Risk management in the telecommunication industry. Case study AMC

Glediana Foto,* Elfrida Manoku,** Valentina Sinaj***

**PhD student, Lecturer at Faculty of Economy; Tirana University*
Mob: 0692950688, @: gledafoto@yahoo.com
***PhD student, Lecturer at Faculty of Economy, "Sevasti & Parashqevi Qiriazi" University*
Mob: 0672050877, @: elfrida.manoku@gmail.com
****Dr., Lecturer at Faculty of Economy; Tirana University*
@: sinajv@yahoo.com

Abstract

Following the events that shocked the global financial system during 2008, all organizations are increasingly paying more attention to risk and risk management. It is understandable that the risk management brings benefits for companies. By undertaking a proactive model for risk management, organizations are able to make improvements in three important areas: operations, processes and strategies.

The aim of this paper is to examine and evaluate the advantages and disadvantages of financial risk management in the telecommunication industry. Moreover, we will make an assessment of financial risk management practices for this industry through a case study conducted at AMC Company. Through this paper we aim at satisfying several objectives: to define variables that significantly affect the financial management in the telecommunication industry; to asses if the proper management of financial risk in the telecommunication industry significantly affects its progress; and to present what is the current status of the overall financial performance of telecommunication industry in Albania and if there is a significant connection between risk management and progress of organizations in the telecommunication industry.

In this study, the focus will be on the risks in the telecommunication business and financial and non-financial indicators of performance measurement. Descriptive research methods are used, in order to describe, explain and investigate the relationship between different variables dealing with risk management in the telecommunication business. Through this method we will also suggest unanticipated hypotheses. The purpose of using this method is the description of the nature of the current situation at the time the study is conducted to explore the causes and certain phenomena

In order to conclude with accurate results and to ensure reliable recommendations we used trusted data from the financial reports of the two largest telecommunication companies in our market, AMC and Vodafone, and data extracted by the Regulatory Authority (TRE) and previous studies over the same subject in the telecommunication industry.

Key words: risk, risk management, telecommunication industry, financial risk

1 Introduction

Through this study we seek to examine and weigh the advantages and disadvantages of financial risk management in the telecommunications industry. Moreover, an assessment of financial risk management practices for the industry will be considered. The study includes reliable data and statistical research. However, undertaking risk calculation, risk management and risk assessment, it can never be complete, since there are always unintended and unpredicted aspects of environment. Business organizations are hiring business managers who can deal with risk and predict the future losses in economy, in order to ensure proper risk management. Although the literature indicates that implementation of this function provides numerous advantages, many authors point out his weaknesses.

Mainly, the purpose of this paper is to study the financial strategies of the telecommunication industry in relation to financial risk. This study attempts to answer such questions as:

What are the variables that significantly affect the financial management in the telecommunications industry? Can proper management of financial risk in the telecommunications industry significantly affect their progress? What is the current status of the overall financial performance of the telecommunication industry in Albania? Is there a significant relation between risk management and progress of organizations in the telecommunication industry?

2 Literature Review

Following the events in the global financial system during 2008, all organizations are increasingly paying more attention to risk and its management. It is understandable that risk management brings benefits to companies. By taking a proactive model for risk management, organizations will be able to achieve improvements in three areas: Operations will become more efficient because the events that bring obstacles to business development will be identified in advance and timely actions taken to reduce these event will reduce the damage caused by them in company operations; Processes will be more effective, because the selection of processes and risks associated with options presented is considered. Also, changes in processes through specific projects will be more effective and safer; The strategy will be more efficient in that the risks associated with different strategic decisions will not be acceptable for organizations and organizations do not want to be found in positions where unexpected events lead to financial loss, interruption of normal operations, delay in projects completion and loss of market share. Stakeholders expect that organizations have complete knowledge of the risks that may cause interruption of operations, not completion of projects on time and failure of various strategies.

