

THE PRIVATISATION OF TELECOMMUNICATIONS IN THE UK - A PRACTICAL EXAMPLE

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In November 1984 the shares of British Telecommunications plc were floated, representing the first of the large privatisations of public sector companies that have taken place in the United Kingdom. Although changes had taken place in telecommunications elsewhere, particularly in North America, the privatisation of British Telecom (BT) and the liberalisation of the UK telecommunications market surrounding that event was truly a pioneering action. For the first time we had seen the transformation of one of the largest public sector corporations into the private sector. In the three years that have followed we have learned a great deal in the UK and it is evident from the conversations that I have had with many countries around the world that our experience has created great interest.

I would like to review briefly the background to the strategy in the UK, then go on to review phases of change that covered the preparation period before privatisation, the privatisation event itself and the three years of experience that have followed, not forgetting a look forward to further possible changes in our regulatory environment.

The paper will then assess the impact of the UK changes on the "stakeholders" and conclude with some observations that may be of benefit to other countries now considering a change in their telecommunications environment.

The Political Background

The election of a Conservative

Government in 1979 and its re-election in 1983 and 1987 has created a period of continuity in the UK strategy in respect of the public sector. In particular, a number of philosophies have emerged which have affected the role of many public sector corporations.

Our currently elected Government believes that competition is beneficial to the health and wealth of the nation, and liberalisation, which is the word we use for the introduction of competition, has taken place in a number of sectors, notably in telecommunications and in the financial structure of the City of London. It is Government's view that they should be involved in governing and not be actively involved in the management of business, so that as a second objective there has been and continues to be a push towards business coming under private sector management.

A third objective involved wider share ownership. Until the early 1980s individual ownership of shares in companies had declined, the only significant participation being indirect through pension and other funds. In the same way that Government had embarked on a program to increase house ownership, particularly related to the sale of local authority-owned properties, the Government wished to encourage individuals to own more shares, and the privatisation of large public sector corporations was seen as a convenient vehicle to achieve this objective.

The table below shows the major privatisation events that have taken place in the United Kingdom and it can be seen that the first of the major sales was that of the privatisation of British Telecom in 1984.

PRIVATISATIONS IN THE UK

	Government Shareholding Sold	Amount Raised	Year of Flotation
British Aerospace	50%	£150m	1981

Cable & Wireless	49%	£225m	1981
	28%	£275m	1983
Britoil	51%	£550m	1982
Enterprise Oil	100%	£390m	1984
British Telecom	50.2%	£3,900m	1984
British Gas	97%	£5,400m	1986
British Airways	100%	£900m	1987
Rolls Royce	100%	£1,360m	1987
British Airports Authority	100%	£1,270m	1987

Why was telecommunications chosen as the first of the large privatisations? It is my belief that telecommunications represents a natural choice for a move into the private sector as the industry is subject to a number of driving forces. In the first instance there is a well-known and well-understood phenomenon of the convergence of the technologies of data processing and telecommunications and the two industries that hitherto have been quite separate are moving rapidly together. This convergence involving the whole area of information technology is irresistible and will continue to confuse the technological boundaries of definition between the industries.

Secondly, the user is becoming more and more dependent on telecommunications to be an effective competitor in whatever business segment he operates. Many businesses and organisations now seek a tailor-made solution appropriate to their business activity which embraces information systems made up of data processing and telecommunications activities. Therefore the user is seeking flexibility in the development of a solution for his business, and necessarily needs to capitalise on the services provided by both the data processing and telecommunications suppliers.

Unfortunately, a third driving force operates in the opposite direction since from a regulatory point of view there is a divergence between the data processing and telecommunications industries. Whereas data processing is an open, competitive, innovative

environment, telecommunications remains a monopolistic and heavily regulated activity. This divergence which is inhibiting the achievement of user wishes can only be resolved by change in the regulatory environment. Although it could be argued that one solution is to create a heavily regulated data processing industry, this is not really in tune with current thinking, and the only obvious conclusion is a de-regulation or, in other words, a liberalisation of telecommunications so that an environment of greater freedom, innovativeness and participation by the private sector can take place to bring it closer to the style and indeed the dynamics of the data processing industry.

Further, telecommunications is now perceived as an essential element in national infrastructure as a support to the economic well-being of a country, irrespective of the state of economic and political maturity.

