Stuck in Time

After the Internet bubble burst, everyone expected a shakeout in the telecom industry. They're still waiting.

BY KAREN LOWRY MILLER

SOMETHING REALLY STRANGE has happened since the last crash. Nothing. When the dot-coms imploded in March 2000, the money fled to telecom stocks — real companies with real business plans that would lead the real Internet Revolution. Carriers old and new borrowed money and ordered equipment to build the New Economy. Then, when the telecom story turned out to be a bubble, too, operators were left with crushing debt and more hardware than they knew what to do with. Investment dropped nearly two thirds in two years. Everyone expected the next step to be a massive shakeout ... but nearly two years later, it hasn't come. "The industry is stuck in the spring of 2001," says Tero Kuittinen, adviser to Opstock Investment Bank of Helsinki, who considers the state of affairs "incomprehensible."

There are reasons for the paralysis, but none quite adds up to a rational explanation. The sense of an industry in suspended animation is perhaps most surreal in the mobile business. In the United States, six operators run nationwide, proprietary networks (on three different technologies). Each is tied to different handset selections, as if ABC and NBC required different televisions. It's as close as it gets to the mid-19th-century railway madness, when rivals attempted to build separate railway networks in England and America. In Europe, still largely a collection of national markets, there are five mobile competitors in the Netherlands alone. Moreover, conventional wisdom says the world does not need seven equipment vendors to supply the wireless networks. They are all global household names, from Motorola to Nokia and Lucent, and at least three of them probably should not be in the business. Meanwhile, dozens of new handset makers keep plunging in, even as Nokia's global share climbs toward 40 percent and experts note that it takes at least a 5 percent share to be cost effective.

One source for the time warp is that bane of the 1990s, the CEO ego. The people running telecom companies started with targets of 20 percent annual growth, a mind-set that's hard to change. "Only gung-ho growth barracudas made it to the top," says Kuittinen. "They can't be seen as the division killers." They also can't accept that these low stock prices are here to stay. The feeling lingers that, once a war in Iraq is behind us and the economy picks up, growth will surge and it'll be back to business as usual. One telecom consultant recently sat down with a U.S. wireless client who wanted to make an offer for another mobile operator, but the target was deeply offended at the fire-sale price. "No one wants to be the fool who cut a deal and sold at the all-time bottom of the market," he says.

This attitude is unfortunately bolstered by a growing sense that the worst of the telecom debacle may finally be over. The Dow Jones World Technology Index hit a post-crash low in October 2002 and has been bouncing along there ever since. Paul Sagawa, the Sanford C. Bernstein analyst who accurately forecast the end of the bubble back when Cisco shares were still skyrocketing, now says, "We're at the bottom. The question is when we start moving up."

Per Lindberg of Dresdner Kleinwort Wasserstein in London predicts an 18 percent rise in spending on wireless equipment this year, even as fixed line spending slips a further 15 percent. The dealmaking

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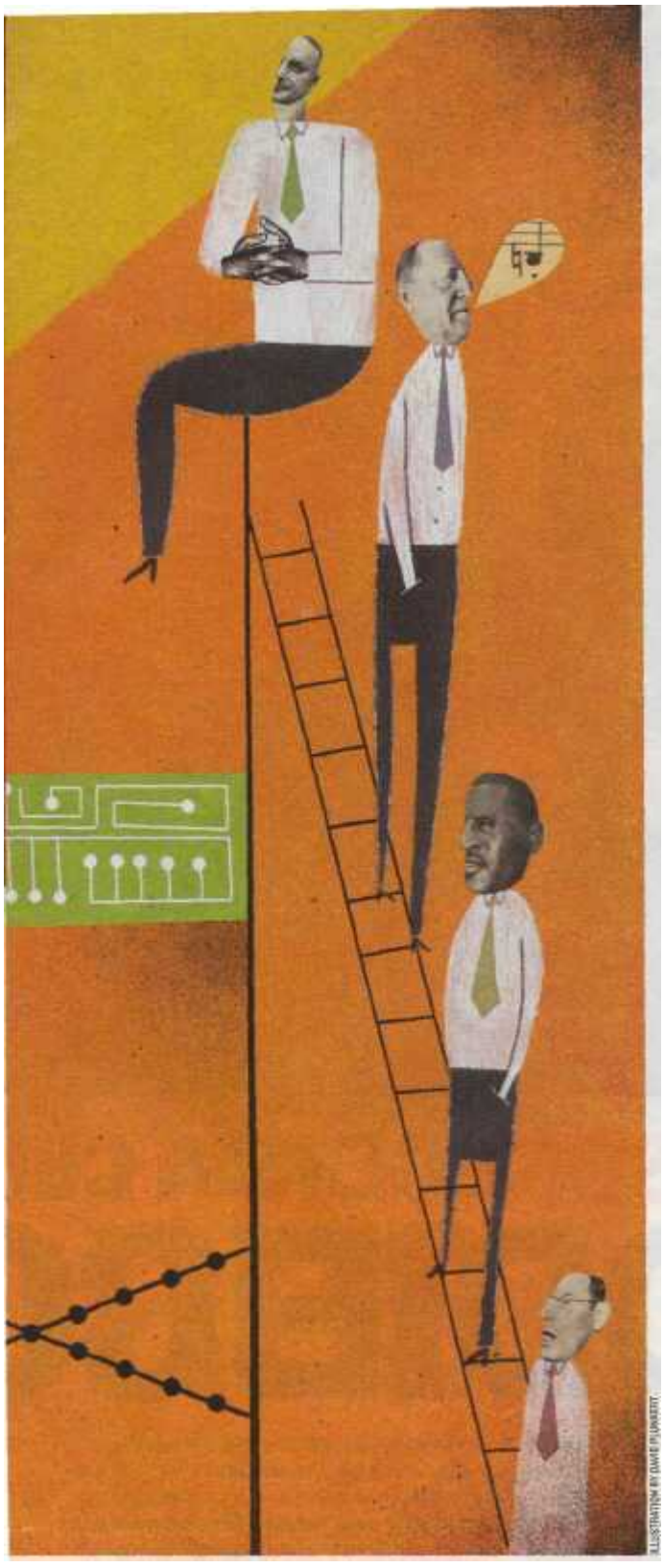

