Case 15

BCH TeleCommunications

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As the Prague police car pulled away from the curb in front of 156 Sokolovska, thirty-two-year-old Jeff Welker bit his lip to hold back the tears. It was bad enough that his partner had left the country and taken all of the $150,000 in cash they had in the BCH TeleCommunications checking account; but to compound matters, this was one of his oldest and dearest friends. In addition to the money, his partner had also taken some important legal documents that were necessary for running the company. It was July 1996 and the business was just beginning to take off.

Jeff's partner had simply left a letter on his desk telling him that he was leaving because the partnership had caused him great frustration, and he was going to Poland and taking the money with him. As he left his spartan office on the second floor of an older building in the northeast section of Prague, Jeff reflected on the course of his life.

Preparation for Prague

For as long as he could remember, Jeff had wanted to go into hospitality management. When he completed high school in Glendale, California, he entered Glendale Community College and ultimately completed an associate's degree in business management with a concentration in food management.

After researching a number of schools that offered bachelor's degrees in hospitality management, Jeff decided to enter the program at the University of Nevada at Las Vegas (UNLV). During his time at the university, he established many close relationships—including friendships with managers and directors of hotels in Las Vegas.

With the conclusion of his work at UNLV, Jeff interviewed with a number of companies and ultimately accepted a job as assistant convention director at a Sheraton Hotel located in the Los Angeles area. Within the next three years, Jeff was promoted several times.

Early Entrepreneurial Speculations

Jeff's family had some wealthy friends in California who had offered financial support to any venture Jeff might be involved in. He filed this away in the back of his mind just in case something interesting did come along. After a couple of years, Jeff was transferred to the Sheraton Hotel in San Diego. He soon became friends with an older man who was a real estate developer in Los Angeles and Hawaii.

Jeff began contemplating putting together a project for a hotel in Hawaii. For the next two years, he worked concertedly on this plan. He even selected a parcel of land in Hawaii, talked to the owner about his interest in putting a hotel there, and developed an aerially shot video of the land to show to potential investors. In addition, he had a graphic artist overlay a sketch of the proposed hotel onto a photograph of the land. Jeff was now twenty-six years old, had enough pledges to build a hotel in Hawaii, and envisioned that his lifelong dream was about to become a reality.

However, this dream was not to be. He had made friends with a young lawyer from New York named Charles. Charles was tired of working grueling hours in a large law firm and planned to quit his job and start a business of his own. Jeff was understandably startled when Charles asked him one day, "Have you ever thought of building the hotel somewhere else for about one hundred times less money?" He continued, "Do you know anything about the Yugoslavian Riviera?" Jeff admitted that he knew almost nothing about Yugoslavia, and he certainly did not know it had a riviera. However, by a strange twist of fate, the travel section of the local newspaper had a twelve-page article on the Yugoslavian Riviera the following weekend. Jeff read each word carefully and began doing some research on this part of the world. He went back to his investors and told them about this new opportunity, and they became as excited as he was. Charles and Jeff began applying for visas; unfortunately, it was late 1990 and early 1991 and war broke out in the country before they could get there. This forced them to scrap the whole idea and begin all over.

Four months later, Charles suggested that they continue to concentrate on Eastern Europe where doors of opportunity were beginning to open for entrepreneurs. He proposed that they consider starting a bar and grill in Prague, Czechoslovakia, which was the gateway between Eastern and Western Europe. Jeff knew a bit more about Czechoslovakia although he had never been there. Other circumstances in his life at the time caused him to rethink the future. He had left Sheraton and gone with Marriott Hotels, and Marriott was in the process of restructuring. Jeff became uncomfortable with the changes he saw taking place and decided Charles's idea was not so bad after all. He quit his job and began serious research on the new project. It was now April 1992.

Research for the Venture in Prague

Although a formal business plan was never developed, Jeff and Charles did spend some time researching the proposed project in Czechoslovakia. Charles had decided that in addition to the bar and grill that Jeff would run, he would like to start an import-export business in Prague because he had always been enamored by this type of operation and had a hunch that such a business might work in this country newly opened to Western goods.

They needed to know the type of goods not presently available in that country. First, they did some research at the library of the University of California at San Diego and visited the Czech Consulate in Los Angeles. Then they flew to Washington, DC, and talked to representatives at the Czech Embassy, the United States Department of Commerce, EXIM (Export-Import) Bank, the IMF (International Monetary Fund), and anywhere else they could get information on the country and the economic climate there. At the Czech Consulate and Embassy they were told there was a great need for used blue jeans and used computers in the country at that time. Charles's law firm had a one-person office in Prague, and that lawyer also assisted them in understanding the country.