Various organizations, should take into account the business performance management, as part of performance management business. Business performance management (BPM) is a set of processes that help organizations optimize business performance. According to many financial analysts, the BPM is seen as a new mode of business intelligence as it is focused on business processes such as planning and forecasting. It helps businesses to find an efficient use of business units, financial, human, and material resources. Furthermore, BPM involves consolidation of data from various sources, research and data analysis, and placing the results into practice.

BPM develops business processes by creating better feedback. Continuous and real-time reviews are helping organizations to identify and eliminate problems before they become large. BPM predictive skills assist the organization to take action to repair the problems and give them time to achieve desired earnings projections. Forecasting is characterized by a high degree of expectation which scenarios should answer "what if?". BPM is useful in risk analysis and forecasting of revenues as a result of mergers or acquisitions of various companies and reveals a plan to pass potential problems. In measuring the performance there are some issues involved. In this study, the focus will be on the risks in the business of telecommunications, and financial and non-financial indicators of performance measurement.

3 Methodology of the study

For this study we used descriptive research method, in order to describe, explain and investigate the relationship between different variables dealing with risk management in the telecommunication business. By this method, it is possible to conduct a study that is free and quick. It also may suggest the contingency hypothesis. Descriptive research provides observations in the study. The purpose of using this method is the description of the nature of the current situation at the time the study is conducted exploring the causes and certain phenomena. In order to conclude with accurate results and to ensure reliable recommendations we used trusted data from the financial reports of the two largest telecommunication companies in our market, AMC and Vodafone, and data extracted by the Regulatory Authority (TRE) and previous studies over the same subject in the telecommunication industry. On the other hand, secondary research data are taken from previous studies and information in the telecommunications industry over the same subject, from articles published about the telecommunications industry information, business strategies, newsletters, audit from financial risk companies, books and studies on strategic management.

While there are several methods for measuring performance, different companies are in doubt which one is most effective method to use. Taking into consideration the financial and non financial models there are two very different systems: the implementation of a mechanism for measuring performance and evaluating existing organization which may bring major changes and adjustments. Moreover, some aspects of traditional systems have deficiencies in non-financial systems and vice versa. Consequently, application of a single system will not result in maximizing the advantages of both systems. Thus, to achieve the analysis that we want, this study will use financial ratios based on information collected by the telecommunications industry in two different companies (AMC, Vodafone). Currently, individual financial details of these telecommunications companies are very discreet, so details of general information on these companies will be used.

Limitations of the study

This study has several limitations that may affect the validity and reliability of results. First, risk management is a relatively new phenomenon in the telecommunications industry in Albania. This is because the industry is relatively new and our country comes from a past with state-controlled economy and management strategies of new businesses in Albania are subject to continuous improvement. Also, implementation of business plans and improving risk management by the Albanian telecommunications companies is due to increased competition, substitute products and customer satisfaction.

Reliability and validity as well as the integrity of data collected, was influenced by the fact that there is little financial information available to the public by companies in the Albanian market, and also information security policies by telecommunications companies, are very strong for reasons of competition that exists in this sector.

4 Risks and uncertainties for mobile companies in the Albanian market

a. **Credit risk**

Credit risk is the risk of financial loss to the company by outside parties, when they do not meet contractual obligations. The maximum exposure to credit risk at the reporting date is the carrying amount of assets. Proceeds from sales could potentially affect the company's liquidity. However, due to the large number of customers and their diversification, there is a concentration of credit risk with respect to such income. Concentration of risk that exists for consumers considered "VIP", due to the relatively small number and high level of transactions they have with the company. For this category, AMC has estimated the risk by following established policies and procedures and has taken the necessary precautions against possible damages.

The company has established specific credit policy under which analyzes the usefulness of credit customers and has an effective management of the attraction of money in case of payment delays and doubts. In monitoring credit, consumers are grouped according to their own credit risk, age profile, and the existence of previous financial difficulties. Customers, who are characterized as suspected, are evaluated in each report; the estimated loss they may cause to the company and limit allowed damage that can be tolerated is defined.

