Industry Views

Communications Review*

A journal for telecom, cable, satellite, and Internet executives

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Communications Review

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Contents

10 Message from the Editor

Features

12 **The Groundwork of Convergence**

As the communications industry continues reshaping its operations and business models in preparation for a convergent, customer-centric world, M&A activity has been rebounding dramatically. To date, however, many deals have reflected the renewed strength of incumbents' financial bases and a reshuffling of global portfolios rather than a drive to pull together the various components needed to create and deliver integrated services. With domestic and cross-border consolidation set to continue, executing sound deals and learning the lessons of the dot-com deal frenzy will be key to success.

by Simon Lamb and Philip Shepherd

18 **Getting the Whole Picture**

Historically, the failure of acquirers to focus on human resources risks and issues has caused many M&A deals to destroy value. Today, as mergers and acquisitions continue apace in the communications industry, successful dealmakers need to raise their game in HR due diligence in order to reveal "hidden" HR costs and potential pitfalls. People-related issues that acquirers, vendors, and investors should focus on include pension liabilities, tax processes, share options, and contractors. Without rigorous due diligence in those areas, buyers may find they have acquired some nasty surprises.

by Steve Couch and Debra De'Ath

24 **Change in Direction**

Digital media and communications technology are doing far more than enabling consumers to access new forms of content. They are actually driving a social renaissance that is creating unprecedented opportunities for the advertising industry to execute its core aims in powerful new ways. PricewaterhouseCoopers calls this opportunity *lifestyle advertising*—and its three foundations are relevance, engagement, and trust. As new media and distribution platforms emerge, the ways in which brands pursue those three as objectives of their customer relationships will need to continue to change.

by Deborah Bothun and Mike Kelley

Perspectives

34 **Ben Verwaayen, BT Group**
Since taking over as CEO of BT Group in 2002, Ben Verwaayen has transformed the world's oldest communications company dramatically, as well as established it as a major player in the global enterprise communications and systems marketplace. Here, Mr. Verwaayen shares his views on convergence, competition, and services—and describes his vision for a global, collaborative space where the consumer is also the creator.

38 **Marcel Smits, KPN**
KPN has expanded from its origins as the Dutch national incumbent to become one of Europe's leading cross-border communications operators and a major player in leading-edge convergent service areas such as IPTV. As CFO, Marcel Smits has been instrumental in driving this expansion. He describes how KPN has achieved its impressive growth by reorganizing and reorientating itself into a truly customer-centric organization.

42 **Sol Trujillo, Telstra**
Since joining Telstra as CEO in July 2005 from Orange, Sol Trujillo has driven a fundamental and rapid transformation of the Australian incumbent operator. As a result, Mr. Trujillo is well on the way to achieving his aim of turning the company into an integrated digital communications powerhouse. Here, he gives his insights into how the transformation has gone to date, and describes the remaining challenges that Telstra is set to overcome in areas ranging from talent to technology.

Au Sommaire

10 Message de la Rédaction

Enquêtes

12 **Les soubassements de la convergence**

Parallèlement à la poursuite de la réorganisation des activités et des modèles économiques du secteur de la communication dans la perspective d'un univers convergent et axé sur les clients, les activités de fusion et acquisition ont connu un regain spectaculaire. Toutefois, à ce jour, de nombreuses transactions témoignent davantage de la nouvelle solidité de l'assise financière des opérateurs historiques et une redistribution des portefeuilles mondiaux plutôt que d'une volonté de regrouper les différents composants nécessaires pour créer et fournir des services intégrés. Le mouvement de regroupements à l'échelle nationale et internationale semble bien parti pour se poursuivre, et la clé du succès reposera sur la réalisation de transactions de qualité et sur les leçons tirées de la frénésie des opérations de l'époque de la bulle Internet.

par Simon Lamb et Philip Shepherd

18 **Avoir une vue d'ensemble**

D'un point de vue historique, de nombreuses opérations de fusion et acquisition se sont traduites par une destruction de valeur, les acquéreurs ayant négligé les risques et les problèmes liés aux ressources humaines. Aujourd'hui, avec l'intensification des activités capitalistiques dans le secteur de la communication, les entreprises qui veulent s'engager avec succès dans des opérations de fusion et acquisition doivent relever leurs exigences en regard des études préalables à l'acquisition dans le domaine des ressources humaines afin de déceler les coûts « cachés » et les écueils potentiels. A cet égard, les acquéreurs, les vendeurs et les investisseurs devraient porter leur attention notamment sur les charges de retraite, la fiscalité, les options d'achat d'actions et les sous-traitants. Faute de réaliser une étude préalable à l'acquisition, les acquéreurs peuvent se trouver confrontés à de mauvaises surprises.

par Steve Couch et Debra De'Ath

24 **Changement de direction**

Les technologies du numérique et de la communication font bien davantage que de simplement permettre aux clients d'accéder à de nouvelles formes de contenu. Elles sont à l'origine d'une renaissance sociale qui crée des opportunités sans précédent pour le secteur publicitaire, lui permettant d'atteindre ses objectifs stratégiques grâce à des moyens nouveaux et puissants. PricewaterhouseCoopers dénomme « *publicité sociétale* » cette opportunité, qui repose sur trois éléments : la pertinence, l'engagement et la confiance. Parallèlement à l'émergence de nouveaux médias et de nouvelles plateformes de distribution, la façon dont les marques intègreront ces trois éléments à leurs objectifs de relations avec les clients devra continuer à changer.

par Deborah Bothun et Mike Kelley

Perspectives

34 **Ben Verwaayen, BT Group**
Depuis qu'il est devenu Directeur général de BT Group en 2002, Ben Verwaayen a transformé radicalement la plus ancienne société de communication au monde pour en faire un acteur de premier plan du secteur mondial de la communication et des systèmes d'entreprise. Ben Verwaayen partage avec nous son point de vue sur la convergence, la concurrence et les services, et décrit sa vision d'un univers mondial et commun dans lequel le consommateur joue également un rôle créatif.

38 **Marcel Smits, KPN**
L'opérateur néerlandais historique KPN s'est développé pour devenir l'un des premiers opérateurs européens dans le secteur de la communication internationale, et un acteur majeur sur le segment des services convergents de pointe tels que la télévision sur Internet. Dans sa fonction de Directeur financier, Marcel Smits a joué un rôle prépondérant dans cette évolution. Il explique comment KPN est parvenu à atteindre cette croissance impressionnante en réorganisant et en réorientant la société pour en faire une entreprise véritablement axée sur les clients.

42 **Sol Trujillo, Telstra**
Depuis qu'il a quitté Orange pour prendre les fonctions de Directeur Général de Telstra en juillet 2005, Sol Trujillo a entrepris une transformation rapide et radicale de l'opérateur historique australien. Sol Trujillo est en bonne voie de réaliser son objectif de faire de la société une entreprise dynamique intégrée du secteur de la communication numérique. Il partage avec nous son point de vue sur l'évolution de cette transformation et analyse les difficultés auxquelles Telstra reste confronté dans différents domaines, qui vont des talents à la technologie.

Contenido

10 Nota del Editor

Artículos

12 **La base de la convergencia**

Mientras que la industria de telecomunicaciones continúa reorganizando sus modelos de operaciones y de negocio y así preparar un ámbito convergente y enfocado en el cliente, la actividad de fusiones y adquisiciones está retrocediendo de forma espectacular. Hasta el momento, muchos acuerdos reflejan más el poder renovado de instituciones financieras importantes y una remodelación de carteras globales que la unión de distintos componentes necesarios para crear y entregar servicios integrados. Continuará la consolidación nacional y transfronteriza, y los acuerdos sólidos y el aprendizaje tras el frenesí del punto-com serán las claves para el éxito.

por Simon Lamb y Philip Shepherd

18 **Obtener la imagen completa**

Desde el punto de vista histórico, los compradores fracasaron al no centrarse en los riesgos y asuntos de los recursos humanos, lo que llevó a la pérdida de valor en un gran número de fusiones y adquisiciones. Hoy en día, las fusiones y adquisiciones siguen de actualidad en la industria de telecomunicaciones, por ello los gestores deben considerar la due diligence en RRHH y así revelar gastos "escondidos" de RRHH y posibles obstáculos. En los asuntos relacionados con las personas, compradores, vendedores e inversores deben centrarse en los fondos de pensiones, procesos fiscales, acciones para empleados y contratistas. Los compradores se pueden encontrar con algunas sorpresas desagradables, si no se realiza una due diligence rigurosa en estas áreas.

por Steve Couch y Debra De'Ath

24 **Cambio de dirección**

Los medios digitales y la tecnología de telecomunicaciones no sólo ofrecen acceso a nuevas formas de contenido. Además, crean oportunidades inauditas para que la industria publicitaria pueda realizar sus principales objetivos de una forma fuerte e innovadora. PricewaterhouseCoopers denomina esta oportunidad *publicidad lifestyle*—y sus tres pilares son la relevancia, el compromiso y la confianza. Al surgir nuevas plataformas de medios y distribución, las marcas deberán cambiar para cumplir estos tres pilares en su relación con el cliente.

por Deborah Bothun y Mike Kelley

Perspectivas

34 **Ben Verwaayen, BT Group**
Desde que fue nombrado Consejero Delegado del Grupo BT en 2002, Ben Verwaayen ha innovado la compañía de telecomunicaciones más antigua del mundo de modo espectacular, al igual que la ha posicionado como mayor *player* en el mercado global de telecomunicaciones y sistemas. Verwaayen da su punto de vista sobre convergencia, competencia, y servicios—y se decanta por un mercado global y cooperativo en el cual el consumidor es a la vez creador.

38 **Marcel Smits, KPN**
KPN ha cambiado de ser una empresa nacional holandesa para convertirse en uno de los operarios líderes de telecomunicaciones en Europa y un gran *player* en servicios convergentes e innovadores como el IPTV. Su Director Financiero, Marcel Smits, que ha sido fundamental en esta expansión, nos describe cómo KPN se ha reorganizado y reorientado hacia una compañía completamente enfocada hacia el cliente y lo que ha llevado a este crecimiento impresionante de la empresa.

42 **Sol Trujillo, Telstra**
Desde que dejo Orange para unirse a Telstra como Consejero Delegado en julio del 2005, Sol Trujillo ha dirigido un cambio fundamental y rápido del operario titular australiano. Así, Trujillo está cerca de cumplir su objetivo y transformar la compañía en una potencia integrada de telecomunicaciones digital. Trujillo relata el desarrollo y detalla los desafíos que Telstra deberá superar en áreas desde la gestión del talento a la tecnología.