Jeff and Charles began exploring names for their embryonic company and decided to use an acronym for the company title. After brainstorming for days, they finally arrived at BCH—an abbreviation for "beach"—a place where Jeff had spent some of the best years of his life. In November of 1992, Jeff and Charles arrived in Prague to launch their business operations. Jeff secretly wondered just where BCH Enterprises would take these two entrepreneurial friends.

Economic Developments in Czechoslovakia

In November 1989, Czechoslovakia experienced what would later be referred to as the Velvet Revolution. In response to the pleas of students and nurses, the socialist government finally stepped down and handed the country over to the people. Great social, political, and economic changes subsequently occurred in the newly freed nation. The disintegration of the former Council for Mutual Economic Assistance (Comecon) was one of the most significant factors for change. The National Assembly elected Václav Havel president of Czechoslovakia on December 29, 1989. Havel came from a family that had a long history of business and cultural activity. In spite of major difficulties under the former socialist government, Havel became one of the most celebrated of all Czech contemporary playwrights.

The primary constraint to any reform efforts on the part of Václav Havel and his new government was the fact that all industrial and agricultural production was owned by the state or state-dependent collective farms. In February 1990, the new minister of finance, Václav Klaus, proposed a coupon privatization project. By paying only a small administration fee, all Czechoslovakian citizens were given the opportunity to obtain a coupon book, which could be used to purchase shares in certain privatized concerns. The first coupon books were sold on May 18, 1992, with the result that 70 percent of the population became shareholders. Following this was a project titled Small Privatization which singled out smaller service and trade premises from state property and sold them at auction.

Another constraint to reform was the less-than-rapid integration of Czechoslovakia into the community of Western European states. Exporters in the Western European countries were delighted with the new opportunity to sell their goods in Czech markets, but they were reticent to buy Czech goods. The former socialist economy was strongly oriented toward Comecon (a planned economy) and the former Soviet Union. This had a negative effect on domestic production and caused the country to be noncompetitive in world markets. The central planning commission stressed heavy industry and neglected the service sector entirely. Because of this, the Czech economy suffered a decrease in exports when Comecon was dissolved, and there was a loss of Eastern markets for their goods.[1]

In January 1993, Czechoslovakia split and became the Czech Republic and Slovakia. With the collapse of markets in Eastern Europe the country began to develop a greater orientation toward the markets of Western Europe, and more foreign firms began to enter the domestic Czech market[2] (see Figure C15.1).

According to one source, by the end of 1994, 65 percent of the gross domestic product in the Czech Republic was from contributions of private sector business activities (both domestic and foreign). However, even though a whole range of laws and decrees had been promulgated which purported to encourage the formation of small business, a proper legal system to defend private property and enterprise and enforce contracts had not been implemented.[3]

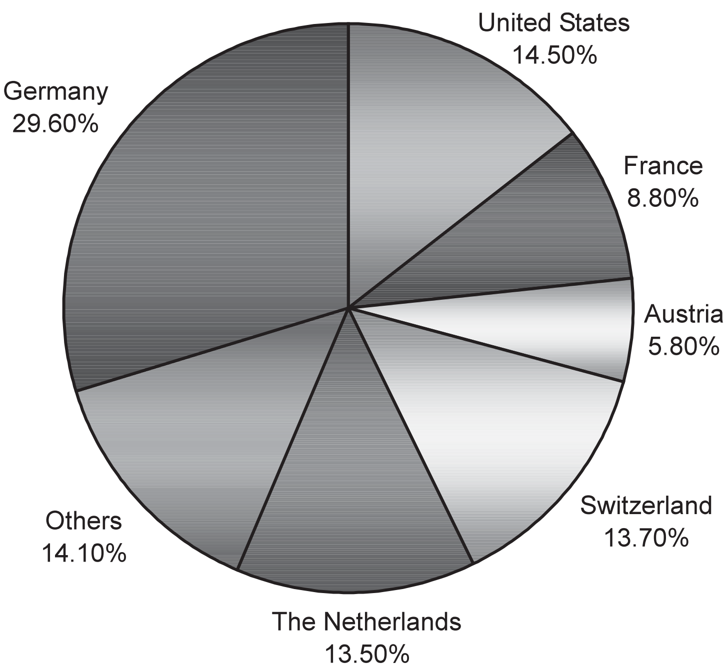

FIGURE C15.1. Direct Foreign Investments in the Czech Republic, 1995

For one thing, the government bureaucracy had become a major barrier to the creation of new enterprises. The former state-owned banks were very slowly being privatized and new banks from other countries were beginning to enter the country. The experience of one company in Russia was very similar to experiences of entrepreneurs in the Czech Republic. This new small business received the required twenty-seven documents—many requiring notarizations—after a loan approval and before the money could be disbursed.[4]