Having considered the money that appears in front of a low level of risk in credit risk, the company has adopted a "policy of deposits" where funds are deposited only with banks. To avoid concentration of risk, the company does not deposit more than 30% of the fund that owns to a only single bank. Financial instruments classified as "available for sale" include listed shares, financial instruments held to maturity, including government securities and treasury bills. Categories of financial assets are not considered to pose a significant credit risk for the company. Loans include loans to employees, which are collected through payroll or related to pension funds. These risks are not likely to pose a significant credit risk for the company.

b. **Liquidity risk**

Liquidity risk is the risk that the company is not able to meet its financial obligations. Liquidity risk is kept at low levels by ensuring that there is enough money if needed, and has credit available if needed to meet financial obligations. The company money on 31 December 2009 were EUR 224 million, amounts to 2,930.1 million Euro loan and Cosmote Group (which is part and AMC) has a term loan of 350 million Euros. For monitoring liquidity risk, the group prepares annual cash flows, in preparing the annual budget, monthly forecasts and performs cash flow for the next 3 months, in order to ensure that sufficient reserves of money to meet obligations its financial position.

c. **Market risk**

Market risk is the risk that fluctuations bring to the value of a company's financial instruments, due to changes in market prices, such as foreign exchange values, interest rates and stock prices. The objective of market risk management is to manage and control the company's exposure within acceptable levels. Individual risks involved in market risk described below in detail as well as company policies for managing them.

d. **Interest rate risk**

Interest rate risk is the risk caused by interest payments on loans. Interest rate risk mainly applies only to long-term loans with variable interest rates. Protection against interest rate risk is managed through ownership of a combination of loans with fixed and floating rate and also through the use of interest rate agreements. On 31 December 2009, fixed rate loans to those floating on Cosmote were 91% / 9% (in 2008: 81% / 19%). Analysis of loans under the interest rate is shown in Table 1.

Table 18.1 — *Analysis of loans 2008 to 2009 Cosmote Group. Source: AMC financial reports 2009.*

	In million euros			
	Cosmote Group		AMC	
	2008	2009	2008	2009
The value of variable interests	1,099.3	503.3	0	0
The value of fixed interest	4,948.4	4,918.6	3,307.1	2,930.1
Total	6,047.7	5,421.9	3,307.1	2,930.1

Table 18.2 — *Sensitivity to interest rates for Cosmote Group 2008 to 2009. Source: AMC Financial reports 2009.*

	In million euros			
	Cosmote Group		AMC	
	2008	2009	2008	2009
Profit before taxes	3.3	4.7	3.5	2.2
Stocks	no info	3.0	no info	no info

Table 2 shows the sensitivity to a possible change in interest rates on loans, deposits and derivatives in the income statement and stock. Sensitivity to interest rate increases by 1% if interest rates will be reduced with 1%, the impact will be similar and the opposite of the previous analysis. Due to the recent instability, observed in the capital and credit markets worldwide, debt approval to have incurred a reduction. Adverse changes in credit markets or lending rates could increase the cost of loans and banks may not wish to renew existing loans.

e. **The foreign currency risk**

Foreign currency risk is the risk caused by the use of foreign currency fluctuations and changes in foreign currency value Cosmote Group company, is part and AMC operates in Eastern Europe and therefore exposed to currency risk due to differences between currencies. Cosmote main currencies are the Euro (Romania, Greece, Bulgaria) and Lek (Albania). Currency risk for Cosmote group is not very important.

f. **Capital Management**

The primary objective for the company's capital management is to ensure that it hold a strong credit rate and stable rate of capital, in order to support its business and maximize value for shareholders. Company manages the capital structure and performs adjustments in order to follow changes in economic conditions. To hold or adjust the capital structure, the company may change the dividend payment to shareholders, return capital to its shareholders or issue new shares An important way of managing capital is to use the net debt ratio to the value of the stock, which is monitored at group level. Net debt includes loans with interest, money, cash and other financial assets.