Inhalt

10 Vorwort des Herausgebers

Beiträge

12 Das Fundament der Konvergenz

Telekommunikations- und Medienunternehmen richten ihren Geschäftsbetrieb und ihre Geschäftsmodelle auf konvergente, kundenorientierte Angebote aus. Gleichzeitig hat sich der Markt für Fusionen und Übernahmen grundlegend erholt. Bisher spiegelten die Transaktionen vornehmlich die wiedererlangte Finanzkraft ehemaliger Monopolisten und die Ausweitung ihrer Geschäftstätigkeit auf internationale Märkte wider, weniger jedoch den Drang zur Bündelung verschiedener Produkte und Dienste für integrierte Angebote. Vor dem Hintergrund der anhaltenden Konsolidierung im In- und Ausland sind gründlich durchgeführte Transaktionen und die Einbeziehung der Lektionen aus der dot-com-Blase wichtiger denn je für den künftigen Geschäftserfolg.

von Simon Lamb und Philip Shepherd

18 Der Gesamteindruck zählt

In der Vergangenheit führte die Vernachlässigung von Risiken aus der Übernahme von Mitarbeitern zur Wertvernichtung bei Unternehmenstransaktionen. Eine erfolgreiche Transaktion hängt heutzutage auch davon ab, ob im Zuge einer HR Due Diligence verdeckte Personalkosten und mögliche Risiken offengelegt wurden. In diesem Zusammenhang sollten Käufer, Verkäufer und Investoren vor allem Themen wie Pensionsverpflichtungen, steuerbezogene Fragen, Aktienprogramme und vertragliche Pflichten näher analysieren. Ohne eine gründliche Due Diligence in diesen Bereichen kann es zu bösen Überraschungen seitens der Käufer kommen.

von Steve Couch und Debra De'Ath

24 Richtungsänderung

Digitale Unterhaltungstechnologien bewirken weit mehr als den Zugang zu neuen Medienformaten: Sie fördern eine gesellschaftliche Renaissance, die der Werbebranche noch nie dagewesene Möglichkeiten zur Unterstützung der Marketingwirkung bietet. PricewaterhouseCoopers nennt diesen neuen Ansatz "Lifestyle Advertising". Dieser Ansatz beruht auf drei Säulen: Relevanz, Kundenbindung und Vertrauen. Mit der Weiterentwicklung neuer Medienplattformen müssen Unternehmen ihre Strategien zur Umsetzung dieser drei Kernelemente anpassen, um die Ziele ihres Kundenmanagements zu erfüllen.

von Deborah Bothun und Mike Kelley

Perspektiven

34 Ben Verwaayen, BT Group

Ben Verwaayen hat seit Beginn seiner Tätigkeit als CEO von BT im Jahr 2002 eins der weltweit ältesten Unternehmen nicht nur fundamental verändert, sondern auch als eins der global wichtigsten Unternehmen in der Telekommunikations- und Medienbranche etabliert. Herr Verwaayen teilt mit uns seine Ansichten über den Konvergenzprozess, den Wettbewerb und das Diensteangebot und schildert seine Vision eines weltweiten, interaktiven Umfelds, in dem der Kunde Konsument und Produzent zugleich ist.

38 Marcel Smits, KPN

KPN hat sich vom niederländischen inländischen Incumbent zu einem der größten grenzüberschreitend tätigen europäischen Telekommunikationsunternehmen und einem führenden Anbieter von integrierten, konvergenten Diensten wie IPTV entwickelt. Als CFO war Marcel Smits maßgeblich für diese Entwicklung verantwortlich. Er berichtet uns, wie KPN sein beeindruckendes Wachstum durch Reorganisation und Neuausrichtung seines Geschäfts erreicht und sich so zum kundenorientierten Unternehmen entwickelt hat.

42 Sol Trujillo, Telstra

Seit seinem Wechsel von Orange zu Telstra im Juli 2005 hat Sol Trujillo als CEO die Umstrukturierung des australischen Incumbents nachhaltig vorangetrieben. Mittlerweile ist das Unternehmen auf dem besten Weg, sich zu einem wichtigen integrierten Telekommunikationsunternehmen zu entwickeln. Herr Trujillo illustriert uns die eingeleiteten Maßnahmen im Zuge des Transformationsprozesses und die anstehenden Herausforderungen - vom Personalmangement bis hin zu technologischen Fragen -, vor denen Telstra in der Zukunft steht.

Message from the Editor

This summer, in the middle of a rather wet Wimbledon fortnight in London, I had the privilege of hosting PricewaterhouseCoopers' annual Communications Forum—a two-day event giving global leaders in the communications industry the opportunity to debate the key trends and challenges shaping the industry of tomorrow. A resounding success, the forum featured lively presentations and discussions of topics ranging from the impact of changing technology and globalization on fixed and mobile operators to the opportunities for content services, the role of regulation, and the challenges around business transformation and M&A.

Amid this insightful analysis, two themes stood out for me. First, traditional industry boundaries are blurring as players strive to develop new business and cost models for a converged, digital world focused on customer lifestyles rather than on products. Second, achieving the transformation necessary to create and support these new models is very tough. Speaker after speaker stressed that reshaping and restructuring, at the industry as well as the corporate level, are both absolute prerequisites and incredibly difficult in this time of widespread, rapid change. The consensus was that people skills and culture present particular challenges.

Those same themes, I am happy to see, permeate the articles in this issue of *Communications Review* even though they were commissioned before the forum took place. I am equally delighted that two of the CEOs who spoke at the forum—Ben Verwaayen of BT Group and Sol Trujillo of Telstra—agreed to be featured in the journal and subjected themselves to in-depth interviews about the challenges and opportunities of piloting a major incumbent into the converged digital age.

The challenge of reshaping today's communications carriers while traditional boundaries blur comes to the fore in the first article, "The Groundwork of Convergence." Authors Simon Lamb and Philip Shepherd examine the dynamics behind the strong rebound in M&A activity since its low point in 2004. They find that although private equity has made the headlines, incumbents' restored financial strength has made the revival possible. And while the talk in the industry is all about convergence and integration across platforms, the largest deals to date have focused mainly on domestic and international consolidation, as providers prepare themselves for the real drive for convergence yet to come. Creating value from transactions, however, will depend on the operators' crucial ability to execute deals well and learn from the mistakes of the dot-com boom.

Just as speakers and delegates at our Communications Forum named people skills and culture as particular challenges during restructuring and transformation, the second article focuses on one factor critical to successful M&A: people. In "Getting the Whole Picture," authors Steve Couch and Debra De'Ath examine the human resources risks and issues that are inherent in M&A and that—with the benefit of hindsight—frequently are blamed when deals fail to deliver the anticipated benefits. The current surge in communications deals, the authors point out, highlights the need for a more robust HR due diligence process that reveals "hidden" HR costs and potential deal-breakers clearly to all stakeholders. Key areas to examine include pension liabilities, tax processes, share options, relationships with third-party contractors, and the potential impact of head-count reductions on operational effectiveness.

In our final feature article, "Change in Direction," Deborah Bothun and Mike Kelley turn the spotlight onto a key shift behind the industry-wide wave of deals and transformational restructurings: the unprecedented, sweeping change under way in the advertising marketplace, and the emergence of *lifestyle advertising.* As new technology and distribution platforms are empowering consumers to interact with content rather than just take it in, digital distribution is enabling advertisers to learn more than ever before about consumers' individual tastes and lifestyles. The result is a blurring of the traditional divisions between content and advertising and between messenger and consumer. Against this background, the authors explore how companies can employ the three foundations of lifestyle advertising—relevance, engagement, and trust—to communicate their brand and transform customer relationships.

Finally, in our Perspectives section, we take our customary trip to the heart of transformation in the communications industry and interview selected leaders and decision makers from around the world. Each industry figure in this issue has a well-deserved global reputation for leading and executing change. First, Ben Verwaayen explains BT's strategy for becoming ever more competitive in a convergent world, as well as how consumers' growing urge to become producers in their own right is reshaping BT's services. Then Marcel Smits, CFO of the expanding Dutch national incumbent, KPN, discusses his company's vision and strategy across areas ranging from technology to regulation. Finally, Sol Trujillo provides a progress report on his company's transformation, and describes how integration across all networks and platforms is key to Telstra's mantra of "making it simple" for customers.

I have been involved in the communications industry for longer than I care to remember, and I can recall no phase as exciting and dynamic as the one we are now experiencing. The technology, the demand, the funding, and the will—all are there to support the creation and delivery of increasingly innovative, personal, converged services. As industry barriers evaporate and communications companies reshape themselves, we all have to decide precisely what business we are in. At root, that is what everyone in this issue of *Communications Review* is talking about.

But is it what *you* are talking about in your business? I would love to hear your feedback, to help us keep our finger on the industry pulse. Whatever comments you might have, please feel free to send them to me at paul.g.rees@uk.pwc.com or at [44] 20 7213 4644.

Paul

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The Groundwork of Convergence

After hitting a low point in 2004, deal values in the communications market have recovered strongly over the last two years. Private equity may have captured the column inches, but the main driver of the recovery has been the restoration to health of the large incumbents' balance sheets. The market buzz has been about convergence and the tantalizing possibilities of delivering truly integrated fixed, mobile, data, and content services, but none of the largest deals to date has been a pure convergence play. Instead, communications companies are preparing the ground for convergence through domestic and international consolidation. Execution—and learning from the deal frenzy of the early 2000s—will be critical to creating value from this new wave of consolidation.

by Simon Lamb and Philip Shepherd

Over the last couple of years, major communications companies have rationalized their portfolios, strengthened the ownership of their separate operations, and increased their footprint overseas. In the United States, in particular, there has been a substantial round of domestic consolidation, including mega deals such as the US$39 billion acquisition of Nextel by Sprint and the $73 billion acquisition of BellSouth by AT&T. In Europe, the volume of communications deals in 2005 and 2006 remained stable, with 447 and 422 transactions, respectively.

Those figures fall short of the volume at the market peak in 2000, when nearly 900 transactions involving European businesses were recorded. But deal values in Europe have seen a strong recovery, hitting more than €100 billion in both 2005 and 2006 compared with a low of €36 billion in 2004. In 2005, substantial individual deals included the €6 billion-plus acquisitions of Wind in Italy and Amena in Spain. In 2006, the landmark transactions included the €25 billion acquisition of O_2 by Telefónica and the €8.5 billion acquisition of TDC by a consortium of private equity investors. Other major non-European deals included Softbank's purchase of Vodafone KK in Japan for $14 billion.

