A Conversation

Achieving Concerted Action: The Proposed BT-MCI Merger

Sir Peter Bonfield and Tim Simpson

If approved, the proposed merger between British Telecommunications plc (BT) of the United Kingdom and MCI of the United States (which is awaiting approval by U.S. and European regulators) will create a $42 billion company, the world's fourth-largest telco (after NTT of Japan, AT&T, and Deutsche Telekom). To effect the merger, BT will acquire, for $20 billion, the 80 percent of MCI that it does not already own (BT acquired 20 percent of MCI in 1994), making this the largest takeover ever by a British company.

The merged company, to be called Concert, faces huge challenges and equally huge opportunities. The prize is enormous – leadership of one of the world's biggest and fastest-growing industries, forecast to be worth over $1 trillion by the year 2000. Winners in this industry will be those groups that can offer their customers high-quality worldwide service – which means those that can form international partnerships that work. In addition to Concert, two other such groups already exist on paper: the Unisource/Worldpartners alliance between AT&T, KPN of the Netherlands, Telia of Sweden, Telefonica of Spain, and the Swiss PTT; and Global One, an alliance between Sprint of the United States, France Telecom, and Deutsche Telekom. If the BT-MCI merger goes through, Concert should have a considerable lead over the other two partnerships, which are less tightly structured.

Making it work will be a formidable challenge. Two strong and successful organizations, with a total of over 160,000 employees and their own distinctive cultures, have to be united across the Atlantic. Each has skills the other needs. MCI needs BT's skills in local telephony to succeed in the next phase of U.S. market development, now that U.S. local services have been opened to competition. And BT needs MCI's skills in successfully challenging dominant incumbents (as MCI has done over 15 years to AT&T) to help BT challenge incumbent operators in the European markets where it has won new licenses. So the merger is not a classic cost-reduction play, but a transference of skills in both directions – difficult to achieve within a single culture, and moreso across cultural boundaries.

Sir Peter Bonfield, CEO of BT, is also the designated CEO of Concert and therefore has ultimate responsibility for the merger's success. In this interview, he shares his view of the challenge and how he intends to meet it.

Tim Simpson: BT on its own was the seventh-biggest telco, and now that it's joined forces with MCI, it's fourth – a very strong position in a rapidly growing industry. *Yet* we have seen in another industry you know well – information technology (IT) – that apparently dominant companies can quickly lose ground as innovative new competitors emerge. How secure do you regard BT's position?

Peter Bonfield: I don't see the telecom competitive scene changing quite as rapidly as the IT industry, where competitors like Apple, Sun, Compaq, and Microsoft can emerge and grow to become leading players within less than 10 years. However, it's certainly true that companies in the telecoms sector, such as MCI and MFS-Worldcom, have become over a 15-year period significant competitors in their own markets. Similar challenges to established competitors are likely to emerge in the telecoms sector, but over a somewhat longer timescale. Thus BT does and will continue to face increasing competitive challenges from determined and fast-reacting new competitors.

So far, BT has responded well and is currently quite well positioned for the future competitive environment. But one of the messages I have been emphasizing to all BT's people over the past year is that, unless we continue to improve and move forward, we will lose ground. We have a chance of becoming one of the world's strong competitors in telecoms, but we cannot take it for granted. The recent merger announcement was a step toward creating a world competitor. In managing our company we have to continue to improve our performance and the service we give to our customers.

TS**:** The United States and the United Kingdom are widely regarded as among the world's most advanced countries for telecoms, with low prices and high standards of customer service. This is immediately linked to early liberalization and the encouragement of competition. How do you view this?

PB: It's true that service standards are higher and prices are lower in the United States and in the United Kingdom. Above all, however, the choice available to customers in these two countries is much greater than that available in less liberalized markets. So, yes, I am a strong believer in liberalization and competition – it's the best way to provide better value and choice to customers. I believe we are fortunate to have learned to compete in a liberalized environment over the last 10 years. Our challenge now is to capitalize on that experience as we expand into other markets.

TS: As a sweeping generalization, up to today competition has been largely within each national market and has not really started to hurt the major players (except possibly in the States). We are now seeing the large telcos make significant forays into each other's markets, with apparent determination to bite and draw blood. Will this lead to a war of attrition, or will there be clear winners and losers?

PB: You are referring to the emerging competitive battle in European countries such as Germany, the Netherlands, France, Italy, and Spain. In the larger of these countries, I think it's unlikely that incumbent telcos will ever entirely lose their market positions – it's inconceivable that Deutsche Telekom or France Telecom will become minor players in their own home markets. However, I think that in some countries, the incumbent operator is not in very good shape to compete, and that in those countries the emergence of competition could present a severe challenge to those incumbents. They are destined to lose market share to new competitors and will be forced to learn to compete with new players, just as BT has had to do. There will be quite a battle, and, yes, you're right, BT will be at the forefront of the battle in many of these markets.

