This paper addresses the current financial infirmities of the information technology and communications (ITC) sector. It analyzes the reasons for the deterioration of the capital markets. The contribution of regulation to this financial malaise is examined, and potential regulatory remedies are analyzed to support the renewal of financial support for the sector.

A huge investment boom took place in the industry after 1996 – $1.3 trillion. Between 1999-2001 alone, US telecom firms borrowed over $320 billion from banks. Credit was not difficult to obtain. But the revenues per investment dollar dropped – $5.08 in 1996; $2.84 by 2001 (Lehman Brothers). Return on equity for the US telecom industry declined from 13.8% in 1996 to 5.9% in 2001 (Merrill Lynch). Investments are expected to decline by an annual average rate of 14%.

The rising ITC valuations had prompted an investment binge. Since companies were valued at multiples of many times capital invested, the high valuations allowed them to invest funds in acquisitions and mergers, which led to a reaction by the incumbents to respond. An example was the mania of the mobile spectrum auctions, which overvalued the licenses and increased the cost structure. Competition in the industry was and is intense, and few, if any, achieved profitability. Moreover, the ITC companies borrowed heavily. This leverage magnifies shareholder value upside in the boom and magnifies the destruction of shareholder value in the bust.

While the paper covers the investment needs of the telecom industry, how financial sector got it wrong, and the governance of the industry, it focuses on regulation’s impact on telecommunications investment and capital structure. In particular, it addresses the linkages of the Federal Communications Commission’s competitive policy and investment incentives, the role of the spectrum auctions, and the role of asymmetrical regulation of the broadband space in contributing to the financial instability of the sector and the uncertainty of investors. Regulation clearly had a role in the current instability in the market, although its responsibility was not as great as other, systemic problems.

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