In putting these driving forces together one is left with the need for a political resolution of the problem, because regulatory change is required, and it was this environment, consistent with the general strategies of our UK Government that I mentioned earlier, that led to the choice of telecommunications as the first major privatisation of a public sector corporation. It is as well to remember that the thinking and preparation for the change in the UK was initiated in the early 1980s, so that we can now look back on seven years of experience of a particular solution applied to a specific country environment.

The Phases of Change

1980-1983

The development of the new telecommunications environment in the UK took place during this period and involved much public and private sector debate over the options being evaluated and considered, involved argument in Parliament leading up to the passing of the new Telecommunications Act and the change of status of British Telecom to British Telecommunications plc in the middle of 1984. As this paper is directed towards an understanding and appreciation of a real privatisation example, I do not wish to spend much time addressing the arguments over the options that were available to Government in the early '80s. However, it may be worth commenting on one or two major items as they do re-appear in the consideration that others are now addressing.

There was much discussion over whether British Telecom should be split up or not, and it is worth noting that the size of British Telecom is close to that of any of the US Regional Bell Operating companies. It was felt that splitting it into smaller units would be inefficient, and there was much resistance from within the Company itself to the problems of handling two changes simultaneously, not only from the public to the private sector but also encompassing at the same time the break up of an integrated organisation.

Secondly, the capital restructuring of the Company was a major task in arriving at the appropriate debt/equity relationship that on one hand had to recognise the prior Government investment in the organisation and, on the other, a ratio that would be appropriate for the Company to be able to fund itself in its future growth and development in the private sector.

Thirdly, the concept of Licences in which the ex-monopolist and others could operate had to be carefully structured, so that each had both obligations and opportunities that in total could best serve the public interest.

Finally the issue of national interest was of course key and a number of measures were incorporated

in both the Telecommunications Licence and the Articles of Association of British Telecom to ensure a degree of protection. For example, that no single shareholder can have more than 15% of the shares, that two of the non-executive Directors are Government appointed, that the Chief Executive should be a British citizen, and the existence of a golden share held by Government to be used to resist any unacceptable change in the Articles of Association of the Company (in other words any major change to the mission of the business).

It is important to understand that in parallel to the vigorous debate over the nature of the new telecommunications environment, certain steps in liberalisation had already taken place, such as the rapid introduction of competition in customer premises equipment, the emergence of a new network supplier, Mercury, and the introduction of competing cellular radio operators. And BT itself began the massive restructuring necessary to prepare for privatisation and subsequent existence in the private sector. The Chairman of the Company, Sir George Jefferson, who had come into the organisation in 1980, set about changing the Company from the top, organising it in divisional terms, introducing outsiders into the Board of Management, and interweaving throughout the structure outsiders, particularly in marketing and finance, with the existing staff. The massive task of creating a management accounting process, which did not exist at all, was initiated, coupled to heavy investment in related data processing activity. In terms of new personnel, it is interesting to note that of the top 600 directors, managers and professionals in the Company today, one quarter of them have been recruited from the outside since 1983. So the period 1980-1983 was one of great change within the Company in an external environment that was increasing in competitive terms and in which the regulatory environment was yet to be finally defined.

1984

1984 saw the finalisation of the Licences, and the clarification of the

structure of British Telecom in readiness for flotation. However, the major issue during the year was the whole program related to attracting investment and a heavy public relations and advertising campaign was initiated in order to present the Company to the public as well as to institutional investors. This was unknown territory as never before had an attempt been made to sell shares in a large organisation on such a wide basis. The concept of Roadshows was created and teams representing Company management and advisors carried out local and international tours to present the nature of the Company and the details of the flotation offer.

The rest is history in that the flotation was an enormous success, not only raising nearly £4 billion for the Government, but attracting over 2 million individual shareholders, not forgetting 96% of Company employees who also became shareholders. There was of course much argument after the event surrounding the setting of the offer price of the shares, but it must be remembered that there was tremendous risk involved in that there had been no track record of a flotation of this size. On balance, it was probably more important for the flotation to be a success at the expense of the price being perhaps a little generous. The subsequent large privatisations that I mentioned earlier have followed a very similar pattern to that pioneered by the team handling the flotation of British Telecom.