The following table shows an increase of this ratio in 2009 compared to 2008 due to the reduction of cash equivalents, and also reduction in stock value due to losses in foreign exchange and purchase of interests controlled by the Albanian state, which was recorded in the value of shares.

Table 18.3 — *Report net debt / value of shares of Cosmote Group, 2008-2009.*

Net Debt	In million euros	
	Cosmote Group	
	2008	2009
Borrowings	6,047.7	5,421.9
Cash money	(1,427.8)	(868.8)
Other financial assets	(135.9)	(35.4)
Net debt	4,484.0	4,517.7
Shares	2,173.2	1,979.7
Report	2.06	2.28

g. **The impact of global crisis**

Unfavorable macroeconomic conditions and the worsening global economic environment, as the economic crisis in the markets in which companies operate at a group level, may lead to reduction of demand by consumers for products and services of existing innovative products. In tough economic time's conditions, consumers may seek to reduce costs by reducing use of products and services, including data services, or going into alternative lower cost offered by competitors. Similarly, under these conditions, the business group customers may delay their decisions to purchase services, can delay the full implementation of service offerings or reduce the use of company services. Furthermore, adverse economic conditions may lead to increased number of customers who can not afford to pay for existing or additional services. If you are in these conditions, can have adverse effects affecting the results of operations of companies.

h. **Reduction of market share and revenue from increased competition**

Leading companies in the Albanian market, AMC and Vodafone, are facing increasing competition and their ability to compete effectively, the main factors have to do with network quality, capacity and coverage, the price of services and facilities, quality of service to customers, developing new products and services in response to customer demands and changing technology, reach and quality of sales, distribution channels and capital resources.. Competition can lead to a reduction in rates at which the company adds new customers, a reduction in size of market share and a decline in ARPU index, because consumers choose to have telecommunications services or other competitive services by other operators. Examples include competition from the Internet-based services, offered by new companies in our market. The focus of competition continues to shift from customer acquisition to retention of the customer, while the market for mobile telephony has become very penetrative.

Inactivation of the numbers of consumers is measured by the departure rate. There is no assurance that the company should not prove an increase in departure rates to customers, especially in these times when we have great growth of competition. An increase in the rate of removal may adversely affect company profits because the company can prove reduction of sales revenue and additional costs to replace lost customers and regain lost revenues. Increased competition has led to low price wireless service and is expected to have other cuts in the future. Competition can also lead to an increase in subsidies to customers for purchase of mobile devices.

i. **Licenses and new technologies**

Companies have committed additional investment in the purchase of licenses for mobile networks and 3G networks. Companies are expected to continue to make investments in mobile network due to the increased use of mobile and need to offer new services and greater functionality powered by the new telecommunications technologies. Accordingly, the rate of capital expenditure in future years may remain high or exceed existing values. There is no certainty that the introduction of new services will continue under the schedules previously provided, or that the level of demand for new services to justify the cost of creating or providing new services. Failure or delay in networking and launch of new services, or increases in costs associated with these services, may have an opposing effect on company operations.

j. **Health risks**

Many countries have expressed concern about electromagnetic signals emitted by cell phones and transmission masts, which can pose health risks and may interfere with the operation of other electronic devices. Moreover, participants in this industry have been open trials about the health consequences as a result of mobile phone use, including brain cancer. While not yet proven that such health risks caused by electromagnetic waves, there is no assurance that the risks perceived by the public regarding the transmission of electromagnetic waves will affect the ability of companies to retain and attract new customers, to reduce the use of mobile equipment or bring other legal issues.