What's driving the deals?

This resurgence in value of global communications deals over the last couple of years has been characterized by three factors: fixed-mobile convergence, consolidation, and international expansion. As major communications companies have seen their balance sheets restored to relative health through disposals and increasing profitability, they have been able to undertake some significant transactions to position themselves to execute convergence strategies, providing users with not only fixed and mobile services, but access to a range of high-speed data and content as well.

Fixed-mobile convergence

Fixed-mobile convergence has been around for a while, at least as a concept, and what's shaping it has evolved during the last two years. In many markets, the growth of wireless revenues has slipped to single figures. Fixed-line voice revenues are falling for many operators while broadband penetration is accelerating. Operators, therefore, are looking at opportunities beyond their core markets, trying to build complementary businesses that capture a greater share of increasing consumer spending on communications, media, and entertainment, blurring the traditional divide between these markets.

At the beginning of the decade, the much-vaunted idea of fixed-mobile convergence failed to deliver the value that was widely discussed and hoped for by many. Mobile operators, for example, saw far greater value in focusing on their core markets—which were still showing high rates of growth—than they did in offering new services. But with many of those same mobile markets reaching saturation, is convergence more likely to deliver on its promise in today's market? A number of factors suggest that pursuing convergence will yield a considerable prize to the successful.

For instance, in the more developed markets of Western Europe and the US, operators are being hit by a number of factors that are intensifying competition. High levels of mobile penetration have reduced the scope for growth from traditional voice services, and data services have yet to have a meaningful impact. At the same time, fixed-mobile substitution has begun to bite hard, causing declines in fixed voice revenues while the growth of broadband encouraged by LLU (local loop unbundling) has opened up the further threat of VoIP (voice over Internet Protocol). Smaller single-service players in those markets are finding life increasingly tough.

As national incumbents set about positioning themselves for convergence, the last two years have seen a number of deals involving the reacquisition of assets that were disposed of only a few years prior.

France Telecom completed its buyout of minority shareholders in mobile operator Orange in 2005. Telecom Italia followed suit with its buy-back of the outstanding 44% of Telecom Italia Mobile (TIM) for €23 billion. Deutsche Telekom completed the acquisition of outstanding shares in ISP T-Online that it spun off in 2000. In similar consolidation in the Irish market, incumbent Eircom re-entered the mobile market with its acquisition of Meteor for €420 million, and Belgacom bought out Vodafone's 25% stake in Belgacom Mobile for €2 billion.

This reversal of the trend to divest assets is a response to the decline in revenues for fixed services and the perceived importance of capturing a customer base that increasingly seeks to use one provider for all its communication needs. In the US, Verizon bought MCI for $8.8 billion and AT&T got back into the mobile business through its full ownership of Cingular following the BellSouth acquisition. Having control of fixed, wireless, and broadband networks looks to be a major priority, as triple- and quad-play converged services are designed and rolled out to consumers.

While many of the transactions of the last couple of years can be understood in terms of pursuing a converged strategy or responding to the perceived opportunities that convergence creates, most are at the preparatory stage. There is a sense of expectation in the market, but also a degree of anxiety, about the extent to which convergence will deliver on its promises this time around. In that context, the €1.3 billion tie-up between NTL/Telewest (now Virgin Media) and Virgin Mobile in the United Kingdom to offer quad-play services will be watched carefully by the industry, and the very public spat between BSkyB and Virgin Media over content will be followed closely. Other deals with a distinctly convergent flavor, such as Sky's acquisition of Easynet and CarphoneWarehouse's acquisition of AOL UK for €548 million, are of great interest strategically but of low value comparatively.

There are also signs that competition may arise from other sectors. They include, for example, eBay's acquisition of Skype and Apple's launch of the iPhone in June—the first handset with the potential and the marketing impact to drive consumers much more rapidly toward convergence. Taken together, then, the signs indicate that 2007 may be the year when the promise of convergence is asked to deliver.

Consolidation
Creating scale through in-country consolidation has been at the heart of several other headline deals of the last couple of years. In 2005, 23% of European deals by value were classed as consolidation, although this percentage dropped in 2006, with 13% representing some form of in-country acquisition. In the US, consolidation represented the majority of the deal value over the same period.

As markets mature, consolidation will increase when smaller operators find themselves unable to compete. Most markets will leave room for only two or three major players. Consolidation will occur particularly as we move into next generation networks and services that will require significant investment. The US market, as mentioned already, has consolidated significantly to three main players. Europe, with a similar sized population, still has at least two main operators per country.

In mobile, recognition is widespread that in terms of market share, the fourth—and in some cases third—place operators will struggle to compete in national markets. Indicating this tougher environment, Nextel and Sprint came together in a deal valued at $37 billion, TeliaSonera acquired Orange Denmark from France Telecom for €600 million to consolidate with its existing operation in Denmark, and T-Mobile in Austria bought mobile operator tele.ring for €1.3 billion. In the Netherlands, KPN sought to bolster its mobile business with the €1 billion acquisition of Telfort, the ex-O_2 Netherlands business, and in Greece, TIM Hellas merged with its smaller competitor Q-Tel to create a mobile business with a subscriber base in excess of three million.

Against a background of declining income for fixed calls, the alternative providers look to be acquiring scale in order to square up against the incumbents with converged offers.

In the UK, Cable & Wireless acquired Energis with the express intention of ensuring that it had the scale to compete with incumbent British Telecom (BT) to provide high-speed converged services. In a similar move across the channel, Vivendi Universal's subsidiary Cegetel merged with Neuf Telecom to create the second largest fixed-line operator in France and a major player for high-speed Internet services. The acquisition of altnet Invitel in Hungary by cable company HTCC typifies the types of transactions that are seeing smaller providers combining to take on incumbents both in their home markets and regionally.

European cable operators also have pursued consolidation in their efforts to compete with incumbents. ONO, one of Spain's leading cable operators, acquired 100% of Auna TLC, the cable division of Grupo Auna, for €2.2 billion, and Liberty Global acquired NTL Ireland. In the UK, in the largest European cable deal of the last two years, NTL acquired Telewest for €4.75 billion, creating the biggest single cable operator in the UK.

Private equity has played a significant role in the European cable market. Cinven, a major player in the cable space, has completed acquisitions in France: Altice One (which also includes Video Com and which serves the Alsace region); Coditel (which provides telephone, broadband, and digital TV to subscribers in Belgium and Luxembourg); as well as the cable operating subsidiaries of France Telecom and Canal+ and the Dutch cable operator Casema (in a deal that brought together Casema—the third largest cable provider in the Netherlands—with Multikabel, the fourth largest). North America also has been an active market for financial investors, with the $25 million acquisition of Alltel by Texas Pacific Group and GS Capital Partners and the proposed $45 billion sale of BCE in Canada to a consortium of private equity firms.

International expansion
The last major boom in operators' corporate activity in 2000 included the execution of deals designed to achieve truly global businesses operating across all major markets. Today, we are seeing a more selective international strategy being pursued by some of those businesses that previously sought to bestride the world. With developed markets showing signs of saturation and revenues under pressure from intense competition, operators are turning their attention to fast-growing markets that have penetration rates significantly lower than those of Western Europe.

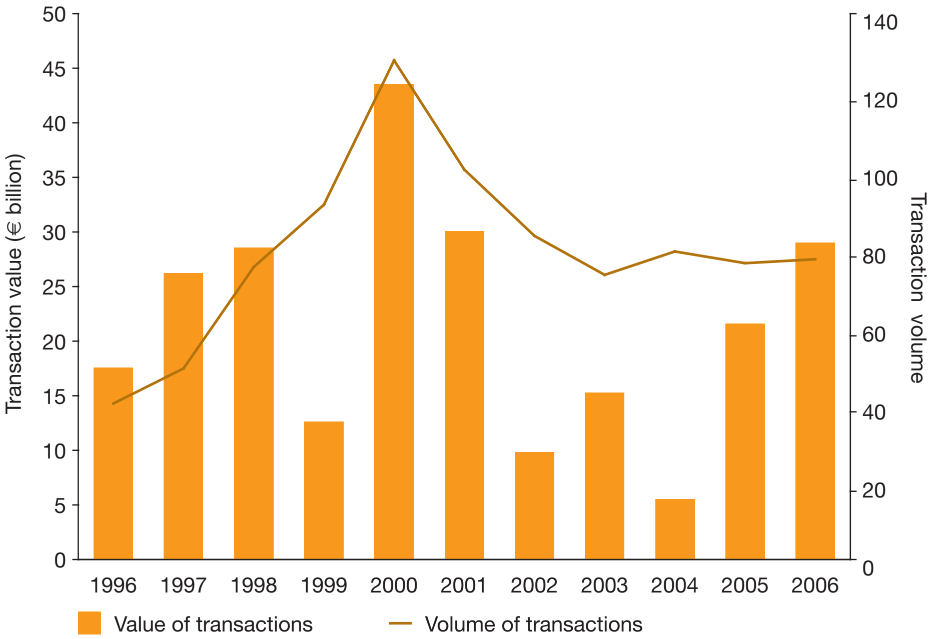
Vodafone, for example, has made significant disposals in Japan, Belgium, Sweden, and Switzerland. Rather than competing against established players in all markets, Vodafone appears to be consolidating its position in the markets in which it has a leading operation and focusing on other markets that suggest significant growth opportunities. These consolidations include acquisitions in Turkey, where it bought mobile operator Telsim for €3.6 billion, as well as acquisitions in Central and Eastern Europe, among them Mobifon in Romania and Oskar Mobil in the Czech Republic for €3.5 billion. Completing the deal to buy a majority stake of Hutchison Essar in India for €11 billion will transform Vodafone's growth profile.

In addition to making the largest European acquisition of 2005 and 2006 (the €25 billion paid for O_2), Spain's Telefónica has also expanded into Eastern Europe with the acquisition of Cesky Telecom from the Czech government for €2.8 billion. Others, too, have joined the race into the high-potential markets in Eastern Europe, with Swisscom's acquisition of Antenna Hungaria, Telekom Austria's acquisition of Mobitel in Bulgaria, and Telenor's buying of Mobi63 in Serbia. Completion of the sales processes of the Bulgarian Telecoms Company and GTS are imminent at the time of writing.