Two separate Czech economies appeared to be developing by the middle 1990s. One was the economy in which new Czech entrepreneurs were attempting to start up new ventures and having great difficulty getting loans (except at 30 percent interest) and breaking through the "old-boy" network, which was a residual of the socialist state. The other sector, which represented companies from Western countries that had access to banks outside the Czech Republic and well-skilled lawyers to assist with the bureaucracy, was experiencing great success.[5] It was within this economic climate that Jeff and Charles hoped to start a business.

Hurdles for the New Business

Many foreign companies that made investments in the Czech Republic became frustrated with the difficulty of getting things taken care of in a timely manner. Every contract or piece of paper needed a stamp by someone to make it official. Sometimes the stamps were paper stamps that could be purchased at a post office, and sometimes they were the imprints of a rubber stamp.

Jeff decided very early that he would not be daunted by such hurdles. He believed that he had to do everything on his own. That philosophy had saved him from many hours of anxiety fretting over the difficulty of maneuvering through business in his new country.

However, some hurdles became insurmountable. With the import-export business, the hurdle was the incorrect information Jeff and Charles had received from sources with whom they had consulted before entering the Czech Republic. Although they had been told by Czech sources that there was a great need for used computers, when they arrived they found that most people who wanted a computer already had one. In addition, although there was a great demand for used blue jeans as had been suggested, any jeans that were imported were either stolen at the border or, if they made it past the border, were burdened with a heavy duty by the Czech government. BCH could not make a profit with prohibitive duties on their products.

Jeff and Charles faced more obstacles with the renovation of a building for their bar and grill. They signed a contract for a stated amount with one construction company only to have them come back later and suggest, "We forgot to put doors and windows in our contract; and also there is water damage in the walls, and we have to fix that." They let this company go and signed a contract with another construction company who later said to them, "Oh, we must add an additional $80,000 to the contract for electrical wiring, elevators, and stairs."

Jeff and Charles began to understand that the signing of contracts meant nothing, and the project would go well beyond their budget. They knew they could not continue to ask their investors to pour money into a black hole, so they gave up. Jeff and Charles lost more than $40,000 on this project. Their deal with investors was that the investors would put $250,000 into the project, but they wanted Jeff and Charles to invest (and be willing to lose) the first $50,000. Jeff wondered if part of their problem might have been that neither of them spoke the Czech language and depended upon translators for all transactions.

An Introduction to Callback Services

Jeff began doing some hospitality management consulting in Eastern Europe since tourism had become a big business after the demise of communism. One of the biggest expenses of the business was the telephone bill. The Czech Republic had a metered charge for local as well as long-distance calls, and the long-distance calling fee at the time was $3.50 a minute. Jeff first used AT&T, then Sprint, then another carrier, but the costs were still quite high.

On a trip back to the United States, Jeff read in a magazine about a company providing callback service for international calling. He called a representative of the company and asked him to explain callback services. The representative explained the process to him in the following way: "You call from Prague to our computer in New York to a specially assigned telephone number, and you hang up before our computer answers. After this, the computer calls you back and offers you a dial tone, and then you dial as if you were in the United States." The representative's explanation was, "International rates in the United States are so much cheaper than the rest of the world that they give you discounted rates."

Of course, when Jeff tried the process, it did not work exactly as the representative had said. In Czechoslovakia in 1992, only one out of ten phone calls worked. In addition, 99 percent of telephones in Czechoslovakia had rotary dials. To use the service, they needed a Touch-Tone phone. They brought one from the United States and then had to get an adaptor to make it work.

One day the CEO of the company that offered callback services called them and asked if they would like the license for the company for Eastern Europe. Jeff immediately responded that they would not be interested because the service did not work. Then the CEO responded, "Would you be interested if we got the service working?" Jeff said they might be interested, and so the CEO got an engineer on the phone to listen to their complaints.

