



BLUESKY

Cook Islands



bluesky 

Investment Case Study

By Jaimee Raymond

BLUESKY

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| Country | Sector | Type |
| Cook Islands  | Telecommunications  | Foreign Investment  |

Background

Phillip Henderson has been the CEO and Country Manager for Bluesky Cook Islands for the past fifteen months. He is a “born and bred Cook Islander” who has been in the telco business for over thirty years. After gaining technical qualifications at an engineering college in the UK in 1980’s, Phillip started in the industry as an Engineering Technician and worked his way into Executive Management. Over the last decade, he has been involved in the vendor side of telecommunications with a global Tier 1 vendor based in New Zealand. During this time, he has watched the technology evolve from stream radio(HF) in the Cook Islands that involved push-to-talk systems to rolling out the latest digital exchanges. Phillip has strong family links in the Cook Islands.

Based in Tutakimoa, Rarotonga, Bluesky Cook Islands is the sole telecommunications provider for the Cook Island population. Bluesky Cook Islands features the “whole gambit of a full service telecom

operation” and operates under an exclusive license or in other words is a monopoly. Associated with this exclusive license is a number of commitments that the Telco has to deliver under a joint venture agreement. This includes a range of services from postal, to fixed line, broadband, internet, iptv, and mobile – i.e. 2G, 3G and shortly 4G in the main islands of Rarotonga and Aitutaki. This also includes some services in the outer islands. Under the joint venture agreement, Bluesky provides full service coverage to the whole country, which means that every populated island in the Cook Islands is serviced at the same price point.

The Bluesky Cook Islands ownership is under a complicated joint venture agreement (JVA) that is 60 percent private owned by Bluesky and 40 percent public owned by the Cook Island government (i.e. a public private partnership). Bluesky Cook Islands is made up of 15 percent local Cook Island ownership (with 5 percent an employee trust and 10 per-

cent a local investor trust) and 45 percent owned by the Bluesky Group (based in Samoa, which includes some unit trust investment and the Samoan government). Bluesky acquired these shares from Spark New Zealand in 2015 for USD\$23million. According to Phillip, this is a “significant” investment considering the size of the country. In addition to this investment, there is the usual capex investment (required with a telco business to maintain and grow the network) that costs on average NZD\$3million per year. Also in 2017, NZD\$6 million will be invested into the business to improve the fixed access network with fibre to the home (similar to New Zealand) and introduce 4G mobile technology. Bluesky is further working with the Cook Island government to bring a submarine cable into the country (i.e. Rarotonga and Aitutaki). However, Phillip believes this large investment has return on investment (ROI) challenges as the market it is serving has limited means to generate the revenue required for a standard ROI. Phillip states that Bluesky Cook Island’s business objectives are “driven by return on investment”, and aim to continue the current business model (as a joint venture) as it enables Bluesky to continually invest in the business, accounting for the losses incurred in servicing the outer islands under the JVA obligations. The sectors that Bluesky are currently focusing on are mobile and internet from the angle of growth and access. In general terms, the focus is on “any digital platform that enables more consumption”.

Motivation to Invest

Starting in American Samoa, Bluesky Group’s overarching vision was to “build bigger and better networks at a better price” and to “expand in the Pacific”. Bluesky soon expanded into Western Samoa and New Zealand and saw the Cook Islands as a desirable acquisition. The decision for the Bluesky Group to invest in the Cook Islands was based on the idea that Bluesky could get “healthy returns” if the company was “well managed”. At the time, there was an opportunity for both the buyer and the seller

as Spark was keen to sell and there were interested buyers - therefore it was mutually beneficial for all involved parties. Of late, Bluesky were looking to extend into Vanuatu and other Pacific Island operations. Interestingly, a Fijian company called Amalgamated Telecom Holdings Ltd (ATH) has recently bought Bluesky and the acquisition process is currently underway.