A trend in the European region has been the expansion of the Middle Eastern operators. Egyptian operator Orascom acquired Wind in Italy for €10.3 billion and, recently, TIM Hellas in Greece, while Oger Telecom spent $6.5 billion on Turk Telekom. Noticeable by their absence from international deals have been the US operators, who have focused mainly on domestic consolidation.

Despite the constant speculation about private equity in most transaction processes, the actual amount successfully concluded is still relatively small, although growing. In 2005 and 2006, private equity accounted for 17% of deals by volume in the European market. However, at more than €30 billion in 2006, they accounted for nearly 30% of value—significantly higher than in the previous five years (which ranged from 15% to 20%). In the biggest single private equity

Figure 1: Private equity poised for major deals?



After European telecommunications transactions peaked in 2000, investors began turning some attention to fast-growing markets in other parts of the world; however, the fact that private equity investments accounted for more than 30% of the deal value in 2006 may indicate a new trend.

Source: Thomson Financial, deals where the target was in wireless, telecommunications services, telecommunications equipment, space and satellites, other telecom, cable networks (not channel management), in Europe (Western and CEE) and the "Acquirer Macro Description" was "Financial" between January 1,1996, and December 30, 2006, with the NTC acquisition included.

deal, the Danish incumbent TDC was acquired for €8.5 billion by a consortium comprising KKR, Blackstone, Apax Partners, Permira, and Providence Equity Partners. One member of that consortium, Blackstone, also acquired a stake in Deutsche Telekom for €2.65 billion.

As noted earlier, private equity plays have been particularly active in cable, but interest has also been significant in other communications assets. Infrastructure has attracted particular attention, as demonstrated by the €5.1 billion investment by Texas Pacific Group and AXA Private Equity in French mobile tower and digital broadcast group TDF, announced in October 2006 (and expected to be completed in 2007).

Some private equity industry commentators have predicted a private equity deal in excess of $100 billion within the next two years. Communications assets, including even some of the larger national incumbents, have been discussed as possible targets for such a transaction. Though some barriers to such a deal taking place exist—including regulatory obstacles—there seems to be little doubt that the disciplined and value-focused approach that private equity brings to the market will continue to exert a strong influence. Add to that the growing willingness of private equity houses to work together (as shown in the TDC and BCE acquisitions) and the limits to what can be achieved in the communications sector appear to be few.

Avoiding earlier mistakes

The substantial deal activity in 2001 and 2002, followed by the stock market falls and resulting liquidity crunch, left a number of operators in a difficult financial position. Operators need to learn from this experience to ensure that the current M&A activity does not lead, ultimately, to disappointed shareholders.

We believe that a revised approach to acquisition is evident in recent M&A activity, showing that indeed a number of lessons have been learned. Those seeking to acquire are now focusing their deals more on strategic fundamentals, formulating clearer rationales, and more rigorously assessing and mitigating risks associated with deals. The market for communications businesses is very competitive, with both trade and private equity players seeking to obtain assets that now represent long-term, cash-generating machines.

To win in auctions, players often need an edge in terms of insights that will enable them to unlock hidden value post-acquisition. Many recent deals have been done at relatively high prices, creating pressure to rapidly implement integration benefits. What creates value in most deals is cost savings, be they in marketing, customer services, networks and operations, or central overhead. Executing such programs is fraught with difficulty and risk, and acquirers will need to invest in the robust methods that can deliver sustainable change while balancing the requirements of "business as usual" value creation.

Investment and change programs that are unbalanced can result in severe consequences, for example:

- Making changes that are not sustainable and that cause customers to perceive degradation to the level of service they receive.
- Eliminating redundancies followed by re-recruitment, often disguised as taking on former personnel as contractors.
- Failing to realize the full value of synergies, often due to former management teams remaining *in situ* for years beyond the original intention.
- Failing to realize expected improvements in earnings from existing performance improvement projects—both revenue and cost related—as a result of not focusing on business as usual.

Another area that companies need to consider after a deal is local context. Communications operations typically serve the needs of local customers and thus have a primarily national focus. There are some genuinely international services—for example, mobile roaming or networking solutions for major multinational organizations—but they tend to be served from operations built on national units. Thus, while there are benefits from international scale (in procurement and R&D), operators need to be very sensitive to local market dynamics. A model that works in one geography or culture often is incompatible in another.

Many acquisitions also have value associated with the competencies of acquired management and other personnel, and nearly all place pressure on management to deliver. Post-merger work that is insensitive to the needs of personnel can result in the loss of valuable people, as well as suboptimal performance in the resulting integrated operation.

We believe that all acquirers can benefit from adopting best practices that have been road tested by leading private equity houses. For such players, debt funding of deals depends on developing bankable business plans and ensuring that financial, commercial, operational, synergistic, and separation aspects behind the projections can withstand the scrutiny of an independent diligence process. This protects equity holders, by helping to control the risk of private equity management being too optimistic in valuations, as well as debt holders. As a consequence, the *planned* cost savings and synergies from integration are normally well founded.

Operators and investors must remember the failed integrations of recent memory—the synergies not realized five years on, the acquired company that vanished through customer and staff defection, the billing project that caused national headlines, the separation costs and issues that resulted in budgets being missed—and translate the carefully prepared pre-acquisition plans into a powerful, closely managed program of work. All of that needs to be supported by a well-mobilized team of managers, from both the acquiring and the acquired businesses, and clear ownership of every aspect of the integration. Those steps, and the funding behind them, must not be underestimated if investors and operators want to drive full benefits from the deals and meet shareholders' expectations.

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QUARTERS ONLY
25¢
1. DROP COIN IN SLOT
2. PULL HANDLE DOWN
ALL THE WAY-LET GO

Getting the Whole Picture

Underestimating the human resources risks and challenges inherent in acquisitions, mergers, internal restructuring, and other major transactions has frequently been cited as a reason for the failure to deliver expected value. While compromised value has been a source of disappointment, in itself it has not been sufficient to raise the profile of the considerable risks and challenges surrounding people at instigation.

However, the environment has changed.

by Steve Couch and Debra De'Ath

As communications companies have rationalized and consolidated their portfolios to strengthen ownership of separate organizations and to increase global coverage, the requirement to cover legal and regulatory requirements has grown. There is a fundamental need for a sound due diligence process on human resources (HR) that allows management, potential investors, purchasers, and vendors to clarify, assess, and manage potential deal breakers and "hidden" HR costs more effectively.

As players jostle for position in communications markets worldwide, the industry is poised to change shape, and competition to intensify. Numerous transactions have been taking place in the communications sector: Cable & Wireless acquired Energis in the United Kingdom; Cegetel merged with Neuf Telecom in France; SBC acquired AT&T and, subsequently, BellSouth in the United States.

In each of those transactions, there were issues concerning people to address and HR risks to assess and quantify. The size of the workforce and its structure and integration needed careful management and a clear strategy. Employee costs are a significant figure on any operator's P&L, and the desire to reduce those costs without compromising service is almost always on the acquiring company's agenda.

Managing people risks in compliance and operations

People risks can be found in aspects of everyday compliance and operations. From a tax perspective, accounting provisions often can provide information on the health of an operator's HR tax accounting as well as the quality of its tax compliance history and relationship with the tax authorities. But a review of the payrolls and associated processes and controls does not go far enough in assessing whether there are income tax and social security withholding issues within the organization.

Some of the largest communications companies, despite robust financial controls and HR processes, struggle to capture, record, and pay the correct withholdings for their employees in the right territories and at the right time.

Recent accounting changes, International Financial Reporting Standards, and regulatory requirements affecting the accounting of share plans and incentives, for example, have shown us that even the largest corporations have had significant HR tax liabilities to pay for the thousands of internationally mobile employees who are exercising share options with regularity.

Such individuals frequently trigger liabilities in higher tax regimes, and companies are finding it very difficult to capture and record the transactions and to understand the global differences both in reporting the transactions and in the tax treatment of these awards. The timing of a transaction can affect the employees' personal tax liabilities significantly and can trigger a series of events for the options holders in a company that is being acquired. The financial liabilities for large operators in this situation can be material, as the growth in share prices has risen sharply for many of those organizations over the past five years.

Managing internal expectations with appropriate, informative communications can ensure that employees understand both their own and the company's obligations to capture and report their benefits in accordance with local territory requirements. Relying on a shared services center to produce accurate payroll tax returns and statements of benefits for each employee demands complete confidence in each of the separate business operations to pass information to the center in a complete format and on a timely basis.

In any country where the local tax authorities choose to conduct an audit of an operator's payroll tax compliance and employee benefits, the organization may discover that it has additional liabilities to pay that previously were unaccounted for. How much the communications company will pay in these circumstances usually depends on how large the organization is within the specific territory—the number of employees, structure, and diversity of operations.

The challenge for most organizations is that no one individual person, function, or department has overriding responsibility for the accuracy of the HR tax liabilities. Typically, responsibility is spread across the organization, and the due diligence process must reflect the need to ask each business unit and its operations the same or similar questions regarding the HR reward strategy, policy and processes, the administration of employee compensation, and HR tax compliance. This information is essential to enable the acquirer to detect and, if necessary, avoid potential financial and reputational risks farther down the line.

HR due diligence: What should it address?

The people within an organization can also create significant financial exposures, and certain aspects of people-related risk are common to most organizations within the communications industry.

The due diligence process provides the opportunity for the acquiring company to test the quality and effectiveness of the target's HR function, the accuracy of the data that it holds on the people within the business, and how that information is used for budgetary and financial purposes. The process also provides the opportunity to assess and review the IT infrastructure supporting the HR function—particularly where the operator has international operations and the acquiring company needs to verify the movements and whereabouts of the mobile workforce.

HR due diligence is not always carried out as robustly as it should be, and the extent of the risks associated with communications operators' people are not always obvious to the purchaser or investor. The consequences for getting it wrong can be costly and can affect the company's reputation, its ability to recruit and retain key talent, and therefore its ability to develop into new markets and territories. The bottom line is that each of those results can affect productivity and profits considerably.

An area of risk that commonly affects employees—and a subject that regularly hits the headlines worldwide—is that relating to pensions liabilities. The questions a potential purchaser should always ask are:

- Does the operator have a very large pension deficit that will need funding?
- How reliable are the figures?
- Are there any unrecorded liabilities?

Extensive regulations, to protect employee pensions, are prevalent throughout the world, and pension liabilities have been known deal breakers in the UK and other countries. For this reason, every aspect of financial due diligence should now incorporate a detailed account of an operator's pension position.