The other major event in 1984 was the establishment of the Office of Telecommunications, OFTEL, the independent regulatory body set up to supervise the implementation of the new strategies and Licences in the United Kingdom. In the search for greater competitiveness and greater freedom in an exciting area of technology it is perhaps regrettable that, because of the imperfections of natural competition, regulation is still required and the establishment of a watchdog necessary to ensure that all parties follow the rules and user interest is protected.

By the time British Telecom was privatised the process of liberalisation was well under way and competi-

tion existed in a number of areas. The second licensed fixed network operator, Mercury, was of course still at a very formative stage. The Licences awarded to British Telecom, Mercury and others were established in such a way that for the hitherto monopolist, British Telecom, many service obligations were included and for the newcomers an extensive degree of opportunity provided for entry into the market.

1985-1988

The last three years really represents the real-life experiences of a privatised telecommunications operator functioning in an increasingly competitive environment. Although the second licensed fixed network operator, Mercury, remains very much smaller than British Telecom, the interconnect agreement between the two operators ensures that Mercury can obtain access to many BT customers, even though it may not be providing the local access itself. Whilst Mercury is in its growth phase, capitalising on the fact that it can utilise the very latest equipment, British Telecom has been passing through a massive modernisation program catching up on the under-investment of prior decades when the Company was under Government control and repeatedly restricted in its capital investment programs. The extent and pace of this modernisation program is often seriously misunderstood and today the Company is spending each day £6 million in new capital programs and installing two new digital exchanges somewhere in the country. In order to be fully competitive in meeting the demands of its customers, British Telecom was faced with an issue over its strategy for sourcing of supplies and has moved towards competitive bidding for public switching, buying not only the System X digital exchange (in which it had invested a large amount of R&D for its development), but also a locally supplied version of the Ericsson AXE10 which we call 'System Y'. This competitive bidding environment has assisted the Company in securing deliveries of public switching at a more competitive price.

The pricing regime that was developed in 1984 gives an opportunity for British Telecom to enjoy the benefits of efficiency. This is achieved through controls on a basket of our charges which ensures that price increases on a year-by-year basis are 3 percentage points below the level of inflation (measured by our Retail Price Index). Within this basket we have the opportunity to rebalance our tariffs and have done so as the returns on assets involved in local and long distance traffic were wide apart. This method of price control, as opposed to a limit on return on equity, ensures that overall the consumer is protected because in real terms telephone charges decline, but at the same time enables the operator to enjoy the benefits of efficiency improvements derived from use of better equipment and improved working practices.

Another aspect of existence in the private sector has been the ability of British Telecom to develop strategies for new businesses both at home and overseas. The Company has embarked on two major programs of development, one in the area of information systems and services, not only producing new value added services on a local and international basis, but also the provision of specialised systems and products in a number of areas. Included in this development was the acquisition of 51% of Mitel, the Canadian based manufacturer of PABXs and related systems, which not only gave the Company access to an excellent product development company, but also access to a number of overseas markets where the Mitel products were already installed. A second axis of development was to take the experience and expertise of the Company into other parts of the world and establish the Company's presence within overseas countries. British Telecom is now very active in projects and opportunities in many countries, particularly the developing countries, in consultancy, turnkey projects, management contracts and equity investment.

The excitement of privatisation in 1984 may well have led to unreasonable public expectations of a rapid transformation of both the performance

and attitude of the ex-monopolist. This year there has been criticism of the quality of service provided by British Telecom, some inaccurate and uninformed. Underlying the criticism there have been problems that the Company has had to handle. Partly these have been derived from an unfortunate strike in the Spring of this year, but more generally related to the problem of migrating from an old network to a new at an extremely rapid pace, we believe unprecedented in any country. The Company has been taking vigorous steps to establish and publish the quality of service standards that we are aiming for and it is our expectation that the criticisms will disappear as we reach the quality of service that the public deserves. However, I believe it is important to put in perspective the fact that the privatisation of the Company cannot be expected to cure the errors and deficiencies of the past overnight, and certainly the principle of privatisation should not and must not be discredited simply because a privatised company has not been able to produce a perfect service instantaneously.