The Investment Process

The investment process for Bluesky Cook Islands started in late 2013 and the acquisition process took six months to complete. This was Bluesky’s first investment in the Cook Islands with the brand fully established in July 2015. The Cook Islands Business Trade and Investment Board (BTIB) were key facilitators in the investment process for Bluesky Cook Islands. Phillip believes BTIB has “well defined and clear guidelines,” that inform investors what areas they can invest in and how they can invest. He ascertains there were no issues with the investment process because Bluesky were simply purchasing a share of an existing business and once this was acquired, “there were no barriers to concluding the deal”. Phillip felt well supported by local government during the investment process as they had an “inherent interest to make it happen” by having partial ownership of the company. Government have been and continue to be supportive. Phillip says Bluesky has a positive relationship with the government and maintains a good relationship with the Minister who is open to advice from Bluesky.

Another important factor that helped facilitate the investment process was the “local community” as Phillip cites there was a lot of “positive support”. In the case of Bluesky Cook Islands, a number of local people formed an investment trust to collect investment funds from local interested investors. The issue with this however, was that these people did not have the experience to put the required trust documents together quickly which made it a “pain-

ful process". Phillip believes this issue arose due to a lack of maturity in the market in terms of local investment, in combination with a lack of government framework in place that enabled an investment trust to be set up. Although the Cook Islands is a trust centre globally, it is Phillip's opinion that the Cook Islands are initially set up to support off-shore interests rather than local interests.

Phillip states that because the company before Bluesky i.e. Telecom Cook Islands (TCI) (owned by Spark New Zealand) was "a very well set up and run company" there were no real concerns in terms of the company's performance and the way TCI was operated. The competency of the Directors was very high. For instance, the Senior Directors of Spark New Zealand were the Chief Executive Officer and the Chief Financial Officer of TCI. In addition, Phillip advises no information was needed to aid the Bluesky Cook Islands investment. The Bluesky Group obtains investment advice from both in house and external legal counsel but in terms of knowing the business and the industry, a lot of that knowledge was gained strategically in house. Phillip asserts that in the technology industry, "an inherent and specialised knowledge of the business is needed" otherwise, "it is very risky". He mentions that Bluesky Cook Islands "had to be smart" in that they did not create an opportunity where the current framework was able to be manipulated by other interested parties to take advantage of it. The outcome was that the previous framework was mapped directly into the new ownership law. In effect it was just business as usual, just a different shareholder.

When comparing investments across the Pacific, Phillip mentions that businesses need to go through a lot of regulatory approvals to do business in American Samoa due to the US jurisdiction. However, in Samoa, there appears to be a lesser extent of this and their investment process is cited to be, "similar to the Cooks".

Benefits of Investment

Benefits of investment in the telecommunications industry in the Cook Islands include employment, the opportunity for local Cook Islanders to invest and significant contributions made to the economy.

Bluesky Cook Islands employs 127 employees in total that comprise 117 permanent staff and 10 casual and/or part time staff. All staff from TCI were retained during the acquisition process with the exception of Phillip, who was the only new employee. It is the first time the company has been fully locally staffed and it is something that Phillip prides his organisation in achieving. Local Cook Islanders hold positions at all levels. Previously, TCI had always employed expatriate CEO's and local Executives. Phillip is the first local CEO. He reports that 46 percent of his staff are women and that 50 percent of the Executive team are female holding positions such as Chief Financial Officer, HR Director, Legal Counsellors and Head of Marketing and Sales. He also remarks that women hold 50 percent of middle management and supervisory positions. The only exception where women choose not to work is field and plant operations, which is male-dominated because Phillip says it is, "difficult physical work that is mostly outdoors".

Enabling the employees of Bluesky Cook Islands to invest in the company has created positive results for the company and local staff. Phillip states that Bluesky is currently exceeding its initial business objectives due to the ability of "being able to turn the team around". He says that by having the employees invest financially into the business, this has affected their performance because they realise "the better they perform in all facets of the business, the better return they get" which has been "a revelation". It is also the first time local employee investment has been done in the Cook Islands at this level.