TS: As a follow-on, doesn't this depend on regulators' determination to ensure fair open competition? There is much skepticism about European regulators' determination to do this effectively. What is your expectation?

PB: *Yes,* of course, this depends on the regulators' determination to ensure fair competition. I am encouraged by the determination of the regulators I have met to do this. There is still much to do in many markets, but I believe we are going to see an effective operating framework for new competitors emerge in each of the markets. It will, of course, take some time, and it will require constant attention to the detail of the regulation. BT and MCI are both skilled in this, and we intend to bring these skills to the new markets where we will compete.

TS: The proposed BT-MCI merger is big, ambitious, and full of risks and opportunities. Much of the merger rationale is based on drawing on each other's skills to attack new markets. What will be the keys to success in this undertaking?

PB: The principal reasons for the merger were to form a larger company able to compete effectively in the United States, Europe, and the rest of the world, and to draw on each company's skills in doing this. BT has long experience in providing, in particular, a full range of services to about 7 million businesses and 20 million residential customers. MCI has not, throughout most of its life as a long-distance operator, had the same level of direct end-customers, although increasingly it is serving business customers directly, particularly in major U.S. cities. However, MCI has developed effective skills in marketing new services and is quick to respond to market opportunities. Therefore, part of the merger rationale was to use these skills for mutual benefit.

The keys to this are pride and respect: pride in our own achievements and skills, and respect for the additional and complementary skills that our colleagues can bring. Don't forget we have already known each other for three years (BT has held a 20 percent stake in MCI since 1994). The process of getting to know each other better at the working level is now well under way, and I am encouraged by how well our people from both partners are working together.

TS: The new Concert is a financial colossus, with $12 billion annual cash flow and enormous reserve borrowing capacity. *Yet* your plans for new market entry are likely to require correspondingly huge investments. Will you have enough cash to achieve your ambitions?

PB: We've done our sums quite carefully. We are encouraged that there is still enormous reserve investment capacity in the new Concert. We made a $4.3 billion investment in 1994 to acquire the first 20 percent of MCI [and we had pretty much paid this off out of internally generated cash-flow by the end of 1996]. Our cash-generating capacity is very strong. It is quite right to say that our investments in new markets and services in the United Kingdom, Europe, and Asia will require significant investment, but we are confident that we will be able to generate the cash we need to provide for this.

TS: Will we see additional partners in Concert – for example in Asia Pacific?

PB: It's quite clear that, in seeking to become a truly global company, we need to have a strong presence in all the major markets. We must inevitably build a larger business in the Asia Pacific region, but we're under no pressure to make an immediate move.

TS: There has been much talk of convergence among telephony, information, and entertainment – much more talk than action, so far, it seems. How do you see this developing?

PB: It's easy to be skeptical about this because the predictions of the pundits are far ahead of reality. But it's also quite clear that increasing numbers of people are making use of personal computers linked to each other over the telephone wires. They are looking for new forms of services that include entertainment as well as information. The technology is providing the means, and it's now up to companies like Concert to develop and offer to customers the kind of services that they want to use. The fact that we haven't seen significant steps up to now in convergence of these different industries is mainly due to the limitations of the service providers. Our challenge is to find the services that customers want to use. I believe we are at the early stages of a real information revolution and only the limits of our collective imaginations are holding us back.

TS: Two big innovations that have really grown are mobile telephones and the Internet. Looking first at mobile, will it ever replace fixed wires?

PB: The number of mobile customers is still growing rapidly in each of the markets where services are available, even in markets such as Scandinavia and the United Kingdom, where penetration levels are already quite high. Even in these mature markets, however, the number of mobile customers is much less than the number of fixed telephony customers, and both are growing quite rapidly. Thus we are not seeing a replacement of fixed telephony by mobile but rather the growth of complementary services, and I believe this is how it will continue. Mobile phones meet different customer needs and will continue therefore to develop in different directions. I do believe, however, that we will see the emergence of linked services using facilities from both mobile and fixed networks operating together. One of the challenges for BT and MCI is to find ways of providing such linked services.

TS: The Internet can be likened to the road system when the motor car first arrived – great for the first drivers, but totally inadequate for heavy traffic. Who is going to build the roads, and who will pay for them?

