British Telecom: Searching for a winning strategy

by Tuomo Summanen and Michael Pollitt

Presented by Carsten Zimmermann
November, 2002

Agenda

- Introduction – Why British Telecom?
- History of the liberalisation process
- Soft competition strategies
- Hard competition strategies
  - A leading global telecommunication provider
  - Facing serious difficulties
- Strategy Reformulation
- Conclusion – British Telecom quo vadis?
Introduction – Why British Telecom?

The UK telecommunications market has been the first European market to be deregulated, thus making it an interesting object of analysis especially in the context of corporate strategies.

British Telecom Overview (2001)

<table>
<thead>
<tr>
<th>British Telecom</th>
<th>Why BT?</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image" alt="Map of the UK" /></td>
<td>• First European Telecommunication market that was deregulated (early 1980s)</td>
</tr>
<tr>
<td></td>
<td>• Regulation exemplary for other European countries</td>
</tr>
<tr>
<td></td>
<td>• British Telecom was first large incumbent that was privatised</td>
</tr>
<tr>
<td></td>
<td>• Competition started 10 years earlier than in other European countries</td>
</tr>
<tr>
<td></td>
<td>• Early mover advantage</td>
</tr>
</tbody>
</table>

- Turnover GBP 29.666 Mio.
- 34.7m total lines of which 28.9m belong to BT
- Workforce ~ 137,000
- UK Market share 65% (total fixed lines)

Source: IDC 2001, British Telecom, A.T. Kearney Analysis
Unlike other European countries, the UK already started in the early 1980s with the liberalisation of the telecommunication market.

### The history of liberalisation in the UK telecommunications market

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>- BT has a legal monopoly over wireline services, network equipment, VAS</td>
<td>- 1984 Privatisation of BT (50.2%) as an integrated company</td>
<td>- 1993 Mercury launches One2One</td>
</tr>
<tr>
<td>- Tightening financial control is foremost aim of government</td>
<td>- Period of duopoly with Mercury (wireline)</td>
<td>- 1994 Orange enters the market</td>
</tr>
<tr>
<td></td>
<td>- Duopoly with Vodafone (wireless)</td>
<td>- Until 2000 82 licensed telecom operators</td>
</tr>
</tbody>
</table>

**1981-1984**
- 1981 British Telecom Act splits BT from the Post Office
- 1982 White Paper recommends privatisation
- 1983 government announces duopoly policy

**1989-1993**
- 1989 further liberalisation in domestic market
- Cable operators allowed to offer telecom services
- 1991 end of duopoly policy

**Recent developments**
- Worsening market conditions
- 3G network construction
- Roll-out of DSL
During the period of duopoly with Mercury only marginal changes in British Telecom's structure and strategy were conducted.

**Developments during the period of duopoly (1981-1991)**

- Soft transition policy (Gradualism)
- Competitor selection
- Growth of role of regulation
- Regulation by bargaining
- Cherry Picking
- Slow restructuring

- Too soft landing into competition
- No restructuring of the company
- „Decade of lost opportunities“
Hard competition strategies

A leading global telecommunication operator

After the government had cancelled the duopoly and opened up the market in 1991, BT redefined its strategy and objectives.

Vision, objectives and approach of British Telecom (1991)

- BT announced the ambitious vision to become a leading GLOBAL TELECOMMUNICATION OPERATOR
- Defending the market share in the UK
- Expanding overseas presence, mainland Europe (extended home markets) and Asia-Pacific
- Develop the market for advanced, interactive and multimedia services
- 1-billion joint venture with MCI, Concert Communications
- Worldwide expansion: Bell Canada (1996), New Zealand, Dacom
- Interactive services, eg. video-on-demand, home shopping
To achieve its objectives, BT undertook a restructuring initiative to form a new organisation, focusing on specific market sectors.

**The restructuring of British Telecom (1991)**

- The Multinational Corporations
- The Small Business
- The Individual

**INITIATIVES**
- Job Cutting for the first time after privatisation
- Selling of its telephone manufacturing business
- Selling of its holdings in cable operators (Thames Valley Cable, Swindon Cable, Ulster Cable, Coventry Cable...)
- General strategy of concentrating on providing network-related products and services

**“State of the Art” Program**

...to become a leading global telecommunication operator

---

**Hard competition strategies**

Facing serious difficulties
The higher competition level has led to shrinking ARPU and decreasing overall revenue for all European incumbent telecom operators, in particular BT.