Relationships with "individual" contractors: Are they integral to the business?

Pensions are probably one of the most obvious areas of risk in the HR function, but what about areas that are less clear? Take a look at the people who are not being treated as employees—third-party contractors, self-employed project managers, business partners—but who are, nevertheless, significant parts of communications organizations. It is important to challenge the payments and benefits that are being made to those individuals, free of withholding taxes and social security.

Relationships with external and third-party contractors require close review and can be barriers to the success of a deal. When a communications company relies heavily on the services of independent and external contractors (personal service companies, project workers, and self-employed individuals), to the extent that those people have become integral to the management of the business, the potential purchaser or investor must be made fully aware of those relationships and the implications thereof.

When third-party contractors represent a significant part of the research and development department and have fundamental roles in developing next generation technology, we ask, how would a change in corporate structure or ownership likely impact their relationship with the operator? As the acquiring company faces a number of risks in this situation, understanding the roles of those individuals, including them in discussions early on, and understanding the nature of the business relationships and the contractual responsibilities and expectations of all parties are all important.

A European operator recently was investigated by the UK tax authorities over the nature of its relationships with more than 3,000 individuals who were engaged on self-employed terms for specific projects, client engagements, and the R&D for next generation technology. The authorities challenged the basis of the relationships between the operator and the individuals and concluded that 60% of the contractors should be reclassified as employees. An assessment for unpaid taxes and social security costs has run into several million pounds (sterling). Although the operator is taking professional advice and appealing those assessments, the time and cost of managing the issues and the resources required to investigate every aspect of the contractor processes and individual arrangements are substantial and disruptive to the business.

That investigation began as a routine inquiry by the tax authorities and escalated very quickly as a result of a transaction and the media coverage that was generated, describing the operator's plans and activities. It illustrates the types of risks and issues that many organizations fail to spot until after a deal has been done, at which point the contractor discovers that he is in a strong negotiating position, in a highly competitive environment.

Reducing costs—and head count

When restructuring the size of the workforce as the result of a transaction, communications companies need to understand how the workforce has been deployed and is being used. In common with the contractors described in the previous paragraphs, it is important not to underestimate the significance of the back-office functions and the nontechnical workforce. These people can be just as important to maintaining the shape and external face of an organization as is the brand itself, and they can support the corporate image in a way that is positive and visible to the operator's markets. The customer experience speaks volumes—and a poor experience can be deafening.

In many examples of M&A activity in the communications industry, the success of a consolidated business was potentially jeopardized by the extended operations being unprepared and overwhelmed by an increased volume of business. The recent experiences of Carphone Warehouse/AOL and NTL's acquisition of Telewest in 2006 (now Virgin Media) provide good examples.

Carphone unleashed a broadband price war in April 2006 when it offered "free" broadband to customers who signed up for its TalkTalk services. The number of new customers generated as a result was significantly higher than anticipated, forcing the company to take on hundreds more staff. At the same time, the pressure on the business to deliver its new service, combined with the anxious-client experience, created a host of problems. By securing AOL's 1.5m broadband customers, Carphone has subsequently quadrupled its client base. The pressures on its operations and ability to deliver services to its customers suggest a potential increase in losses for 2007, recently estimated at £70 million.

Managing people risks: Assess commercial expectations from an HR perspective

- Understand the effect on your finances, immediate and future, of any commitments that have been made, such as incentives, pensions, equity arrangements, and other benefits.
- Consider which HR data and metrics will help you achieve the business objectives of the transaction or the restructuring activity.
- Understand the extent of any contractual obligations concerning employees and obtain legal advice both relevant and appropriate to the territory in which you are operating and carrying out the transaction(s).
- Review and measure the quality of HR reports on business-critical aspects of people's performance.
- Engage with the workforce and ensure that employees understand what is expected of them and how they will be rewarded, what it will feel like to work for the new company, and what the future of the business looks like.

continues on next page

Managing people costs and related risks during the M&A process

- Price transactions accurately and appropriately by quantifying issues (such as the costs of relocating) that concern people and benefit programs.
- Be sure to take into account significant liabilities and employment obligations, both current and future, that relate to pensions, share schemes, change of control, and severance promises.
- Take advice on restructuring the workforce—whether you need to relocate employees, redeploy specific skills, or calculate severance arrangements.
- Conduct a comprehensive review of contracts and reward structures.
- Communicate with employees—engage with the staff and maximize the ability to maintain business as usual during a period of change.

Historically, NTL has suffered criticism for poor customer service and its service proposition. The impact on NTL's workforce, reflected by poor retention and low morale, created a significant risk to the operations in various aspects of the business. The company's more recent deal activity reminds us once again that when differing operating styles and cultures come together, the sustainability of the business deserves much consideration. Success requires careful planning and a clear strategy for the people issues, both during and post deal.

Reducing head count is a probability of any transaction. Managing the redundancy process across several countries caused one global operator a significant headache in 2006.

In this example, the organization had announced to the markets and the international media that it would reduce its workforce by 6,500 people across five European countries to concentrate on expansion in Africa and parts of Asia. The HR and finance functions were centralized and the cost of severance payments was calculated based on a rudimentary understanding of the employment law in each of those five countries. The local teams were not consulted because of the sensitivity of the plans to cut jobs, and the corporation's own due diligence failed to identify that local practice and union agreements required payments to individual workers that far exceeded the minimum legal requirements. A risk review of the HR operations, set up to support the due diligence process, identified these areas of potential financial exposure, and the company was forced to recognize additional costs of more than €12 million.

Building and rewarding the right team

The communications industry relies heavily on the talent of its people. With companies operating in an increasingly competitive market, the need to recruit and retain the best talent to ensure an edge over their competitors must be a consideration in the consolidation process.

Arguably, incentives are more relevant and motivating to management when performance measures and incentive designs are directly aligned to business strategy. It is a legitimate aim of shareholders that executive rewards should discriminate appropriately between stronger and weaker performers over the long term. The HR due diligence process can be used to measure the adequacy of the performance system of the target company and the basis on which bonuses and incentives will be triggered. Managing the conflicting demands of executives and shareholders in the current governance and regulatory environment is a difficult and challenging task.

The point at which many organizations have felt the need to harmonize incentives, and even salaries, often has occurred when executives from different home countries have been working alongside each other in the same location. This tends to occur more frequently with large, cross-border mergers in which the two leadership teams are combined to work in a common executive group.

Although employees working in different countries but fulfilling similar roles generally accept that their rewards differ, given variations in local market conditions and practices, executives undertaking international or global leadership roles may have an alternate viewpoint. At this level, the balance of business and leadership skills has universal appeal and market relevance. In the deal environment, it is essential to identify, at a very early stage of the transaction, the people who will be key in successfully integrating the business and for its future potential. After this process of identification, the acquiring company will be better informed about the quality of talent within the organization and can then benchmark those individuals appropriately and with the business strategy and objectives firmly in mind.

Conclusion

When looking at the profile of an acquisition target in the communications industry, give adequate attention to identifying and addressing the people risks and issues that might challenge the viability of the deal or influence its price.

Any communications company embarking on a significant transaction will face considerable risks and challenges in relation to the human resources—the people—aspects. Whether a transaction consists of acquiring or restructuring in a local territory or across international borders, its success will rely heavily on the company's ability to identify key risks and to manage effectively the financial obligations it inherits, such as pension costs or legal and contractual entitlement.

Employee communications require careful consideration and the ability to engage with the new and extended workforce. Maintaining business as usual throughout the period of change will reflect the strength of the management team and the quality of the talent therein.

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Change in Direction

The most fundamental shift in the history of media usage is upon us. Empowered by new technology and distribution platforms, consumers are engaging with media and advertising in new ways. They are interacting with content, not just taking it in. Advertisers can now gain far greater insight into consumers' preferences, interests, and points of view than ever before. Even as change resounds through the industry, the advertising marketplace does not yet fully reflect this profound movement or the consumer control resident in the shifts.

by Deborah Bothun and Mike Kelley

The formerly crisp lines between content and advertising, messenger and consumer are officially blurred. Consumers now talk directly to companies as well as about them. Having gained the power of a worldwide forum, consumers can, very publicly, impact brands, products, and services. They can skip or ignore whatever they do not wish to view or engage. No longer limited by geography, they can participate in new social worlds that influence their media and their purchasing, to an extent never before witnessed.

A technology-driven social renaissance is creating unprecedented opportunities for the advertising industry to execute its core principles in powerful new ways. Instead of attempting to position themselves alongside the segmented lifestyles of mass audiences, advertisers must now aim to position their brands within the lifestyles of individual consumers. This opportunity PricewaterhouseCoopers (PwC) terms *lifestyle advertising.*

Lifestyle advertising is advertising and messaging that allow advertisers to respond to consumer feedback interactively by means of an ongoing dialogue. It embraces online discussion boards, chat rooms, weblogs, user-review forums, and social networks to gain greater insight into consumers' preferences, interests, and points of view. It is personalized, participatory, and socially interactive. It is relevant, engaging, and trustworthy. It is built on dynamic, real-time conversations.

We are moving from a world of impressions into a world of engagement and influence. Lifestyle advertising is part of a business strategy that will turn consumers into customers not through transactions, but through sustainable relationships. Companies that adopt lifestyle advertising will be the best positioned to influence conversations concerning their brands as well as consumers' purchasing behavior, and to monetize the ongoing customer relationships they seek.

The lifestyle advertising approach—requiring new media strategies and significant organizational changes—forces companies to look away from traditional advertising and toward the opportunities and demands of today's converged media environment *(see Figure 1).*

The three principles

The foundations of a lifestyle advertising strategy—relevance, engagement, and trust—have been goals of the advertising industry since its inception. But the manner in which brands strategize around, pursue, and achieve those goals has changed and will continue to change dramatically as new media and distribution platforms emerge.

Relevance
Relevance means advertisers have to understand and build strategies on what's important to customers' lives. Historically, most marketers depended on media companies and distribution networks to create content and aggregate demographically segmented audiences to receive the advertising messages. To understand relevance in the converged media era, brands must acknowledge the complexity of their audiences. Audiences no longer are easily defined by one or more factors such as age, sex, ethnicity, education, income, or postal code. Removing barriers, especially geography, the digitally driven social renaissance is connecting people with similar interests, lifestyles, hobbies, and thoughts.

"If you just concentrate on traditional segmentation, you're going to miss people that could be interested in your product, but don't fit into your stated demographic," said Geoff Ramsey, co-founder and CEO of independent market research firm eMarketer. "The Internet allows you to find better targeting clues based on actual behavior or actual interest, as indicated by a search or a profile."

