now, perhaps all this conjecture is completely misplaced. We are only, after all, taking the current attitudes of investors to their logical conclusion, and things can change.

What we seem to need, however is a dramatic about-face:

- Investors being prepared to accept and support service provider business plans that offer realistic returns, not fast bucks, and being happy to wait many years for modest returns on their investments in most cases.
- Investors being much better informed about the sort of telecom operations, and their underlying technology and software vendors, that are likely to grow, over time, into solid money-earning businesses.

What are the odds?

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