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TESTIMONY OF

ANTHONY L. WILLIAMS

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MARKET ENTRY BARRIERS FOR SMALL BUSINESSES IN THE TELECOMMUNICATIONS INDUSTRY

The lack of access to capital for small businesses, and particularly minority-owned businesses, has been, and continues to be, the primary barrier to entry and growth in the broadcast and telecommunications industries. Congress supported this finding during hearings leading to the enactment of the 1992 Small Business Credit and Business Opportunity Enhancement Act and in the Omnibus Budget Reconciliation Act of 1993. There are also many studies which cite and confirm this fact.

For minority businesses in particular, there is a direct correlation between access to capital, ownership and the FCC policies which have been used to grant communication licenses over the years. Ms. Antoinette Cook Bush, partner with the law firm of Skadden and Arps, cites in a recent law review article this depressing history. She states:

"With regard to the FCC's own broadcast licensing practices, the agency granted radio licenses to exclusively non-minority applicants until 1956 and television licenses to non-minority applicants until 1973. Moreover, this disparity was further entrenched by the licensing methodology--comparative hearings--which favored applicants with experience in broadcasting. Few minorities had employment opportunities with broadcasting companies until the civil rights laws and cases concerning education, equal employment opportunities, fair housing, and voting rights in the mid-60's and early 70's -- years after the valuable radio and full power TV licenses had already been granted to non-minority applicants. Accordingly, the FCC's comparative hearing procedure contained an inherent bias in favor of non-minorities until reforms were finally adopted in 1978. These reforms, however, were not extended to the cellular radio service when it switched to the lottery mechanism. Therefore, the most valuable telecommunications licenses were [once again] granted to non-minorities in similarly disproportionate percentages as in the broadcast context..."

Essentially the only means for a minority applicant to acquire a broadcast or cellular license today is to purchase one from an existing licensee. This is attributed to the fact that the most valuable broadcasting licenses were granted by the time the comparative hearing preferences were adopted in 1978, and that the cellular radio licenses were granted primarily to non-minorities. Purchasing such properties, however, requires access to capital. The FCC's tax certificate policy and distress sale policy were the only policies that encouraged such sales. These policies were limited to broadcast and cable and neither policy exists today.

In the past two years, the FCC utilized some small business and minority business preferences practices in the auctioning process. When this occurred, there was substantial participation by small and minority businesses in the auctioning process and a fair allocation of licenses was issued to the small and minority business sector. This practice, in turn, attracted capital. When these policies were not applied, few, if any, small and minority owned businesses were awarded licenses. The Commission and Congress both have acknowledged that without the set aside of some these licenses for the small business sector, small and minority businesses would not be able to compete with more established broadcast and telecommunications companies that have almost unlimited access to capital.

The Telecommunications Act of 1996 has dealt the most recent blow. By practically removing ownership caps and restrictions, consolidation of the telecommunications industry is rapidly underway. In radio broadcasting alone, owning a single radio station has become a prescription for bankruptcy. Consequently, lenders and investors have revised their financing policies to exclude stand-alone radio operations in favor of multiple-owned properties concentrated in specific markets. Further, the rapidly escalating prices of radio properties has increased the demand for capital in an environment where small and minority businesses increasingly lack access to such capital.

By their nature, small and minority businesses in the telecommunication field tend to be start-ups and/or turn around situations requiring a significant amount of equity capital or a combination of debt and equity. Most of this capital has been provided over the years by Small Business Investment Companies (SBIC's) and Specialized Small Business Investment Companies (SSBIC's, formerly known as MESBIC's). The capital available in this financing community, however, is small relative to today's cost of entry and can't begin to address the capital needs of today's market place without leveraging larger sources of capital. As Congress feared in the late 80's and early 90's, the elimination of small and minority business policies by the FCC, combined with the implementation of auction rules, would have the effect of removing small and minority business from the competitive licensing process. This fear is coming to pass. With out specific measures designed to level the playing field, small and minority businesses are at a significant disadvantage. They cannot compete with larger, well established communications entities for the capital resources currently available to finance this new era of growth. Consequently, strategic alliances are a must in capital intensive industries.

For example, one minority-owned broadcasting company in its recent effort to expand, bid the highest price for the purchase of a major market radio station. Despite its high bid, and its readiness to put up the required down payment, the seller accepted a lower bid from a non-minority company because of the bidder's apparent ability to access capital more quickly. Another, minority-owned broadcast company, in its efforts to expand, had to retain the services of its non-minority law firm to make a blind offer to purchase another station in its market after previous attempts to make a direct offer had failed. The blind offer was accepted.

If we look at the FCC's recent history of auctioning licenses, significant participation by small and minority businesses has been limited to those auctions which have had some form of preferred treatment for small and minority businesses. The more that preferred treatment has been given to small and minority businesses, the greater their participation in the bidding process and the actual purchase of licenses. Further, where minority business preferences have been allowed, strategic alliances have occurred resulting in one instance the largest minority-owned telecommunications business in the country (PCS Development Corp). On the other hand, where minority business preferences have been denied, there have been no strategic alliances.

What can FCC do to increase small and minority business access to capital? I believe that the Commission must reinstate policies that will help level the playing field. In broadcasting, the consolidation of the industry will ultimately remove small and minority businesses from all of the financially viable markets unless the Commission and Congress revisit the ownership cap policy and create economic incentives for existing broadcasters to sell to small and minority-owned companies. In the area of new license issuances, the Commission must ultimately reinstate the type of small business and minority preference policies it originally adopted for the C and F block auctions, restrict certain auctions to competition among small businesses and preclude strategic alliances before the auctions commence. The Commission must also expand its financing policy to include the provision of capital needed by small businesses to construct and market new communication systems if they are to compete with larger better capitalized companies with ready access to capital.

Example, I believe the Telecommunications Development Fund (TDF) will be substantially under-capitalized. Although the intent is laudable, it is a fund with a mandate to provide financing assistance to a large array of small businesses in a variety of telecommunications industries. The TDF cannot begin to address even a fraction of the financing need in today's economic environment without a substantial infusion of capital resources. If TDF can amass $50 million in capital over the next three years (which is an optimistic projection), this amount could only provide seed capital for 10-15 businesses, and probably fewer. Remember, this is supposed to be an all purpose, nationwide fund. In comparison, existing minority managed funds with a limited focus are larger. Why not provide incentives for institutional investors to invest in these funds?

The issue of how FCC defines small businesses is also of concern. A business which has $50 million in annual revenue may be small when compared to AT&T, however, a business which has $5 million in annual revenue is small when compared one that has $50 million in annual revenue. They cannot not be expected to compete fairly on equal ground. I believe that the commission should consider a tiered process which allocates to smaller businesses greater preferences. When doing so, the Commission must protect against potential shame companies that create shell corporations or partnerships that are backed by companies which do not meet the small business criteria.

The FCC was created in part to be the watch dog of the public interest when it comes to granting publicly owned communications licenses. Further, the FCC continues to have a mandate from Congress to ensure that economic opportunity exists for small and minority-owned businesses under a competitive bidding regulatory regime. It is, therefore, incumbent upon the Commission to advise the administration, Congress and the Supreme Court on the policies and legal procedures which are necessary to implement these mandates. As it has done so well in children's programming, the FCC must likewise step up its efforts on behalf of the public, small businesses, women and minority-owned businesses.