Bluesky Cook Islands make a significant contribution to the local economy. Bluesky spends around NZD\$1.5 million a year on standard supply items in the Cook Islands such as materials for infrastructure and general maintenance from building, electrical, plumbing and construction suppliers. Airfares and shipping to the outer islands are other expenses that are supplied locally. However, all technology supplies come from offshore.

Barriers and Disincentives to Investment

A number of factors can act as potential barriers and disincentives to investment in the telecommunications industry in the Cook Islands. Challenges range from issues with government, the Chamber of Commerce, conditions of the joint venture agreement with government, high operating costs, limited supply and trade links and employer challenges.

Although the local government supported Bluesky Cook Islands in the end, Phillip states that initially they made the investment decision difficult to quantify. At the time of acquisition, the government sent out confusing signals as they proposed changes in the current legislation but were unable to define what those changes would be. For that reason, there was a defined risk that was not able to be qualified in terms of what the new market was or what the new legislation was going to be and how that would affect the buy price/value of the purchase. This created uncertainty in the market as the seller wanted maximum value for their shares, while at the same time government was signalling major changes in the legislative framework. There were also commitments from the government that they would work in the interests of the value of the business since they had a 40 percent shareholding in the business. Since the acquisition, government has continued to signal changes without defining them. As a consequence, the perceived value for local investors has been less than the reality and

local investors have held off on investment. In addition, Phillip disapproves of the way the local government rely "too heavily" on consultant's advice, because he argues that many consultants have not recently worked in the industry or been in business. He believes an investor needs to understand certain risks prior to investing. Phillip further thinks that the Cook Island government sits on a tenuous majority like a lot of Island governments, so it only takes a couple of votes and one seat before there is a chain of government. Lastly, he emphasises the challenge with a monopoly is that Bluesky is operating under "fairly strict" conditions of a joint venture agreement.

Phillip states that the Chamber of Commerce has been a vocal supporter of deregulating the Telecoms sector, whilst some members also supported the acquisition by Bluesky. According to Phillip, the Chamber has issues with the lack of competition in the Telecom space. The Chamber provided very little information and investment advice in this case. Phillip believes this was due to a lack of understanding of the business and the risks involved, particularly around delivering universal service. However, he has since restored and sustained an amicable working relationship with the Chamber of Commerce as Bluesky Cook Islands are a member of the Board and recently renewed their membership. In comparison to other government run entities, Phillip says "BTIB is a totally different beast" as it is much more focused on "proper governance, proper investment advice and opening doors". BTIB is the vehicle that supports and smooths the path for investments in the Cook Islands.

The Pacific has its own set of challenges and each island country is unique and different. For the Cook Islands, the resident population is 11,500 and the country covers 2.2 million square kilometres. It has a sparse population so that has many inherent challenges. Under the joint venture agreement with government, Bluesky Cook Islands has to deliver

telecommunications access to all Cook Islanders, which has proven to be challenging. One major challenge is that there is very high operating costs associated with building networks. Opex is also a challenge because everything is delivered by satellite. Transporting equipment to and within the Cook Islands has high airfreight or shipping costs. Yield per customer in the outer islands is very low and it is challenging when you are required under a joint venture agreement to provide same priced services. Bluesky Cook Islands also has a commitment under the government agreement that they invest "absolute values of investment". For example, the joint venture agreement requires Bluesky to invest X million dollars every ten years in the outer islands. The government has put conditions in place to ensure that dollar values of investment are guaranteed so it is quite "well defined". Phillip says that this prevents Bluesky "from running the network into the ground" as it guarantees reinvestment in technology and ensures the outer islands receive the required levels of service. As a result, Bluesky are compelled to continually invest in the business.

