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Colombia to Privatize State Telephone Company

by LADB Staff

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The government of Colombian President Alvaro Uribe is seeking to sell a majority stake in the state-owned Telecomunicaciones de Colombia (Telecom) to private investors. Uribe claims that the move is necessary to make the company more competitive, and he had set up plans to sell a majority stake of Telecom to Telefonos de Mexico (Telmex), owned by Mexican billionaire Carlos Slim. But the objections of Colombia's chief auditor led to the announcement of an open auction for the company, potentially scuttling the US$350 million sale to Telmex that had been on the table.

Deal with Carlos Slim's Telmex hits snags

Telecom is Colombia's largest fixed-line operator with 3 million installed lines and 2,000 employees. Last year it posted a profit of US$407 million, the first profit the company has seen in years, which follows on the heels of a 2003 restructuring.

In July, President Uribe announced that the government would to look for an international partner to invest in Telecom, claiming that the company could not remain competitive without such help, especially with growing competition from wireless technologies. Uribe also said such a move could help the company meet its pension liabilities.

In mid-August, Telmex announced that it sought to purchase a majority stake in Telecom, planning to take over operations or administration, or a combination of both. The announced purchase price was US$350 million, which would get Telmex 51% ownership in Telecom while the Colombian government would retain 49% ownership. Telmex said on Aug. 26 it had agreed to pay US$260 million in cash and another US$90 million in stock in its local unit Telmex Colombia plus assume as much as US$3 billion of debt over 15 years for control of the Colombian company.

On Aug. 21, a few days after the Colombian government made a preliminary agreement with Telmex, it announced that Telecom would enter the mobile-phone market. "The presence of [Telecom] in the mobile market will generate additional revenue and contribute to its financial sustainability in the medium and long term," the National Planning Department said in a news release. But a week later, Colombian auditor general Antonio Hernandez urged the Telecom board to reject the Telmex offer.

In a letter, Hernandez said the agreement between Telmex and Telecom lacked transparency and that, without a competitive auction, Telmex would get too generous a deal. "The transaction, as it has been presented, poses a grave risk to the public good," Hernandez wrote in the letter, which was made public on Aug. 30. Hernandez said the deal undervalued Telecom.

Telmex should invest at least US$500 million in the company, the auditor general said. Hernandez's recommendation, which echoed similar statements made by lawmakers and candidates for next
year's presidential election, was nonbinding, and Slim had already met with Uribe to celebrate the
deal. Still, Communications Minister Martha Pinto said on Aug. 30 that the government would nix
the deal if the criticism by Hernandez and others was deemed valid. "If the observations are seen by
the government to be valid, and if the transaction violated the Constitution or the laws of Colombia,
we will not go through with it," Pinto said.

Two other public Colombian telephone companies, Empresa de Telecomunicaciones de Bogota
(ETB) and Empresas Publicas de Medellin (EPM), said on Aug. 21 that they and an unidentified
foreign partner wanted to challenge Telmex for the right to partner with Telecom. ETB and EPM
each own 50% in mobile operator Colombia Movil, which competes with Movistar, the local unit of
Spain's Telefonica Moviles, and Comcel, owned by Telmex affiliate America Movil.

**Auction opens sale for bid**

In late September, Colombia cancelled the agreement to sell Telecom to Slim and announced plans
to hold an auction so other potential buyers could bid for the carrier. "We will always seek the best
offer," Telecom president Alfonso Gomez said in a Sept. 28 interview, adding that he hoped Slim
would take part in the bidding.

Slim spokespersons left it open whether he would bid or would abandon purchase plans
for Telecom. Telmex would now reconsider its options, said Arturo Elias Ayub, director for
communications and strategic alliances at Telmex, in a conference call from Mexico City. Telecom
agreed to follow Hernandez's suggestions for a third-party valuation of the company and for
making the deal transparent.