Jeff was uncomfortable with the prospect of selling. However, Jeff also realized that although he was doing hospitality consulting, his partner was not doing any consulting work and this new venture might bring some money into the company. Also, since they would primarily be speaking with representatives of Western companies, language would not be a hindrance. The growing number of Western companies doing business in the Czech Republic provided an excellent customer base for this service.

As much as Jeff hated the idea of calling people and convincing them that they needed to buy their service, he and Charles reluctantly accepted the licensing and marketing agreement for Eastern Europe. This would be the first company to offer such services in Eastern Europe.

Charles began immediately working on the project in May 1993; within four months, he had signed up sixty people. When Charles went back to the United States for two weeks, he asked Jeff if he would follow up with some companies that he had sent information to and see if they were interested in the callback services.

First, Jeff called people who had recently signed up and asked about the service. The service from Czech Telecom (the former Czech monopoly) was so bad at the time that it took ten tries to get one call through. The people Jeff called who were using the service said they got their calls through seven out of ten times. As one might imagine, they were very pleased with the service. In addition, all of the companies that Charles had sent information to wanted to sign up for the service. All of this happened within thirty minutes, and Jeff was astounded.

After completing the calls, Jeff picked up the English-language newspaper, *The Prague Post*. He saw some ads placed by large multinational companies that were doing business in the Czech Republic. On a whim, Jeff picked some of the companies at random and called them to explain their callback services; the common reply was, "How fast can you send information and have a meeting with us?" Jeff hurriedly sent the information to the companies, met with them soon afterward, and very quickly signed them up for the service.

He was doing so well with the large companies that when Charles returned he said he would continue to work with the multinationals and Charles could stay with the smaller companies. Charles concurred with this suggestion. At this juncture of the operations, they decided that it would be appropriate to name the portion of the business dealing with callback services BCH TeleCommunications (see Box C15.1).

Competition for BCH

The biggest competitor for BCH TeleCommunications was the state-owned Czech Telecom. In the former centrally planned economy of Czechoslovakia, the government had a monopoly in all industries. There was no private enterprise. In the 1980s, the U.S. telephone monopoly, AT&T, agreed to break up into a number of smaller regional local calling companies which allowed competition for the long-distance calling market. The transition in Czechoslovakia was hampered because the legal and economic infrastructure necessary to move to a free market system was slow and cumbersome. Czech Telecom refused to believe that it would be possible for another company to compete with them.

Soon after BCH TeleCommunications began offering callback services, the Czech government and Czech Telecom came to Jeff and Charles and threatened to kick them out of the country. They presented the young men with official documents with the required

BOX C15.1.
BCH TeleCommunications DirectDial Services

BCH DirectDial Services provide international telephone services that can save you up to 42% on your international calls.

There are many added values when using *BCH DirectDial Services:*

- Best rates
- No monthly fees
- Direct dialing to all countries worldwide
- 24-hour unbeatable customer service
- Many different kinds of connections to fit the needs of customers
- Detailed call record every month for free
- Easy billing in CZK, USD, or by major credit card

Joining ***BCH DirectDial Services*** is easy. We will need only this information:

- Where the client wishes billing information to be sent
- The currency the client wishes to pay with
- The local numbers to be connected

This routing creates two billings for each call:

- The first is charged by the local telecom
- The second is charged by ***BCH*** at tremendous discounts

BCH DirectDial Services is one of many top-quality services offered by BCH TeleCommunications. Please call us for more information about ***DirectDial*** and the many other attractive products and services available form Central Europe's leader in discount international telecommunications.

number of stamps on them and said, "You must leave the country in sixty days." Jeff and Charles consulted with their Czech lawyer who said, "They may make your life more difficult, but you have done nothing wrong." These two relatively naive young Americans soon discovered that competition may come in a thousand different disguises, and some may actually threaten your well-being or your life. Jeff mulled over the truth that every entrepreneur must know his or her competition well and understand how to survive in the midst of competition.

Often, when Jeff would give information about the company to potential customers, they would ask, “This is great. Does it break any laws?” Jeff would assure them that it did not; however, when these same customers called Czech Telecom, the company would claim callback services were illegal.

Jeff became aware later that other countries—including the United States—did not always view this new process as enthusiastically as he did. Often, the established operator community in a country publicly and legally took a dim view, claiming in various ways that the services actually constituted wire fraud. The operator community was especially troubled by revenues they were unable to collect on the use of their assets, and they also suggested that it circumnavigated their international conventions for settlement.

