Getting your strategy right is easier said than done: just ask BT

A regular column on the information industries

Jason Whalley and Peter Curwen

In the aftermath of 3G licencing around the turn of the millennium, UK fixed-wire incumbent BT exited the mobile sector and sought to reinvent itself as a broadband focussed operator. Such a reinvention recognised the declining opportunities associated with voice telephony and the opportunities emerging from the internet. Initially, this reinvention would see BT use its existing operations, which were significant if unexciting, to finance improvements in its infrastructure that would enhance its competitiveness. At the same time, BT invested in new businesses that it felt were more attractive than voice telephony.

After investing in a variety of online businesses without great success, BT shifted its focus and started to acquire sports rights. A simple logic underpinned the shift of BT towards this type of content: not only would consumers want to watch the sports that BT had acquired but bundling different products together would also encourage the adoption of the company's broadband-related services. Over time, it was argued that this strategy would shift the revenue base of BT, moving it away from existing services such as voice telephony towards new areas such as broadband and content.

Looking at the financial results of BT, a plausible case can be made that the strategy has been a success. Those parts of the company selling broadband or internet products to households or businesses have seen their financial performance improve. For example, the earnings before interest, tax, depreciation and amortisation (EBITDA) for BT consumer increased between 2012 and 2017. The same was also true for BT business. Moreover, BT boasted in its 2017 annual report that it was the UK's largest fixed-wire broadband provider with more than nine million customers and that daily viewing figures for BT sport had increased by more than 10 per cent. So, Why have pre-tax profits reached a plateau? Why has the share price collapsed? and Why has Gavin Patterson, the CEO, been sacked?

A "simple" answer to these questions is that BT is currently facing too many simultaneous challenges. Collectively, these challenges, outlined below, taxed the ability of managers to implement the transformation of BT and raised questions about their ability.

How to tackle the BT pension plan deficit is a long-standing challenge, with BT in recent years increasing its contributions while indicating its intention to reform the scheme in its favour – a proposal that was vehemently opposed by the

Jason Whalley and Peter Curwen are Professors at Northumbria University, Newcastle upon Tyne, UK.

Communication Workers Union. When BT's proposal was rejected by the High Court in early 2018, BT's share price declined on fears that the company would be required to contribute additional sums to close the pension scheme deficit. In May 2018, it emerged that BT would contribute £4.5bn to the scheme by 2020 to help reduce the scheme's deficit which was estimated to be £11.3bn.

In the summer of 2016, it had emerged that profits at the Italian subsidiary of BT Global Solutions, the company that sells services to businesses, had been overstated by £268m over a number of years. BT launched an investigation, suspended staff who subsequently left the company, adjusted its earnings and incurred a £260m charge. The incident lowered the share price of BT, irritating investors in the process, and led some commentators to suggest that BT Global Solutions could be sold, with *Deutsche Telekom* being touted as a potential buyer.

As noted above, a key component of BT's reinvention has been the purchase of sport rights. Acquiring sport rights, especially to football games, does not come cheaply. Since 2012, BT has paid significant sums to obtain the rights to show football games from the English Premier League – to date, BT has spent £2.6bn just for these rights. This figure does not include the cost of showing football games in other leagues and competitions or the cost of purchasing the rights to show other sports such as cricket and rugby. While the purchase of content was initially welcomed, as it would attract customers and thus increase revenues, some commentators have recently questioned how effective it has been. Not only is the purchasing of content expensive, but the amount of unique controlled subscribers that BT has been able to assemble is relatively small, thereby emphasising the importance of pricing as a tool to attract customers.

Openreach, the company that operates last-mile infrastructure within the UK, plays a key role in the financial success of BT. Between 2012 and 2016, Openreach contributed around 40 per cent of BT's overall EBITDA, and although the contribution declined in 2017 because of the purchase of mobile operator EE in 2016, Openreach still contributes a third of the group's overall EBITDA. In other words, the success of Openreach plays a significant role in shaping the overall financial success of BT.

Openreach has not embraced fibre as quickly as its customers, politicians or the government would have liked. In many respects, this is unsurprising. Instead of investing in fibre, which is costly and takes a good many years to pay for itself, BT opted to "sweat" its existing copper assets through, for example, using new technologies such as G.fast to improve broadband access speeds.

BT also lost a bruising encounter with Ofcom over the status of Openreach. This dispute resulted in legal separation being imposed. As a result, while Openreach continues to be owned by BT, its autonomy and, it is argued, its need to satisfy the needs of its other customers has been increased.

These challenges should not be viewed in isolation but rather as part of one larger interconnected strategic challenge. If BT is to continue to narrow the pension deficit, acquire content and invest in its network, then what happens to Openreach is key. Investing in fibre will be costly, thereby reducing the financial resources that Openreach will be able to contribute to the rest of BT. This will, in turn, affect the pace at which the pension deficit will be narrowed, how much content can be acquired and how EE positions itself for the onset of 5G. BT has sought to free up additional resources by announcing that it will be reducing its headcount by 13,000. Significantly, these manpower losses will be concentrated among BT's managerial and administrative employees and will be partially offset by the recruitment of 6,000 new engineers.

Openreach is a very profitable business and as such would be attractive to outside investors. Rumours of investors taking stakes, both minority and majority, that value Openreach at anywhere between £12 and £25bn, have circulated. The sale of Openreach would be transformational for BT, not only in terms of the amount raised but also in terms of its relationship with Ofcom and the wider telecommunications industry. But should Openreach be sold? Certainly, the full divestment of Openreach would reduce the number of challenges being faced by BT's managers, allowing them to concentrate on other issues. The pension deficit could be narrowed, or perhaps even closed altogether, and disgruntled shareholders could be placated with the payment of a one-off special dividend.

A partial sale would raise less money and thus require BT management to decide where to spend the windfall. Moreover, turning Openreach into a joint venture, partly owned by either rival telcos or infrastructure investors, is not without its own set of problems. As separating Openreach from BT has, to date, proven to be difficult, there is no reason to expect that full separation would be any different.

Whoever replaces Gavin Patterson as CEO of BT will need to be good at juggling competing, often conflicting, interests. Juggling these interests – the demands of shareholders, employees, pensioners, customers, rivals and the regulator – will shape how the broadband focussed strategy of BT is implemented. How BT has sought to reinvent itself has been shaped by events, both internal and external, and by a sometimes fractious relationship with Ofcom – just a few days afterPatterson was sacked as CEO he advised his successor to forge a good working relationship with the regulator. What events at BT vividly demonstrate is that implementing strategy within an environment as complex and dynamic as the telecommunications industry, is easier said than done – it simply never seems to go according to the plan.

Corresponding author

Jason Whalley can be contacted at: jason.whalley@northumbria.ac.uk