Advertisers are already experimenting with ways of delivering relevant brand experiences to niche audiences.

BMW, for example—a pioneering advertiser lauded for its innovative 2001 BMW Films campaign—was the first advertiser to partner with TiVo to deliver customers a much-desired, non-interruptive, engaging, interactive viewing experience. The automaker targeted the car-crazed customer with a television ad campaign for the show *Test Drive* on niche cable network SpeedTV—a channel dedicated to motor sports and automotive programming. By embedding "interactive tags" in promotional spots leading up to and during the premiere, BMW provided viewers with the opportunity to access more information, schedule recording a program using their DVR, or view an exclusive BMW video from the television program itself rather than from an ad. This example shows one way that the DVR can evolve from the threat it is seen as today into an advertiser's ally.

Engagement
In theory, relevant advertising delivers a more engaging, effective experience for consumers. The Advertising Research Foundation defines engagement as "turning on a prospect to a brand idea enhanced by the surrounding context," but the term is still the subject of heated industry debate. In practice, there are two main levels: brand-level engagement between a customer and an idea, and product-level engagement as a customer nears the point of purchase. The former is an emotional experience while the latter is almost purely analytical.

Various media have been used to engage the consumer. Traditionally, a broad-reach media platform such as broadcast television has been used for brand-level messaging; and local, targeted media platforms—such as radio, print inserts, or direct mail—have been used more for tactical communications, such as specific offers and calls to action. Redefining engagement, converged media enables advertisers to engage the consumer at both the brand level and the product level in the same experience. Marketers and content providers can employ rich broadband media to engage consumers through messaging and ideas and then follow up almost immediately with a specific product offer or direct call to action.

In new advertising models and in converged media, engagement is measured by how much information and social capital a customer is willing to contribute to energize a conversation with a brand, often in pursuit of a personal reward (e.g., free, ad-supported media content). Engagement is currently manifested and quantified through site or service registrations, users' comments, consumers' profiles, and sharing information with other customers or communities. Many advertisers have identified the growth in user-generated content, social networking, and digital interactivity as an opportunity in which consumer proponents of a brand tout the brand through digital word-of-mouth. The result is the dynamic co-creation of the advertising messaging.

Among the media companies and advertisers that are recognizing the opportunities is The Interactive Channel (TIC) in Hong Kong, which is pioneering an engagement-oriented entertainment and advertising model. Available to nearly one million subscribers on Hong Kong's cable television system, TIC uses broadcast TV, Internet, radio, and mobile networking technology to simulcast its programs globally across all media platforms. TIC encourages the audience to interact directly with every show via short message service (SMS) and Web chat. "We even offer our audience the ability to team up with actors in the studio on various shows as well as to interact with each other," said Robert Chua, TIC's chairman and founder, adding that involving the audience directly in the content pays off from an advertising point of view. During commercial breaks, a separate window rolls public chat comments received throughout the show—offering advertisers solid evidence that the audience remains engaged with the content during breaks.

Trust

Trust also takes on new meaning and importance in converged media. In this new interactive world, trust is a two-way street between consumers and advertisers. The building blocks for an engaging, trust-inspiring conversation are transparency and a willingness to allow customers to play a role by producing advertising content or even directly shaping the product-development process.

But today's converged marketplace suffers from a notable lack of trust on the part of both producers and consumers, which can create barriers to emerging advertising models. On the consumer side, PwC's Convergence Monitor survey indicated that 80% of the survey's global employee respondents were concerned

Figure 1: Comparison of traditional advertising and lifestyle advertising

Attribute	Traditional advertising	Lifestyle advertising
Influence driver	Message	Conversation
Communication	One-way	Two-way; based on interactive, ongoing feedback
Messaging	Static message	Dynamic dialogue
Distribution	Single media	Converged/cross-media
Targeting	Broadcast	Narrowcast
Relationship	Brand to mass audience	Brand to individual consumer
Customer information	Limited and demographic	Rich and psychographic
Directionality	Linear path to transaction	Nonlinear; multiple paths to transaction
Measurements	Periodic	Real-time
Brand control of message	Fully controlled	Control shared with consumers and consumer communities

By embracing the opportunities as well as the demands of today's converged media environment, companies will move away from traditional advertising and develop the sustainable relationships with customers that characterize lifestyle advertising.

about the security of their information on the Internet. Advertisers, content providers, and distributors are also experiencing tension around trust. Deep uncertainties surround user-generated content, and the economic models supporting the social networking space are undoubtedly stalling, but not prohibiting, growth and experimentation in this area.

Still, recent industry forecasts indicate that some companies have made bold first forays into the space. Online social networking advertising initiatives constitute roughly 2% of total ad spending in the United States but are projected to grow to almost 9% of total spending by 2010, according to research from eMarketer. Many companies have already begun to test those digital waters and reap the rewards.

American Express was one of the first companies to support the development of social networking. The company's Open Network enables owners and executives of small- to mid-size businesses to share business tips on a range of topics from managing work/life balance to managing inventories. Serving as a destination for consumers' conversations, American Express does not interrupt users' experience to advertise products for sale, but instead non-disruptively makes offers that might appeal to its captive audience.

Social networks, however, are not always self-contained, niche customer communities. German automaker Audi listened closely enough to its target market to understand how and where young, influential, interested buyers were spending their time—the blogosphere. The company influenced the conversation about its brand by running a blog component for its A3 campaign on more than 400 relevant blogs through the BlogAds network. According to Audi's agency partner, GMD Studios, blog advertising generated 29% of the traffic to Audi's A3 site. An article on Adrants.com stated that Audi was able to leverage the consumer trust inherent in the blogosphere with a campaign that purportedly cost 0.5% of its overall media budget—less than a single banner ad on a mainstream search engine.

By devoting organizational resources to monitoring conversations about the brand online (in the blogosphere, on social networking sites, etc.) and by establishing strategic partnerships with vendors who report on and analyze such conversations, companies can identify, monitor, and connect with "key influencers."

In China, Pepsi and Motorola boldly entered this arena by aligning themselves with the "Back Dorm Boys," two Chinese college students whose grainy video downloads spoofing the Backstreet Boys and other pop stars attracted a huge following online. Identifying the duo as key conversation influencers, Pepsi and Motorola were able to associate their brands with the cutting-edge image of the self-made Web stars—Pepsi by placing them in a commercial and Motorola by commissioning the production and generation of viral videos.

Historically, marketers have trusted people to be consumers, but not producers, of content associated with their brands. This notion drives News Corporation's strategy of creating separate areas of MySpace that are considered "safe" for brands that fear advertising placement near incompatible or unsavory content.

"We've taken 50 years to develop local TV brands and relationships with consumers," said Terry Mackin, executive vice president of Hearst-Argyle Television. "You can make one mistake by taking a piece of user-generated video and not having it properly vetted for appropriateness and infringement, and that hurts the brand's reputation."

Community filtering and editorial processes to engender trust among advertisers, content distributors, and consumers are already in the works. Magnify Networks, for example, is pioneering technology in which peer review becomes a user-driven, collaborative filter, allowing online communities to review and rate new video submissions, self-selecting the videos that best fit the community profile.

To successfully engender trust, lifestyle advertising efforts must be genuine and transparent. Any attempt by an advertiser to contrive a conversation to attract an audience—through fake blogs ("flogs"), for instance—is likely to be exposed, to potentially brand- and trust-damaging effect.

Seeking engagement by creatively collaborating with consumers is not without risks, and most companies have yet to jump into the fray. However, PwC believes that the level of risk associated with participating in conversations in pursuit of engagement is not only acceptable but also critical to business growth.

A continual process

In this digital renaissance, companies that adopt lifestyle advertising must also adopt strategies that account for the realities of a converged, multiplatform media environment—realities that change the ways consumers engage with media and can be influenced. In turn, methods of monetizing media through advertising, discussed throughout this article, will necessarily change as well. Advertisers, content providers, and distributors must mobilize consumer communities around conversations to more effectively measure and unleash their power.

We believe that companies must be as dynamic as the marketplace itself. They must stay in constant communication with consumers, use the insights gleaned to build and maintain the business backbone that will best support company strategy, respond to changing customer demands, and regularly evaluate their market influence. Lifestyle advertising requires companies to be always listening, always changing, always responding, and always evaluating—the principles underlying any good, trusted relationship.

Companies that treat lifestyle advertising as a continual process, not as a one-time initiative or campaign, will be best positioned to drive the all-important shift to thinking of every individual consumer as a customer. The most successful lifestyle advertising companies will create the brand loyalty and engagement that turn conversations into transactions and, ultimately, relationships.

Optimize conversations

Some forward-thinking companies are taking listening to the next level, moving their conversations with consumers off the Internet and directly into the boardroom.

Knowing your customer

Belgian communications company Belgacom Skynet involves users in developing and testing their online products, TV programs, and related media services through a program called Skybrain. Almost quarterly, Skynet invites selected representatives from its consumer testing community to participate in its board meeting and provide input directly to the company's executives. Skynet has found this model of consumer involvement to be very effective, as it helps them create and close a direct feedback loop. The consumer participants enjoy a unique, personal relationship with the company, and executives receive ideas that might not have surfaced in-house. Skybrain has become a platform for open innovation that brings customers into the highest levels of decision making.

Other companies are harnessing the power of direct consumer feedback by connecting with key influencers to gain insight into changing consumer demands, receive early feedback on new products and services, and build awareness about the brand within well-defined social networks. Procter & Gamble, for instance, recently established the Vocalpoint network for influential mothers. In exchange for receiving advance product information, samples, and discounts they can share with friends, individual mothers identified as key influencers can participate in product trials, provide feedback directly to Procter & Gamble, and spread the word about products they enjoy using.

Respecting customer boundaries

The ability to influence the newly empowered consumer rests almost entirely on an evolving and often implicit social contract. In exchange for personal information about their interests and purchasing habits, customers expect to receive free, ad-supported content and targeted, relevant advertising. But without up-front agreement as to how that information is collected, used, and distributed, the delicate social contract between consumers and corporations will be under constant pressure.

A recent Carnegie Mellon study reported that while personalized greetings and product-based personalization of online advertising can help create a unique purchasing environment for each customer, the success of investments in personalization depends ultimately on whether and to what extent consumers perceive privacy violations in the acquiring and using of information personal to them.