In terms of local supply chain and trade links, Phillip says he purchases as much as he can locally but if it does not exist then he will get what is needed elsewhere. He thinks the Cook Island supply chains are limited due to an absence in technology companies. He advises that for technology purchases particu-

lar to the business, "I would not buy from a local agent because that just adds cost with no additional value". Instead, Bluesky Cook Islands goes direct to the source, as he believes "the cheaper we build the networks, the better pricing we can offer our customers". He says, "What drives our price is our cost and we do as much as we can to keep our cost down". As a technology company, all equipment and specialist support comes from offshore. From a group perspective, Bluesky has a centralised procurement process where they procure a lot through a procurement agent. One point of using a group relates to economies of scale, as it is easier to get better pricing in this way. Phillip states that "size matters in procurement" and this is where Bluesky has an advantage. For example, Bluesky is currently building 3 networks, one that will be launched in the Cook Islands within two weeks (of writing). Bluesky was able to negotiate a contract with a Tier 1 vendor, and get better pricing by approaching them with a bigger network requirement. Phillip advises that if they had built the network on their own they would probably be spending another 30 percent of what they are currently spending (which they cannot afford to do) so "that's the impact".

However, one of the problems with being a small operation was getting competitive prices from the big vendors. Bluesky's mobile provider across the Cook Island network is Huawei, the fixed network



is Nokia and its next generation network (NGN) is Redcom Laboratories from the US. From a strategic perspective, Bluesky uses smaller vendors who build platforms that are suitable for Bluesky's products. For broadband and mobile access, Bluesky will approach the Tier one vendors. Phillips says that a Tier three vendor is the cheaper option but these vendors often do not survive or lag in R&D development. Bluesky has "learnt a lesson" as they will spend a premium to get a Tier one vendor because it is guaranteed that this vendor will be around long term. Although the majority of customer complaints are centred on the cost of telecommunication services in the Cook Islands because they want the same price as New Zealand, there appears to be a lack of understanding of the structure of the costs associated with setting the networks up and economies of scale.

With regard to improving local supply chains, Phillip says many local suppliers are yet to get into e-commerce and that to a certain extent; this has been hampered from the local banks. Although the ANZ and Westpac banks are present in the Cook Islands, they have not yet rolled out the same e-commerce payment capabilities that countries like New Zealand enjoy. An issue with slow take of e-commerce technology is that in the Cook Islands on the 20th of every month, Bluesky has to cater to customers still coming in to pay by cheque or cash. Phillip advises that online payments only represent about 7.5 percent of total payments and he would like to drive this figure higher. In the Cook Islands, Bluesky are slowly getting people to spend less time making physical payments but Phillip says the bank fees do not help the situation. Bluesky Cook Islands have also started emailing customers electronic bills even though some people still demand printed bills. Phillip however is optimistic about the e-commerce movement, as he believes the Cook Islands will eventually "get there".

Phillip states that his main challenge as an employer has been "filling roles" as there is nobody in the market to fill some positions. For example, there have recently been five vacancies available at Bluesky Cook Islands but the company did not receive any applicants. Phillip struggles to fill vacancies in a range of positions "from a field force worker, to a retail sales person through to a Financial Controller". Bluesky Cook Islands have taken actions to make the job and remuneration more attractive as the company pays employees above minimum wage i.e. NZD\$9 starting rate (minimum wage in the Cook Islands is NZD\$6.50 an hour). He believes this issue is due to the Cook Islands still suffering from the immigration problem as the country continues to see Cook Islanders "pack up and leave", they feel "the grass is greener in Australia and New Zealand". While he understands this trend, many will learn that the lifestyle in the Cook Islands is more balanced and that there are lower living costs in the Cooks. Much to Phillip's regret, he now has to consider recruiting non-local employees. Although this goes against company policy as Bluesky Cook Islands aim to recruit locals, Phillip says he is "left with no choice", given the evident gap in the local workforce market. For instance, when a Financial Manager position was advertised for 3 months with no suitable response. Phillip is now contemplating whether a non-Cook Islander should fill this position. Another barrier was getting the locals on board to invest, and it continues to be a barrier.