1989 +

1989 will represent five years of experience of our current regulatory environment and the rules established at privatisation envisaged a review at this time. The first five years will represent a process of progressive but persistent introduction of competition whilst enabling British Telecom to continue its process of modernisation and change, and enabling the new entrants to become effective and established in the market place. The process of compromise that is inherent in the structure of our current regulatory environment is also helpful in minimising disruption in the market place. The issues that are now starting to be discussed in terms of the regulatory environment post 1989 include the areas of continuation, or not, of the duopoly in fixed network operations, the revisiting of the pricing control mechanism, RPI-3, the question of resale of basic communications facilities closely related to

definition of value added services, and the delicate issue of quality of service in that the regulator is under some pressure to establish mandatory performance standards for operators.

The outcome of these deliberations is uncertain with many parties having an interest in proposing changes to the regulatory environment. What is certain however is that the process of change will continue and the telecommunications environment in the UK, already a very open and competitive one, will continue to give greater choice and flexibility for the consumer.

Assessment So Far - Stakeholders

In trying to assess the experience of privatisation of telecommunications in the UK it may be helpful to view the experience from the standpoint of a number of "stakeholders" in the business. I define as stakeholders: customers, shareholders, employees, the Government, regulators, suppliers, competitors and the media.

It is probably true to say that **customers** have yet to experience the full benefits of change as our program of modernisation of the network, so badly needed, is somewhat incomplete and the objectives of the Company to perform to the standards of the top telecommunications operators in the world is probably not possible until around 1990. However, customers do have a much wider choice of equipment, both for business and for residential purposes, they can access a second fixed network supplier, they do have a choice of mobile communications from two aggressive competing companies (in one of which British Telecom has a major part to play) and in real terms telephone charges have declined thanks to the RPI-3 formula embodied in our Licence. Apart from the short-term disruption in service standards during 1987 there has been steady improvement in both the provision times for new lines and services, and our ability to respond to faults.

As far as **shareholders** are concerned, until the events of October 1987, those who bought British Telecom shares at flotation time at 130 pence, were seeing the value of their shares

roughly doubled and a yield on their investments exceeding the average for the UK stock market. Today the company is viewed as a defensive investment and retains the attributes of both a utility and an information technology company which is somewhat unique, particularly as the Company has heavy research and development activity relatively rare for a telecommunications operator.

Employees, many of whom for the majority of their working careers have been in a Civil Service environment, have encountered a major cultural change. Although many of them certainly did not ask to be moved to the private sector, they have adapted remarkably well and many welcome the freedom and opportunity that is now possible in operating in the private sector. The balance between the role of management and the unions has progressively changed in that, prior to privatisation, managers were rather more administrators and the unions acted as the major path of communications to employees. Today it is the managers who manage, and it is the managers who communicate with the staff. Unions retain an important role in the organisation and much debate continues over changes in working practices which are so essential to the future efficiency of the organisation. Flexibility in employment terms and conditions have been introduced, particularly for the more senior staff. So far, staff turnover has been largely through natural wastage, although the full impact of reduced manpower levels will not be felt until our modernisation program is complete. A major ongoing issue is the resolution of the problems inherent in historic inefficient practices that result from decades of negotiations over the responsibilities of each job grade. The Company is encouraging greater flexibility and attempting to introduce a system of remuneration that rewards performance rather than automatic annual increments. It is particularly encouraging to report that notwithstanding the original purchase of company shares, when 96% of employees participated, around 40% of our staff contribute regular savings each month to a share

save scheme which gives them the option at the end of a specified period of having the savings back with interest or convert them on an option basis into Company shares. One must note that this is in sharp contrast to the advice of the unions at the time of flotation when employees were recommended not to take up the share offer.

The Government has received £4 billion for the sale of its 51% holding, and has declared its policy in the future to sell off all or part of the remaining 49%. In addition, through dividends and taxes, in 1986 alone we contributed £1.4 billion to the Treasury so the Government should be more than satisfied with the financial impact of the privatisation of the Company. Despite holding 49% of the shares and nominating two Directors, it is important to understand that the Government does not interfere in the day-to-day decision making of the Company, and the relationships between the Company and Government are those shared by other large responsible companies rather than any particular relationship derived from the historical State ownership. Also the breakthrough in individual share ownership achieved by the British Telecom flotation has led, with the other major privatisations, to nine million individual shareholders, more than double the level in 1983. Few would disagree that British Telecom today has a new drive and commercial vigour resulting from the opportunities and responsibilities of operating in the private sector.