PB: The growth in the use of the Internet should be seen by companies like ourselves as a huge opportunity. It's extremely encouraging that so many customers worldwide have embraced the opportunity offered by the Internet and are learning new skills and tapping into new sources of information as a result. It's quite clear, to use your analogy, that the telcos are going to have to build the roads. We are already investing millions of pounds in creating the infrastructure for improved Internet access for our customers and we will do this, both for business customers needing their own facilities, and for private customers wanting to access the public Internet.

The payment mechanisms are being worked out and will have to be established. I believe the telecom operators working together can do this – the market is capable of creating the necessary structures and we do not need a heavy bureaucratic overlay.

TS: Is Internet telephony a threat or an opportunity?

PB: It's both. Internet telephony has raised a very important issue: how will the network of the future evolve? Internet traffic, including telephony, does not require the same kind of switched network as conventional telephony, and it may be that this is the forerunner of the network of the future. This is an issue that is being extensively studied by all the major operators.

TS: At a recent management dinner, I heard you describe very clearly four main elements of your management philosophy:

• Delegation: „own, decide, do“

• Open sharing of information, enabled by technology

• Listening to customers

• Investing in people – training and learning Could you describe for our readers what you mean by these principles?

PB: These are certainly some of my main operating principles. The first is not so much about delegation as about creating an attitude of mind in our people that they should feel able to take ownership of an issue and to make something happen without waiting for permission. Obviously, this can't be taken to extremes; you can't have a thousand managers each taking action independently. However, it's far more important to take action than to wait to be guided, and it's an attitude of mind I ceaselessly promote. The coordination of our actions will come through open sharing of information. If we use the technology to its full potential we have enormous scope for sharing information openly around the company, and I am a strong believer in open sharing of information. As a large telco, we have a particular challenge to do this effectively and demonstrate to our customers how to do it.

Customers are the driver for everything we do and we all need to stay close to our customers. Understanding what they need from us is more than simply talking to them, it's about listening and thinking creatively how to meet the needs they express. Finally, training and learning for all the people in the company is crucial. Ultimately the collective skills and knowledge of our people will be our competitive edge and it's vital that we continue to invest in our people – training them and capturing the lessons we learn as we move forward.

TS: Concert will have more than 160,000 staff members. How will you reach them?

PB: The number of people in the company changes all the time as we adjust to circumstances; but you're right, it's a large number of people, and clearly I can't have dialogue with all of them. However, I believe in being visible to our people and using every possible means to get my messages and my beliefs across. Electronic mail and internal video are two means to achieve this. I have even opened up my own Web Page on our internal internet service. The most important thing is to ensure that my actions are visible to our people and consistent. And I work hard to listen to what our people tell me, which I can do through a number of face-to-face employee programs that we run.

TS: One of Concert's challenges is to grow new businesses from the base of the existing business. This requires new and different skills. How will you develop these?

PB: This is a challenge for all businesses and one I have faced repeatedly in my previous role at ICL. New businesses in their start-up phase require extra encouragement and nurturing. We have to be prepared to make mistakes and see some new ventures fail so that others will succeed. The existing telephony business is so huge that any new business we create is going to look small by comparison in its first few years. However, it is critical to our future that we succeed in finding new ways to do business and this is one of my particular concerns. For example, in the area of professional multimedia services, BT has developed a number of specialized services for particular industry groups, which are starting to grow very respectably.

TS: On a personal note, you appear impressively relaxed and spontaneous, despite the size and pressure of your job. How do you manage this and avoid being swamped?

PB: Thank you for those kind words. It's not always the case. However, I do enjoy my work enormously, and this relieves some of the pressure, as does my passion for keeping fit. I also believe in speaking openly and frankly, and this enables me to appear spontaneous even when giving a prepared text. And I believe in working through other people – I don't try to do everything myself, but rather seek to generate enthusiasm among the people around me, so that we work together as a team. I regard myself as fortunate to have such an interesting job, and I'm having fun.

Sir Peter Bonfield is one of the United Kingdom's leading businessmen, having taken over as CEO of BT, one of Britain's largest companies in terms of capitalization, at the age of 51. He spent his early career with Texas Instruments in the United States, before becoming CEO of International Computers (ICL), the United Kingdom's largest IT company. He successfully steered ICL through its sale by ITT to Fujitsu and developed an excellent working relationship with the Japanese company's top management, as well as making ICL the most successful of the indigenous European computer producers. He is determined to continue BT's development from a strong national telco to one of the world's most successful international communications companies.

Tim Simpson is a Vice President of Arthur D. Little, Inc., and a leader of the firm's -European practice in telecommunications, information technology, media, and electronics. He advises both telecommunications operators and equipment manufacturers on issues of strategy, organization, and development of new businesses. In addition to consulting, his experience includes spells as a general manager in the electronics industry and as a software designer.