Just a week prior to the announcement of the auction, the Colombian Tribunal de Cuentas delivered
a nonbinding memorandum to Telecom's board that said the agreement with Telmex violated
constitutional principles such as equality, impartiality, public notification, and free competition.
An auction may lead to another round in Slim's battle with Telefonica SA, the largest telephone
company in Spain and second largest in Latin America, for domination of the region's telephone
markets.

Telefonica chairman Cesar Alierta had told Uribe his company wanted to bid for Telecom after the
government had accepted Slim's Aug. 26 offer. "They may have to pay a little more for Colombia
Telecom," said Xavier Escala, who covers telecommunications in Latin America for Banif Securities.
The purchase of Colombia Telecom would have made Slim the biggest investor in Colombia's
telecommunications business. America Movil, Slim's wireless carrier, already is the nation's biggest
mobile-phone company, with 9.2 million subscribers as of June 30.

Bogota-owned phone company also seeks to sell out ETB, the main telephone company in
Colombia's capital, is making moves to court Telefonica. It plans to cut 1,000 employees to reduce
costs and make the business more attractive to foreign partners such as Telefonica. The job
reduction amounting to 25% of the workforce will be completed by the end of next year and is part
of a 90 billion peso (US$40 million) cost-cutting plan to help the Bogota-based company become
more efficient, ETB CEO Rafael Orduz said.
"ETB has a very aggressive strategy to reduce costs," Orduz said in an interview at the company's headquarters. The company, 87% owned by the city of Bogota, is reducing staff as it holds talks with Madrid-based Telefonica for a possible venture or sale. ETB, with 1.9 million fixed telephone lines, also is in merger talks with EPM, Orduz said.

On Sept. 2, Telefonica chairman Cesar Alierta met Orduz, officials from EPM, and the mayors of Bogota and Medellin. "Alierta was very frank and said they wanted to participate in the fight for Telecom but, if that did not work out, they wanted to form part of the capital structure of EPM and ETB," said Orduz, who added that he speaks daily with Telefonica officials. "It's preferable they don't have control, but we are looking at possibilities, and one is to have other strategic partnerships," Orduz said. "All I'm saying is that the only possibilities are not only the Mexicans or only the Spanish," he said.

**Analysts concerned about monopoly**

While market analysts appeared to approve of the telecommunications privatization, many interviewed by Bogota daily El Tiempo repeated the concern that Telmex not take on monopoly or duopoly status in the Colombian telephone market. Telmex-Telecom would have represented half of a potential duopoly, with ETB and EPM joined together in a potential partnership with Telefonica constituting the other half. Telmex has not increased its rates in Mexico since March 2001, but, in the first years after privatization, there were many user complaints about high costs, bad service, and unjustified charges. After the 1990 privatization of Telmex, there were periodic increases in rates.

During the 1994 economic crisis, the federal government called on the company not to hike rates in order to halt inflation. That brought accelerated increases in 1996 and 1997, especially in local phone rates. Long distance rates went down as a result of competition. Regionally, Telmex has announced its intentions to expand its presence in Chile, where it competes fiercely with Telefonica. One of its main focuses there, according to general director Jaime Chico Pardo, will be wireless-technology development.

This September, the company celebrated 15.9% growth after its first year operating in Chile with US$60 million in revenues. Telmex maintains a virtual monopoly on fixed lines in Mexico and has operations in six countries of Latin America. Last year, Telmex acquired Brazilian long-distance operator Embratel and Chilean long-distance operator Chilesat. It also bought AT&T Latin America, which provided data services to mostly corporate customers in Argentina, Brazil, Chile, Colombia, and Peru. Slim has spent at least US$4.2 billion in the past 2 1/2 years to build a telecommunications network from Mexico to Argentina. Competitor Telefonica has spent more than 42 billion euros (US $50 billion) on acquisitions since 1990, mostly in Latin America.

On Sept. 2, the company announced plans to invest US$300 million this year in its mobile phone unit in Colombia.

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