What about the media? It is bad news that sells newspapers, not good news, so that we as a large and well-known organisation have been subject to a heavy media attack in 1987 related largely to the issue of quality of service. This is frequently connected to the size of profit we make and the figure of £2 billion profit before tax has been described as an obscene figure. What is so often overlooked is that, in terms of return on capital, it is a perfectly acceptable level as our turnover is nearer £10 billion. It is encouraging to note that the regulator has stated publicly that he is satisfied that the level of

profits we earn are reasonable for the type of industry in which we operate. However the media have chosen to take the absolute value of profit and compare that to criticism of the service that we provide.

The UK regulator, the Director General of OFTEL, has himself pioneered a new environment and not only has responsibility for ensuring that the Licensed operators obey their rules, but follows very closely the interests of the users to be satisfied that competition and user choice is real. The regulator is politically and financially independent of Government, and he exercises his independence vigorously. His view of the experience of the last few years will of course be a major factor in recommendations for any change in the regulatory environment post 1989. Equally, regulators in other countries are impacted by the changes in the UK. For example, the erosion of the traditional bilateral agreements between telecommunication operators has been accelerated by changes in North America and the UK, and OFTEL is continually sought by others who are exploring the possibilities of change within their own countries.

It is probably an understatement to say that the telecommunications supply industry in the UK was rather unenthusiastic about the changes, simply because so many of them had a large captive customer in British Telecom, which to say the least made life comfortable. The disadvantage of a large captive customer at home is that enthusiasm for exporting is diminished. There are already significant signs of change of attitude from the UK based industry, now that the home market is open to many suppliers and the proposed rationalisation of the industry reflects not only changes at home, but the nature of the worldwide telecommunications market. To be fair, the UK telecommunications industry does operate at a great disadvantage in that the market at home has been liberalised and is competitive whereas so many markets around the world remain heavily protected and the barriers for entry are very high.

It may surprise you that I include competitors in my list of

stakeholders but as the dominant supplier of telecommunications it is our policy to compete firmly but fairly in the market place the standards we set both technically and commercially are of significance to competitors, particularly those that are small and operate in narrowly defined sectors of the market. British Telecom welcomes competition. It is our firm belief that it is an essential spur to change and the creation of an innovative approach within the Company.

Observations

In trying to learn from the UK experience, let me preface my remarks by saying that there is no single correct solution for implementation, but it may be that the pioneering that has taken place in the UK can be of help in the development of new approaches in other countries.

The transformation in the UK is not yet complete, particularly in regard to the technological, organisational and cultural aspects of British Telecom. In any case, the goal is continually moving.

There is no doubt that the maturity of the country, and in particular the maturity of the telecommunications network, is a very significant issue in determining a future program of change. For example, the introduction of competition, not just in equipment but indeed in networks, is both feasible and practicable in a country with a mature network. It does however become rather more difficult in a developing country where the main priority remains the development of the main telecommunications infrastructure.

The term 'privatisation' has, I suspect, been somewhat misused and it seems to me that for the developing countries the issue is how effective access to private capital can take place to speed up the enhancement of the national telecommunications infrastructure, be that on a national or perhaps a regional basis. This is a separate issue from that of the restructuring of the PTT, where the natural desire is to create a spirit more related to the commercial world

than the Civil Service environment. I believe that the restructuring or commercialisation of the existing operations is appropriate in any case and more importantly is a prerequisite to the successful privatisation of the state owned enterprise, either wholly or partly. The transfer of the state telecommunications operator from public to private status will only be truly effective when the style and efficiency of the organisation can be demonstrated to be attractive to the private investor. The dilemma of course is how you motivate such an organisation to change in the absence of competition. The experience in the UK is that competition is an excellent agent for change.

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MICHAEL LAW RETIRES

Ada Hulshoff

Michael Law has left many friends, the PBAA, ACLA and the other Australian causes he has at one time or another got himself involved in, to return to his native England and retire.

No one would argue his retirement isn't more than deserved. No one would argue either, that his retirement leaves a huge gap in the life of a number of organisations and people, most of all the PBAA.

Michael is the undisputed father of public broadcasting in Australia. There were others there with him to share the hard work, pains and joys of gestation and birth, but he stayed to hold the baby. Let me qualify that: he did much more than just holding it. He nursed and cared as the public broadcasting family grew, he mopped up many messes, washed his fair share of dirty linen, but most important of all, he nourished and kept on nourishing this broadcasting family with his

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