will likely begin when prices rise high enough, but how high is high enough? "Everyone is waiting for the other guy to make a move," says Kuittinen.

Caution still lingers from the latest bout with merger mania, finally destroyed with the demise of serial acquirer WorldCom last year. Technology deals in particular have a bad reputation going back to the 1960s. Look at the grief Hewlett Packard's Carly Fiorina is still getting over the internal war she won to merge with Compaq. Closer to home, telecom mergers have a dismal track record. Sony and Ericsson joined in April 2001 to make mobile phones, but their combined market share has fallen from 8 percent to 5 percent. The attempt by Alcatel and Lucent to merge in May 2001 fell apart amid rancor over control.

Industry experts compare the stasis to the prisoner's dilemma: many companies are thinking about deals that would be good for the telecom industry as a whole, but to sacrifice first could give rivals an advantage. Do Alcatel and Philips really need to be making phones? Shouldn't Motorola just spin ofFits networks and focus on phones and chips? Will Lucent collapse, leaving the rest to pick up the pieces? As for the operators, Verizon and ATT Wireless are expected to survive in the United States, if only because they are the biggest. But maybe Cingular should just merge with T-Mobile? Vodafone is on its way to becoming a pan-European operator, but most of the others should just stay home, as there is room for only three big players, says analyst Jason Chapman at Gartner research. And while deal-starved bankers and consultants run around with proposals, they often have different views of the same company: Ericsson posted losses for nine straight quarters, but it boasts some of the best systems technology in the world. No one can agree on who deserves to survive.

Speak of the madness of the telecom world, and people generally think of the billions spent on thousands of miles of fiber-optic cable that now lie unused. The mobile industry has the opposite problem. It has signed up so many new users that it is getting overloaded, with customers reporting dropped calls and busy networks. It needs money to invest, but is boxed in by the broader industry travails. Many are owned by telephone companies like Bell South and Deutsche Telekom, which are heavily in debt and can't get a hearing from bankers themselves. Debt levels are so high that issuing bonds is out of the question, and credit-rating agencies have all telcos on a tight leash. Even independent mobile players would be laughed out of half-empty Wall Street suites for trying to raise money on the stock market at the moment.

No one is looking to find the Next Big Thing by buying out rivals anymore, either. The hyperfaith in technology is gone. European operators who borrowed billions to win licenses for third-generation mobile networks probably won't break even on these investments until 2014, estimates Michelle de Lussanet of Forrester Research. Embarrassed carriers are now focusing on how to make money with the technology they already have, such as the new camera phones that send photos and multimedia messages. Says Ben Wood, an analyst for Gartner: "A healthy dose of reality hit our industry like a bolt of lightning."

The longer the delay, the harder and more costly it will become to get the mobile industry moving again. If an operator can't invest to improve the network, the value of the company will deteriorate. With too many operators in the business, price wars have broken out, and customers are coming to expect deals like free minutes on the weekend. The longer the equipment makers wait to link up, the farther apart their labs will be on technology, and therefore the more expensive they will be to weave together. "It takes a while to run down a multibillion-dollar company," says Bill Frezza, wireless expert with Adams Capital Management in Boston. "The industry has to get rid of the incompetent and the unlucky, and then start over."

No CEO, even post-Enron, can be expected to act for the common good. That's not how business works. But if someone does break the telecom deadlock, the result may be uncommonly good. •

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Fonte: NEWS Week, v 141, n. 8, p. 32-33, 24 fev. 2003.