5 Recommendations and conclusions

Strategies that AMC could follow to be successful

While competition in the telecommunications market in becoming stronger, increase the purchasing power of consumers, and consumers have more choices. This will force prices down and service will lead to a price war between companies, influencing both the quality of service. The greatest danger occurs when companies focus only on prices and forget about quality and customer service. In the telecommunications industry, customer service and his loyalty are very important factors.

AMC should focus on customer service and product differentiation as an effective way to compete in the market. Telecommunications market, customer service offers more opportunities than other strategies, for a mobile operator, to differentiate from its competitors. AMC can be differentiated through sales representatives, service specific programs for different target groups, rapid response and meeting the requirements to subscribers. Lack of a customer service could result in over subscribers to other operators, who may have a better reputation. The more increase customer loyalty to a mobile operator, the harder it is his passing in another operator. In other words, when a customer is satisfied with the existing operator, the consumer is less willing to change service provider.

Therefore, AMC must maintain a good reputation there, communicating with its subscribers, and working hard in terms of customer service. Importance should be given the power of customers who have large contracts such as big companies that get more numbers from the same operator and generate huge revenue for the mobile operator. Also the cost leadership and differentiation strategies are good, but good study environment around the company. Generally known that the Albanian telecommunication market, phone prices have decreased with increasing competition.

Companies follow one another in pricing policy. And not all companies in our market can compete successfully by having the same strategy as that of cost leadership. However, differentiation can be achieved in several ways. According to Porter, the industry should have cost only a leader, but many companies have differentiated from each other. Although AMC is pursuing the strategy of lowering prices and also to cut operational costs of maintaining the network, greater focus is toward differentiation and customer service. Can be thought a combination of two strategies to offer a differentiated product that has a lower cost than other companies products and a higher cost than products that offer cost leader in the market.

AMC may use the network effect by offering lower prices for customers who are within AMC. When customers call outside the network, pay different prices are usually higher than calls within the network. In this case the customer is willing to pay more, if we have a large number of customers subscribed to the same network, because it wants to stay out of this great network. This strategy also creates positive effects when recruiting customers and other family members on the same network.

Since the services offered in this industry are similar, AMC should focus more towards differentiating its products and services. It is very important that AMC was the first company in the industry and has a large number of loyal customers, and should be the first to follow the directions to gain strategic advantage in the market. In this industry it is very easy to be copied and services first company to implement new services should take into account these factors. Since the strategy of "First-Mover" to be differentiated to succeed, AMC should not stop its operations for a moment, even if successful differentiation is present. Also, mqs products and services are easy to duplicate by competitors, it is very important to the company through core competencies to strengthen competitive advantages. AMC should not only reinforce core competencies as the application of latest technology, but also reinforce and lead professional processes. Steadily the company should recruit professional people who contribute to the success of the company. Also education and training of employees is very important to be in line with technological development of this industry.

6 References

AKEP, *Information on the Market: Mobile phones and Albtelecom*, 2003-2008.

— *Presentation of the indicators of the electronic communications market*, Tirana, October 2010.

— *Statistical indicators and overview of the electronic communications market in Albania*, 2010.

The 2009 Ersnt & Young business risk report telecom, Ernst & Young, 2009.

Cosmote Group, *Financial Yearly Report*, 2009.

Vodafone Plc, *Annual Financial Report*, 2009.

Telecommunications snapshot survey, Ernst & Young, July 2009.

Exploring Corporate Strategy, 7th edition, G. Johnson, K. Scholes, R. Whittington, 2005.

The Telecommunication market in 2009, Intrum justitia, 2009.

Fundamentals of Risk Management, Paul Hopkin, 2010.

Financial Risk Management In An Integrated Framework, S. Mehmood & M. Zhang,

Blekinge School of Management, September 2010.

Corporate Finance, Theory and Practice, Pierre Vernimmen, 2009.

Fundamentals of Financial Management, 10th edition, Brigham & Houston.

Strategies in Telecommunications Industry during Privatization Process Towards

Competition, Th. Nilsson, U. Rosenqvist, Blekinge School of Management, 2005.