Argentina and several African countries had attempted to block the switching techniques that enable callback hardware to capture identification codes and reroute calls.[6]

Jeff was also aware that there was growing interest—even in the Czech Republic—in substitute products and services such as e-mail and fax messages. These were both low-cost alternatives to long-distance calling and competitors for callback services. In fact, the telephone companies themselves seemed to have a bright future. Unlike BCH, they were not tied to the one product for long-distance communications. In 1995, the world spent 60 billion minutes communicating by phone, fax, and e-mail, four times the amount spent in the previous decade.[7]

An issue raised with this type of operation was international comity. International comity is based on the principle of respect. “Comity is implicated where domestic and foreign laws conflict. When a conflict occurs, a country must decide whether to respect the foreign law or to enforce its own domestic law. In making such a decision, the domestic body balances domestic public interests against international considerations. The domestic body is under no obligation to abide by the foreign law; the decision of whether to respect foreign law is entirely discretionary.”[8] Jeff reasoned that these potential problems might put a constraint on callback services.

The Company Grows and Takes on More Staff

BCH soon began to represent other telecommunications companies such as Sprint, DirectNet, AxCom, and Dial International (DIT), which did not have representatives in Eastern Europe. They also expanded the operations of BCH TeleCommunications into Poland, Slovakia, and Hungary in July 1993. Jeff, meanwhile, expanded his hospitality management consulting into Slovakia and Hungary. The company was doing so well that the Office of the Ministry of Finance identified BCH as one of the top new companies in the country and sought Jeff's advice on ways to help Czech entrepreneurs succeed (see Box C15.2).

Jeff speculated that their company did well not only because of the cheaper telephone services that they offered but also because of the good technical support they provided their customers. The company hired an engineer just to work on technical problems and help with plans for future expansion of the business. Jeff found it interesting that over 50 percent of their new business came from referrals by satisfied customers.

The company also had an excellent staff of people working with them. One was a young lady named Ivana Svobodova. She had come to work for them in 1994 as a receptionist and within months had worked her way up to sales associate and finally became a director of the company. When Ivana had a free minute, she read everything in the office about the operations of the company. When people called the company, Ivana could answer their questions and actually began to sell the company's services over the phone without a meeting. She soon became the person on the staff that Jeff most depended upon to give a realistic assessment of his ideas for the operations in the Czech Republic. She was a native of the country and knew better than he what would work and what would not work there. An added benefit was that Ivana was a native and could assist with Jeff's learning of the Czech language, and she was also a trustworthy translator.

Crisis for Jeff Welker

By January of 1995, Jeff noted that their callback service operations had grown by 150 percent since they had become involved with it two years ago. He had heard that callback services in general were growing at a rate of 15 percent a month. BCH operations were grow-

BOX C15.2. Financial History of BCH

1992

Revenues from restaurant	0*
Revenues from consulting	0
Total revenues	0
Expenses of restaurant	$15,000
Profit (loss)	($15,000)

- *Restaurant*—No money was generated from the restaurant because contract disputes prevented the building from being completed. The owners spent much of this year finding a place to build (location, architect, contractor, etc.).
- *General*—In addition, they used most of their time getting themselves established in the business community (networking and getting involved in the expatriate community).

1993

Revenues from consulting	$10,000
Revenues from telecom	50,000
Total revenues	60,000
Expenses of restaurant	35,000
Expenses of telecom	12,000
Expenses of consulting	1,000
Profit (loss)	$12,000

- *Consulting*—Company established a hospitality and communications consulting arm of the firm. The primary targets were the hospitality industry and the service industry (real estate, law firms, and grocery stores).
- *Telecom*—At the beginning of this year, the company broke into the telecom market offering discount callback services. BCH was the first to offer such services in the region, and

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*Numbers are rounded off to the nearest thousand.

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gained about 100 customers in the first year. They worked out of Jeff's apartment and began a full advertising/marketing campaign.

1994

Revenues from consulting	$25,000
Revenues from telecom	105,000
Total revenues	130,000
Expenses of consulting	3,000
Expenses of telecom	154,000
Profit (loss)	($27,000)

- *Consulting*—This part of the business grew well and kept Jeff busy all of the time. The company expanded its activities into Slovakia and Hungary (for specific clients). Much of this revenue (which was almost pure profit) was supporting and paying many of the company's past bills and financing the marketing efforts of the telecom division.
- *Telecom*—This project continued to grow very rapidly. At the end of the year, the partners decided to work on their own. Instead of making a commission for another firm, BCH would actually buy and sell their own international time from large telecom carriers. In addition, they took on a third partner for additional expansion. He was an expatriate who had lived in Prague for two years. They added four full-time sales staffpeople and moved into a large office complex. They added one postgraduate (from graduate school on a one-year internship) to assist with the think-tank process of expanding. They were actively marketing their services in Hungary.

