

1997: the dawn of economic reality in communications

Mergers, acquisitions, lawsuits. Last year was simply another typical 12 months in the life of Australia's communications players

In November 1997, the federal government's "Get Rich Quick" scheme (a.k.a. Telstra's public offering) took the ASX by surprise. There was a mad last minute dash for applications to invest in the one-third of Telstra on offer and, despite the worldwide market slide in October, 1.8 million individual investors bought Telstra shares at \$1.95 each. They were subsequently rewarded several times over as the stock rose to \$3.38 (February 4, 1998), a 73 per cent increase in the three months since listing. And the public investors weren't the only ones with smiles on their faces: those involved in the issue made \$300 million in fees from the public offer and share trading.

The question now is whether Telstra shares can continue to rise in value. As the *Sydney Morning Herald* asked in a year-end 1997 business review: "Telstra's share buying spree was led by fund managers needing stock for its inclusion into the All Ordinaries index in January 1998. Many brokers say Telstra is overvalued. Does anyone care?"

But the Telstra float was only one of several significant milestones in telecommunications and media during 1997. July 1 marked the start of industry-wide deregulation, an event eagerly awaited by new players such as regional cable/telephony company Northgate Communications in Ballarat, Victoria, AAPT, and overseas giants BT and WorldCom.

"Deregulation brought a lot of players into the market as resellers," says Peter Cox, principal of media consultants Peter J Cox & Associates. "We have top international companies taking their first steps in Australia, reselling existing capacity, interconnecting onto Telstra, buying wholesale long distance traffic. Over the next few years they need to build infrastructure because there is no margin for resellers alone. They have fixed costs in terms of the capacity they buy and all they can do is cut prices in response to the competition.

"Telstra has fought a great rearguard action, using its huge capital base to withstand the competition but to make serious future headway we now need line number portability, access dialling and far more competitive prices on products."

The pay TV operators, straddling common ground between telephony and television, were left standing. While subscriptions rose steadily – in December 1997 some 800,000 homes or 13 per cent of the total viewing audience paid to receive Foxtel, Optus, Australis, Austar, East Coast TV or another regional service – the infighting became an artform. Another year of litigation and merger proposals and counter proposals saw accumulated industry losses rise to \$3.1 billion since start-up four years ago.

"For subscription television, 1997 was the year of reality it had to have. With the overbuild, high program costs and huge subsidising of set-tops, the business was obviously totally unviable," says Cox.

"The lust and hyperbole of the operators crumbled as they came to understand the economic realities of the market. No one knows why they didn't foresee this, why they didn't build correct business models, why they didn't understand that the technical route they undertook was incorrect and why they insisted on ploughing millions of dollars into it."

Cox says the major disappointments of the year included Australis' inability to push its subscriber base beyond 100,000, Optus' failure to build successful local telephony, and the lack of a competitive local loop telephone system. "The problem with being a pioneer in leading edge technology, as the Americans would say, is that a frontiersman always ends up with arrows in his back," he says.

On a separate front, the pay TV operators took on the commercial free-to-air networks in an attempt to secure for themselves some leverage in the forthcoming digitalisation of Australian broadcasting.

Digital broadcasting – both for television and radio – means that multiple services can be transmitted simultaneously on a single channel. With regards to television, the Australian Broadcasting Authority (ABA) specialist group recommended in February 1997 that the free-to-air networks each be given access to one full digital channel for each analog channel they currently own. The pay TV operators were in uproar.

Television is currently broadcast on an analog network which is considered inferior to digital. Digital permits the broadcasting of more channels on one

bandwidth and an improved signal. The pay TV industry fears that having paid millions of dollars for satellite licences and to build cable infrastructure, the free-to-air networks (including the ABC and SBS if they are given the funds to convert) will be given free access to additional channels which they can then use for subscription TV or pay-per-view services. The pay TV lobby argues that the free-to-air operators should only be given the capacity which replicates their existing analog channels, and that extra digital spectrum should be auctioned to new players.