**Price Development 1996 – 2010 (€)**

<table>
<thead>
<tr>
<th>Source: JP Morgan estimates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local tariffs</td>
</tr>
<tr>
<td>National tariffs</td>
</tr>
<tr>
<td>International tariffs</td>
</tr>
<tr>
<td>Fixed to mobile tariffs</td>
</tr>
</tbody>
</table>

**ARPU 1996 – 2010 Narrowband customer**

Besides decreasing revenue streams in the core business, further inorganic „burning platforms“ evolved.

**„Burning Platforms“ - Inorganic**

<table>
<thead>
<tr>
<th>Inorganic</th>
<th>Alliances</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• BT underestimated Worldcom’s financial power, thus the bid battle for MCI</td>
</tr>
<tr>
<td></td>
<td>ended when Worldcom offered $37 billion for MCI (1997)</td>
</tr>
<tr>
<td></td>
<td>• Need for global partner</td>
</tr>
<tr>
<td></td>
<td>• July 1998 AT&amp;T and BT revitalise Concert</td>
</tr>
<tr>
<td></td>
<td>• Concert’s revenues are 1/3 lower than predicted leading to the closure of</td>
</tr>
<tr>
<td></td>
<td>Concert, leaving a GBP 7 billion for AT&amp;T and BT</td>
</tr>
</tbody>
</table>

**Mergers & Acquisitions**

| • BT missed the rapid developments in the European market |
| • Tried to compensate this by „an 18-month“ shopping tour in 1999 |
| • BT spent billions to acquire minority stakes in second tier mobile telephone companies |
| • BT failed to rapidly integrate the acquired companies in order to achieve cost and margin improvement synergies |
|   — In operating efficiencies |
|   — In margin improvement |
|   — In Capex consolidation |
|   — In headcount reductions |
Also organic problem areas, like high debt levels and decreasing EBITDA margins had to be solved.

**„Burning Platforms“ - Organic**

<table>
<thead>
<tr>
<th>Organic</th>
<th>High debt levels</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• 3G licenses in UK, Germany and Netherlands (e.g. €10.1 billion for German license)</td>
</tr>
<tr>
<td></td>
<td>• 3G network construction (approx. €5 billion)</td>
</tr>
<tr>
<td></td>
<td>• Acquisitions and large capital expenditures in the 1996 – 2000 years</td>
</tr>
<tr>
<td></td>
<td>• Driving forces were growth optimism, confused strategies and easy access to capital</td>
</tr>
</tbody>
</table>

**Decreasing EBITDA margins**

• With price pressures in its traditional businesses, BT got under pressure from the market to trim its cost structure, and has been cutting back on its capex and opex.

**Strategy Reformulation**
Due to serious financial difficulties, British Telecom had to redefine its strategy.


- **Vision**: BT announced the less ambitious vision to concentrate on the voice and data markets in the UK and mainland EUROPE
- **Objective**: Cut debt from GBP 30 billion to GBP 15 billion
- **Approach**: Demerger of BT Wireless, Sale of Japanese mobile stake to Vodafone, Sale of Airtel in Spain, Dividend payments scrapped, Sale and lease back

To achieve its objectives, BT undertook a restructuring initiative to form five separate public companies.

**The radical restructuring of British Telecom (2000)**

- **BT Ignite** (Broadband)
- **BT Openworld** (Internet)
- **BT Retail** (Residential)
- **BT Wholesale** (Other carriers)
- **BT exact Tech** (R&D)

**INITIATIVES**
- Demerger of BT Wireless (now O2)
- Changes in management and management style (Executive team reduced)
- Reorganisation
- Cost cutting
- Sale and lease back

**RESULTS**
- Financial situation stabilised (debt < GBP 14 billion)
- BT did not fall into the lowest investment rating
- Revenue and EBITDA enhancement
The impression could arise, BT had gone back to its roots. This is not entirely the case.

**BT - back to the roots?**

"A Leading Global Operator"
"An integrated telecom company"
"Content is king"

Concentration on UK and Europe
Focussing on core of the company
Access, traffic and VAS business

**Not entirely.**

**Broadband Roll-out**
- Broadband a central element in the next future
- Dynamic broadband applications with Microsoft

**Profitable Revenue Growth**
- 3 lever bundles to profitably increase revenues (product, pricing, commercialisation)
- 12 month ultimatum to break even unprofitable business sectors (BT Ignite)
- Major acquisitions are ruled out

**Opportunities**
- Interactive TV alliance with BSkyB
- Video and multimedia applications
- New applications in PC-telephone-Sound system area