1995

Revenue from consulting	$31,000
Revenue from telecom	175,000
Total revenues	206,000

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Expenses of consulting	3,000
Expenses of telecom	217,000
Profit (loss)	($14,000)

- *Consulting*—This division continued to generate revenue that was used to support the expansion efforts of the telecom division. The partners had decided that it was not necessary to continue to grow this division but to maintain it and use it as a networking effort to further support the telecom division.
- *Telecom*—The company moved to a less expensive private office. BCH added two more postgraduate interns. They expanded their services portfolio to include an international calling card. This proved to be successful for the next two to three years. The sales team grew by two, and then they added two full-time customer service staffpeople. At the end of the year, their third partner was asked to leave the firm, and this added a large financial burden to the bottom line because of his severance costs. The company expanded into Poland and established a full office. One of the partners was stationed in Poland 85 percent of the time. BCH began working with a total of three telecom service providers. These were firms through whom they bought and sold telecom time. This allowed BCH to add more services to its portfolio.

1996

Revenues from consulting	$17,000
Revenues from telecom	180,000
Revenues from glass/crystal	3,000
Total revenues	200,000
Expenses of consulting	1,000
Expenses of telecom	39,000
Expenses of glass/crystal	70,000
Profit (loss)	$90,000

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- This was a year of great change.
- *Consulting*—This division basically was winding down its activities, and the company began to concentrate all of its efforts on the telecom division. This had been very enjoyable for Jeff and a good moneymaker, but he no longer had enough time for all of its activities.
- *Telecom*—There was much unrest in this division as it continued to grow. All three interns left the firm because they were disgruntled with the overall direction and management of BCH. One of the primary partners—Charles—decided to depart BCH on a permanent basis; and as he did, he removed all of the financial assets of the firm and left the country. This brought on an enormous financial burden to the company operations. At the end of the year, there were only two employees on the payroll. Three additional employees stayed on for four months without pay.
- *Glass/Crystal*—BCH decided to start up a new project of exporting glass and crystal to the United States and Canada.

ing in Poland and Hungary, and Charles wanted to take over the business operations in Poland. However, Charles became increasingly unhappy and frustrated in the business and in his relationship with Jeff, so he left a letter for Jeff telling him he was leaving the business and taking $150,000 in cash with him. It was now July 1996, and Jeff felt that the rug had been pulled from under him. He normally had a very positive outlook on life, but this setback seriously discouraged him.

With no money in the bank and all of his legal documents gone, Jeff considered filing for bankruptcy. Under the former socialist state, "bankruptcy" was a word that no one mentioned. Central planning had always provided an easy way out for money-losing enterprises. Under the new government, bankruptcy was beginning to play a role; however, the process was not working well. Usually, for struggling companies, a hint of the possibility of insolvency meant scrambling to hide assets before creditors noticed. The 1991 Bankruptcy and Settlement Act was based on rules dating back to the Austro-Hungarian Empire. The Act had already been amended ten times, and parliament, bankers, and unions were wrangling over proposed amendments again.[9] The average bankruptcy period in the Czech Republic, from start to finish, was six years.[10]

Jeff also had to take a hard look at the future of callback services. Although these services had been extremely profitable until now, he wondered about the growth of alternative means of communication. Total revenues for callback services in 1994 were $200 million and in 1995 were $350 million; they were projected to grow to $500 million in 1996, $1 billion in 1997, and to $2 billion by 1998.[11] A recent article had also suggested a possible saturation of this market. The author reported that in1990 there were only six callback operations in North America, and at the present time there were over 200—all offering consumers in dozens of foreign countries cheaper (and even illegal) international phone and fax calls.[12]

In addition, the U.S. Federal Communications Commission (FCC) had taken notice of the disparity in international dialing rates and was considering new pricing rules that would force foreign carriers to lower their rates or face possible punitive measures. The FCC saw competition by the callback services as an additional means of encouraging other nations to comply.[13]

Jeff wondered to himself how he could survive and make the business prosper with no money to pay his staff or creditors. He also wondered if this would be a good time to move into a related business that would have greater prospects for profitability in the future. Although Czech Telecom was still a monopoly, now 27 percent owned by Swiss and Dutch investors, by the year 2000 the monopoly was to be broken up and competition from other companies would be welcomed.