Digital television has the capacity to offer a single picture of enhanced quality, otherwise known as high-definition television (HDTV), or the same channel space can be turned into up to five channels of conventional quality. So the government has a choice. It can use the additional capacity for converting existing services to HDTV or it can hand out further services to all broadcasters, free and subscription. But if HDTV proves to be a flash-in-the-pan, it will be difficult to justify giving the existing free-to-air networks additional spectrum for multichannel services.

Senator Alston has already indicated that he remains unmoved by the pay TV lobby, saying that digital television does not give free-to-air networks any advantage over pay television operators. Quoted in the *Australian Financial Review* on November 6, 1997, he said: "The way that pay television is going, particularly satellite, we may be looking at 100 to 150 channels in the near future, whereas with multichannelling, the most we're likely to get is four to five channels.

"The only thing we want to make sure doesn't happen is that the free-to-air transmorphs into pay TV and we've indicated to the Federation of Australian Commercial Television Stations (FACTS) that we don't want that to happen," he said.

FACTS, which represents Seven, Nine and 10 networks and regional

broadcasters, wants each broadcaster to be allocated 7Mhz of spectrum to permit HDTV. It wants a 15-year period of exclusivity for spectrum use and no extra charge above the \$180 million the industry pays in licence fees each year.

The government, which is expected to release its policy on digital technology for television and radio around March 1998, is understood to want the commercial television stations to agree to fund the unused sixth channel for community TV in each capital city in exchange for being given digital channels at no charge.

In other issues affecting television, of the three commercial free-to-air services, Network 10 had perhaps the most complicated 1997 with a major battle with the ABA looming over its ownership. CanWest Global Communications was found by the ABA in April 1997 to be in a position to exercise control over the broadcaster. The discovery stemmed from a series of transactions that took place between November 1996 and January 1997 involving both newly formed and existing companies controlled by CanWest.

The ABA assessed that CanWest had an overall company interest in 10 (derived from its voting interest) of 52.49 per cent. It found CanWest in breach of sections 57(1) and 57(3) of the Broadcasting Services Act. In short, a foreign owner must not exercise control of a commercial broadcasting licence or have interests in that licence in excess of 15 per cent (20 per cent aggregate for all foreign owners).

CanWest was given six months to fix the ownership oversight. It then appealed and asked for more time. Another six months was offered and a solution is now due by April 4, 1998.

Last year was also the year of reports. The first, Bob Mansfield's examination of the Australian Broadcasting Corporation's (ABC) internal intricacies, was released in January. The second, David Gonski's

report into the film industry, became public knowledge a month later.

Mansfield's document on the ABC was positive in tone and restrained in its recommendations. In short, it was cautious and conservative but supportive of the national public broadcaster, underpinning traditional programming values and dismissing the idea of advertising or sponsorship. A start was made to the recommendations that non-news and current affairs production be outsourced, property holdings rationalised and international broadcasting services Radio Australia and Australia Television International sold (Network Seven picked up ATVI in September for an undisclosed but rumoured sum of roughly \$10 million, including debts). Successful implementation of these and Mansfield's overall recommendations should allow the ABC to provide domestic broadcasting services within budget restraints and fund upcoming digitisation.

With respect to Gonski's report, there was palpable relief in the film industry that neither the findings nor the government response were quite as hard-hitting as was feared. The loss of the Australian Film Commission's (AFC) Special Production Fund and its "Distinctly Australian" initiatives were forgotten in the aftermath of the federal government's four-year commitment to the Film Finance Corporation (FFC) and other funding initiatives in November when Senator Richard Alston announced the establishment of a pilot "Film Licensed Investment Company" and the retention of the Division 10BA and 10B tax concessions.

Alston also retained Commonwealth ownership of Film Australia and extended the \$6.4 million National Interest Program until 2000/03. He accepted Gonski's recommendations to develop an international marketing strategy for the industry, explore outsourcing and remove the requirement of union consultation for

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