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Growth and Development

As the CEO and Country Manager of Bluesky Cook Islands, Phillip is happy with Bluesky's return on investment to date. He also believes that because Bluesky has exceeded the budget, the Board are also happy and the shareholders "impressed". Phillip is further pleased with the company's market place performance, despite no sector competition. Bluesky is exceeding all conditions of the joint venture agreement. He sees room for growth and highlights the fact that the Cook Islands economy is very reliant on tourism (75% of GDP). Phillip believes that Bluesky are not yet servicing the tourism sector as well as they could. He also says the residential market is "maxed out" in terms of telecom spend, and does not expect to get anything out of this. Tourism is where there is discretionary spend and this is where Bluesky is wanting to grow.

The governments' vision was that all Cook Islanders would have access to telecommunications and in partnership with Bluesky Cook Islands; this has been delivered using an effective framework. Phillip believes this has been more successful than people give the government credit for. He says "there is only one telecom Minister in the whole of the Pacific who can say he is delivering modern telecoms services to his whole population... under a monopoly.... ranked the fourth most affordable in the Pacific". He further states that Bluesky Cook Islands has succeeded in their objectives from a government perspective. From an investment perspective, Phillip believes there is "nothing unusual" about the returns that Bluesky Cook Islands is receiving as he advised they are "not making a lot" and are "not being unethical about it". They produce financial reports for government and are fully audited. If the investment process could be undertaken again, Phillip says that he "probably would have negotiated a better price with Spark". Although he believes, the negotiated price was fair, in accordance with the due diligence.

Phillip is optimistic about the Bluesky Cook Islands investment in the course of the next five years, as long as the company "does the job right". He mentions how the fibre (submarine cable to be installed over the next three years) will benefit the investment, as it may reduce the cost of doing business. Future investment is also on the cards for Bluesky Cook Islands. The capex programme involves investment upwards of NZD\$12million to continue to improve the telecommunications network in the Cook Islands. This includes the NZD\$3million annual investment that keeps the network current and evolving. Phillip believes in the philosophy that as a telecommunications company reinvests in new technology, old technology becomes obsolete (as it is no longer viable). He says, "It's a constant cycle of investment, retiring some of the legacy networks and technology that people reluctantly want to give up". For instance, he is confident the copper fixed line network will be retired within the next five years i.e. there will no longer be a need to use landlines in the Cook Islands as the population will fully migrate to mobile technology. Phillip reports that the Cook Islands has more mobile phones in the market than the population so he is certain that everybody who needs to be contacted can be contacted.

A key future opportunity identified by Phillip is "strangely, competition". He believes that although competition can be perceived as a threat, in this case it will "compel the business to act differently", and that this will become "a positive catalyst for change" - which is "exciting". Phillip says Bluesky Cook Islands is "open to competition", but he does not believe that if the market is opened up, government will achieve what they want. He contrasts this potential scenario to what happened when the telecoms market was opened up in New Zealand and says, "The prices never really came down" and "customer service fell apart". However, he maintains that all telco providers in New Zealand continue to operate to a point that neither of them go out of business. He further states that price can be regulated and that the Cook Island government are in

a strong position to regulate the market price. He believes that if you do not have that competitive pressure on, then quite often the business can take the easy way out. He cites, "As soon as you have the threat of competition, you change" and "that's when things get really exciting...I love it". On the contrary, Phillip states that a future challenge to the Bluesky Cook Islands investment is the local government. This is because government can be too reliant on consultant's advice such as the Asian Development Bank (ADB) – as that is where a lot of their concessionary funding comes from.

Phillip would recommend investment in the Cook Islands as long as the investor understands the risk that comes with it. He says, "Investment is all about risk". For instance, it should be understood that in the Cook Islands, the economy is built and sustained by the tourism industry so if that market is decimated in any way e.g. a cyclone occurs, or the wrong sector is developed – that is where the risk lies. He believes the national tourism authority is well managed and "it has a very clear vision of how and where it needs to grow". The top three tips that Phillip would give to a potential investor is to 1) be clear on understanding existing legislative framework, 2) be clear that you can get a license to operate and 3) understand the operating environment you are coming into. For example, if an investor is planning on investing in the telecommunications industry in the Cook Islands, they should be aware that the current population is currently 100 percent served so any new entrants will be coming up against an aggressive competitor and they will be "fighting for a small piece of the pie".