The study showed that, on average, more than 85% of consumers react negatively to personalized greetings in e-mails, suggesting that consumers are likely to perceive a violation of privacy if they see their names in e-mail advertisements. Acquired customers—those whose information is purchased from the outside—always react negatively to personalized greetings, even if they are followed by targeted product recommendations. As the study reported, the economic value of personalization depends on which effect is stronger—the benefit of relevant, personalized product advertisements or a perceived infringement of personal privacy.

Change and respond: Organizing around lifestyle advertising

The strategies and organizational structures of businesses across the advertising value chain must mirror the new media market itself. If they are to maximize and, indeed, monetize their lifestyle advertising potential, businesses must be open, have real-time flexibility, and enable informed risk taking. They must organize around and execute on the ongoing conversations in which they are participating. When they act—whether through a strategic shift or a change in product or service offerings—companies must make their responses clear to the consumers who influenced the decision making.

"The media industry has new expectations, and there's an education process—analyzing, configuring, building, and supporting—that takes time, effort, and expense," said Karl Spangenberg, vice president of Integrated Advertising and Commerce at AT&T Entertainment Services. "It all starts with the vision and the commitment that the vision is worth pursuing."

The overarching vision of a lifestyle advertising strategy must be developed collaboratively. Every part of the organization responsible for generating advertising revenue must help evaluate and revise the strategy. This may sound fundamental, but we see many companies that do not break down the organizational silos, build the agile business platforms that allow them to act with real-time speed, and prioritize new revenue strategies in a collaborative way. Developed from the ground up, a strategy that accomplishes those three business goals ensures that everyone involved in executing the vision has helped create it and is prepared to respond to the market's demands proactively, rather than reactively.

Build in agility

To stay in sync with consumers, companies must act and react with speed—an essential feature of lifestyle advertising organizations and infrastructures. Companies built around agility can pursue innovation, experiment with new ad models or methods of monetization, and build business relationships rapidly and in an informed way.

Within organizations, this means building agility into every back-office system and decision-making process. According to Shawn Strickland, vice president of FiOS TV Product Management, the company's broadband television initiative is one example of a holistic approach to building agility into business infrastructure. "Building products and capabilities as opposed to building specific features has been a big enabler for us. When we set up this initiative, we set it up with very small teams, and people have been accountable since day one because you didn't have 10 people to rely on to get something done."

Agile, back-end business platforms enable companies to execute innovative, customer-facing, lifestyle advertising initiatives with the speed the market requires. Today, the ability to deliver targeted ad content dynamically and responsively is critical and depends largely on agile platforms and the interactions within the lifestyle advertising ecosystem. Collecting and analyzing data in real time, for example, enable informed responses to consumers' demands. Companies are just beginning to establish the strategic partnerships that facilitate those capabilities.

In the video-on-demand environment, media measurement provider Rentrak Corporation is developing a product for the advertising community that will allow ad effectiveness to be measured and analyzed on a near real-time basis. "Advertisers will be able to track actual views of their content, and if the audience isn't there, decisions can be made quickly to switch out an ad using dynamic insertion so that the message will be seen by a more targeted audience," explained Cathy Hetzel, senior vice president of Rentrak's OnDemand Essentials.

Measure the marketplace

To succeed, lifestyle advertising requires "real-time speed." Real time is the speed with which a content provider or an advertiser must be able to capture data about audiences or individual customers; the speed with which it can analyze and communicate based on that data; and the speed with which it can act on the analysis. Organizing around speed fulfills the imperative to more dynamically act on ideas and innovations. It shifts the strategic emphasis squarely to evidence-based decision making, which, in turn, makes all members of the advertising value chain more accountable for their performance.

Advertisers, content providers, and media distributors that are pursuing enhanced accountability through real-time measurement are finding that the lack of widely accepted measurement standards among new distribution platforms hinders evaluating marketing efforts effectively.

While the online platform has raised the bar on the measurability and accountability of advertising spending, many online advertising and marketing efforts—particularly around user-generated content and social networking—are too new for a clear consensus on how best to measure them, or on what emerging measurement methodologies indicate about their monetization. Forward-thinking companies, along with their measurement provider and agency partners, now have a unique opportunity to pioneer measurement standards, increase advertising spending accountability, and lead the industry in investing in the technologies and processes that will better gauge the effectiveness of advertising in this era of converged media.

As new measurement proxies, metrics, and, eventually, standards emerge, it is imperative that advertisers, agencies, and content providers shift their focus from reporting to rigorously analyzing data. With an overabundance of readily accessible user data in the digital space, industry players must learn to separate the wheat from the chaff and quickly turn volumes of information into actionable intelligence.

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Perspectives

Five years ago, many commentators were writing off the national incumbent operators as also-rans in the race toward the converged digital future. Regarded as debt-laden, bureaucratic, overly reliant on declining fixed-line revenues, and struggling to come to terms with a deregulated and increasingly competitive environment, the incumbents supposedly were easy prey for more agile, innovative upstarts.

As of 2007—re-energized by new, visionary leaders—many national incumbents have roared back with a vengeance. They have seized the initiative in rolling out innovative, converged, customer-led services to consumers and corporations and have expanded far beyond their traditional geographical and service boundaries. Each revitalization has required a wide-scale transformation of organizational structures, technology, cost bases, skill-sets, and corporate culture.

In the following interviews, three leaders who have achieved precisely that type of turnaround at an incumbent operator describe how they did it. Looking to the future, they share their views on what lies ahead for their own businesses—and for the converged communications industry as a whole.

An Interview with Ben Verwaayen, BT Group

BT is the world's oldest communications company. Today, it has operations in 170 countries and aspirations to be an integral part of a move toward global collaboration. Here, CEO Ben Verwaayen discusses the blurring of consumer and corporate markets, the global competition for talent, and the challenge of communications companies to deliver individualized services to their customers.

Communications Review: Convergence has brought a lot of change to the industry and to the markets we serve. Where do you see the biggest changes, and what strategy is BT taking to stay competitive?

Verwaayen: Over the last three to four years, the communications industry has created the ability to disintegrate the physical proximity of a seamless corporation. We have freed up the talents of people from the limits of their physical presence. That has massive implications. Hundreds of millions of people, bright individuals who in the past couldn't compete, today have at least a chance to be part of the economic landscape. Companies have the ability to think about talent in a totally different manner because they no longer have to relocate individuals to the company's physical location. This development has a profound effect on the ability to allow the best to work with the best.

Initially, there was the phenomenon of outsourcing, which basically tasked people to do things that were designed and invented in one part of the world in another part of the world—based primarily on lower salary costs. But that has now shifted. It is no longer outsourcing; it is global sourcing. It is not a task designed in one part of the world executed in another. We are moving into an environment where there is co-designing, co-thinking, and the opportunity to create brands and end-to-end capabilities wherever you are in the world.

The reason for all of this is the digitalization process of communications networks. Everything you can digitize you can mix, because it is zeroes and ones. Today, we can digitize more and more.

At BT, we now have the network capability to reach every corner of the world and to secure the integrity of what the network transports. And, therefore, individuals and corporations no longer can just communicate—hello, here is my e-mail—but they also can collaborate and work together in real time. That is the major change happening right now. A few people have started to realize it and have put their toe in the water, for example, using doctors in India to look at an X-ray of someone in another country. But these are only the first steps. We are in the early days of globalization.

Many people think globalization means simply to duplicate on a more cost-effective basis, but that is a gross underestimation of the unleashing of talent and capability we are witnessing. And communications is only a part of what collaboration offers as a capability. Collaboration is possible because there is a convergence between IT and networking, which will affect our industry massively. It will affect what we sell, which, at the end of the day, is only two things: productivity, because you lack it, or lifestyle, because you want it. Whether at home, in the office, or while traveling, those are the two main drivers for behavior; and behavior is all that counts.

Communications Review: So, we need to look at the consumer differently. How does that affect the services that BT and others will provide?

Verwaayen: Our industry produced an ingredient for this change that I have explained: We made safe connectivity possible around the globe. Other people did all the rest of the stuff on top of that. Collaboration didn't exist. Since collaboration is a mix, you need the talent part and the IT part to come together. Who is going to take care of that? That's the next battleground for a handful of companies, because you have to be global and you have to have reach. BT was extremely lucky to have been in this space early on, and we are now expanding very rapidly. But even if you are not a global services operator today, the reality is that your customers' behavior is going to change because the capabilities people notice in the office, they want at home.

The youngest generation of customers no longer wants to consume—they want to produce. They want to be players, not passive consumers of services and capabilities. They become not only your customer but also your supplier. Look at YouTube and others: a million hours of content created over a short period of time. People want to be active participants in what they design. Our biggest problem in broadband is not the broadband product, but rather all the stuff people want to do with it. They don't behave as we have designed; they behave as their intuition tells them. And the younger they are, the more knowledgeable they are—not about the technology itself, but the "so what?" or the "what do I want to know?" of technology. That is one changing behavior.

A second changing behavior is that inventions are no longer started in the corporate world; they are now starting in the consumer world. Sometimes people have more capabilities in their PC at home than they do in their PC at the office. Or they have fewer restrictions and therefore more opportunities. And communications providers have to match that. At the same time, people have a more nomadic life; we do not want to be restricted. What used to be the mobile world—talking—now has to become an integrated mobile world. It has to be an IP world, where exactly the same capabilities will be available everywhere to a very critical consumer.

Can we deliver that? Well, only parts, because we are still trying to give 100% of the United Kingdom a broadband network; we are close at 99.9%. We will get there, but it will take time because I'm still struggling to get some people to understand what an e-mail is. So, you can get to the philosophy; you can get to some components of the technology; you can translate the economic model so it works; then you need to get the talent to deliver it. This is a huge challenge. Once you had to compete for opportunities, say, only with your classmates in your city, then your competitors became the classmates in your region, and now the challenge becomes competing with your generation.

I think we as an industry can learn a lot from oil. Oil has been the number one ingredient of productivity over the last 50 years: oil, oil products, and the capabilities of them. Oil is an industry in and of itself, but it is also an ingredient of others. The same is true now for collaboration and communications. We are becoming an integral part of somebody else's business. That is the BT story. We sign contracts with corporations, and in a few months it is difficult to distinguish between who works for BT and who works for the corporation because we become an ingredient of their way to go to market.

Communications Review: Where do you see BT's revenues coming from in the next five to ten years since there is more blurring between the consumer and corporate markets?

Verwaayen: Consumer is 25% of what we do; enterprise is 50%. Enterprise, by definition nowadays, is global. While you may be a very local company, where is your supplier? Where is your customer? Where is your employee?

In a traditional way of describing where a company generates revenues, you ask, is XYZ a British company, or does the fact that they have 80% of their business around the globe make them non-British? You can't look at revenues that way. The whole idea of being global is that you don't have an exporting mind-set; it is not "I am located here and I am bringing my value from here to other places." It is more distributed than that.

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The computer industry went through this with its mainframes and "slaves." The industry realized that using a central hub and long lines connecting the other computers was a very vulnerable structure, not powerful enough or agile enough, and instead came up with the distributed network design. All kinds of routers and computers together create a much more agile and powerful machine. It is very difficult to find the central hub, but the strength of the combination is much more powerful than in the past. I think organizations need to learn from that.

Communications Review: In our other interviews, executives have talked about the consumer markets and their importance, especially given convergence. You are talking more about the enterprise market as driving opportunities.

Verwaayen: First, I'm thinking about the market globally, at a macro level. Then I am thinking enterprise. Then I am thinking about a change in the consumer, because, at the end of the day, an enterprise is consumers making decisions. There is no such thing as an enterprise worker who is not a consumer. They leave work and take their experience in the enterprise with them as consumers, and vice versa.

Communications Review: You talk about a global collaborative space, where the consumer is also the supplier. What do you see as the constraints in such an environment?

Verwaayen: Quality, decency, taste, hackers, security, all kinds of things. Are there barriers? Yes, but, at the same time, the whole concept on which BT will provide its next generation of service to the world will be an open concept. We have acknowledged that we can't limit service to our customers because of the limit of our own creativity; we have to invite the world to participate in what we bring to our customer base. That, in and of itself, is a revolution.

The market is millions and millions of individuals, not one average or one segmentation policy. We use customer segmentation, but in that process we make an average because we recognize that an 85-year-old is slightly different than a 5-year-old. I am convinced that what we need to do is to build an environment in which the building blocks will allow individuals to design services on an individual basis. But we need to do that where we have an economically feasible model around it. We are all learning.

Communications Review: Are there technical constraints?

Verwaayen: Absolutely. But we can build a service-neutral core IP network that can transport everything digitized: video, voice, data. If you can transport it, you can mix it. You can transform a voice call into an e-mail, and then you can distribute it to any place in the world. You can ring-fence it with software to secure it; therefore you can mix it with other digitized information, but there are limitations. For example, how fast can you roll out changes? What is the state of your software? What is your legacy environment? What is your ability to educate employees and consumers? There are many limitations.

At BT we have mapped out a journey that is directionally correct. The telco sector as we know it will disappear. It will be commoditized on one end and will be highly specialized on the other end, but I'm not so sure which end is which.

For example, we signed a contract with a major bank, basically to develop the back of the box so they can go anywhere they want in the world, at any point in time, and be a bank. In this case, we are not a classic telco because our service has little to do with providing a voice call. It has a lot to do with understanding what a bank is; we have a vast knowledge of what financial exchanges do. When the boundaries of the classical sectors of the economy become blurred, we have new complexities to navigate.

What I think our sector has not done well enough is to answer the "so what?" question. We have a bunch of wires, chips, and memories. But what is the "so what" of it? You can't be everything to everyone everywhere—it is impossible—so you have to make your choices. Thirty-five years ago, the ITU [International Telecommunication Union] would decide on the technology, which we all would buy and put in the ground. That was our job. Now we have to create capabilities. This is a massive change. Some people will do it one way, some another way.

Communications Review: Who will be the competitors in this new communications environment?

Verwaayen: Anyone. It could be your supplier. It could be someone we haven't thought about yet. You see this happening in other industries. Our biggest task, then, is managing competition, not just competing.

Communications Review: How does a company like BT, with your history and size, manage this change among your workforce?

Verwaayen: A year ago, I spoke before a group of 350 new recruits to our company. We had just won an award from Forrester recognizing us as one of the most innovative companies in the world, which for BT was a major accomplishment. I asked these young people to tell me what the biggest barrier in the company is and said I would remove it. One young man said, "The biggest obstacle in this company is you." (He still works for us.) I asked why. He explained that when he has an idea he takes it to his boss, who takes it to his boss, and so on up the chain until it gets to me. "So, at the end of the day," he said, "your framework of what good is will determine whether my idea gets a chance or not. People navigate upwards, and how dare you, as a 50+-year-old, even aspire to think what is in my head?" He was 100% right.

So, there is an art of letting go, of setting the boundaries but giving the freedom to do things that I may not understand. We have to do that in our organization. The first step is to recognize that what this young man said is right. The limitations of what I like and don't like cannot be true for everyone.

Ben Verwaayen is chief executive officer of BT. As a member of the board of directors, he chairs the operating committee.

Before joining BT Group in 2002, he had been with Lucent Technologies since 1997. His position on leaving was vice chairman of the management board. Prior to joining Lucent, he worked for KPN in the Netherlands for nine years as president and managing director of its subsidiary PTT Telecom. From 1975 to 1988, he worked for ITT in Europe. He was appointed an independent, non-executive director of UPS in March 2005.

Mr. Verwaayen graduated with a master's degree in law and inter- national politics from the State University of Utrecht, Holland.

For more information, visit the company's Web site at www.bt.com.

An Interview with Marcel Smits, KPN

KPN provides a range of communications services in the Netherlands, Germany, Belgium, and other parts of Western Europe. Since privatization in 1989, the company has risen to the challenge of competition—in its own market and abroad—pursuing unique ways to grow the company while facing industry hurdles, including heavy debt loads, joint ventures, and changing consumer demands. Here, CFO Marcel Smits talks about how the company is taking a not-so-traditional approach to technology, distribution, and marketing.

Communications Review: What impact are the current industry changes having on KPN's strategy?

Smits: Two very fundamental things are happening in the industry. First, the cost of bandwidth is rapidly declining. For example, we are now buying HSDPA [high-speed downlink packet access] equipment for a quarter of the price that we paid two years ago, and the equipment offers four times the bandwidth. So, within two years the cost of bandwidth in the mobile space has declined by a factor of 16. In the past, the barrier to entry was provided by the fact that to build a network you had to make a huge up-front investment. Our industry is becoming less capital intensive and, therefore, easier for new entrants to access.

Second, the infrastructure used to be separate but is now converging into a single protocol, Internet Protocol [IP]. Not only are infrastructures becoming cheaper but there is now competition from one infrastructure to another. The cable infrastructure never competed with the telephony infrastructure until the Internet came, and then they both launched broadband. And in the broadband space, they're competing. This is true especially for newer services. Basically, if you have MSN or if you use Skype or a Google application service, those services don't care what IP pipe you have—cable, DSL, or UMTS-related EBA—as long as there is an IP pipe.

We think that those changes are going to happen in the mobile space as well. The mobile space just follows the fixed-line space with a certain time lag.

Now for KPN, that means two things. First, we have to make sure that our infrastructure is competitive from a cost point of view. You're going to survive only if you hit the lowest cost. As a company, we are obsessed with making sure that our scale on the infrastructure side actually translates itself into a cost advantage. That means we have to invest in implementing the newest technology to make sure that we shed the old infrastructure and that we can get to the lowest cost point.

Second, a very fundamental belief inside KPN is that if ownership or control over infrastructure is not going to be the barrier to entry, then we must make sure that whoever is out there is going to use our infrastructure. We believe that we will win only if we run our infrastructure as if it's a semi-public service. We don't need regulation anymore to get us to open up our infrastructure. We do it voluntarily, and we have had great success. We are, I believe, the only company in Europe who can rightfully say we will treat you as a real partner rather than just as a capacity filler. We never had a regulatory requirement to bring Aldi onboard in Germany, but we did. After we had them onboard in Germany, we took them to Belgium, and now we are trying to get them to the Netherlands. We have decided that we might as well try to grab a big position in the wholesale space.

Communications Review: How do you organize the business to reflect the changing market?

Smits: I think we've been helped tremendously by the government. They basically said to us, in 1995, go away and do the commercial thing. They told us, we will give you a regulator who is going to be quite harsh on you, and we will not be buying lots of products from you. To make matters worse, they said, we are going to be buying lots of products from your competitors because they need to grow. We did not get any help from the government, but it did not stand in our way when we wanted to become a more commercial operation.

If you pretend to be a customer-centric organization, then it's totally not logical that your primary organizational split is a split on a technological basis. It just doesn't make any sense. We were one of the first companies to go through full fixed-mobile integration. When we presented this integration to the market, we said that we didn't think that technology was going to drive convergence but rather up- and cross-selling opportunities, integrated distribution, and the like would.

Communications Review: So, does technology play a role in being a market leader?

Smits: We do not think that a particular technology is going to be the silver bullet of success. We believe that the technology we are providing to our customers is generic. We're not a pharmaceutical company, but the only difference, really, is the customer interface—and that has everything to do with branding. It has everything to do with distribution and execution. We are obsessed with execution dimensions, apart from cost, because we think that the real winners are the people who execute better than others.

We've had great success in Germany. People seem to think that we're absolutely brilliant marketers. Actually, it comes down to the simple idea of saying to customers, if you're happy with your mobile phone handset and don't want another handset, we'll give you cheaper minutes. That's a very credible story. Within a 12-month time frame, we have brought in four million customers. That's been the driver of our business.

Everybody else was focusing on complicated, integrated WiFi/GSM phones, and GSM bundled with DSL, and God knows what other combinations. But what people really want is to keep their phone and to have cheaper minutes. What drives success is whether or not you can flawlessly execute. You have to know your customers; and if you know what they're doing with your products, you can talk to them at a level that is relevant to them. The things we get excited about are normally low-technological-impact/high-economic-impact ideas because they are relevant to our customers.

Another example is from the business market. Last year, we ran a contest in our sales department to look for ideas to generate more EBITDA [earnings before interest, taxes, depreciation, and amortization] in 2007. The team that ultimately got the prize came up with a very simple idea: Since we track the bandwidth capacity utilization that our customers have, let's do something with that data. The idea was to identify customers who hit maximum capacity more than once every month, call them up, and recommend that they scale up to a higher connection.

Since implementing that idea, we have seen several things happen. First, customer satisfaction went through the roof because customers invariably say, it's wonderful that you're calling because my network was acting up and I wasn't sure why. Second, the customer says, yes, I'll take that bigger pipe. Third, customers don't dream about writing a tender for a bigger pipe—they just buy it from us. That little initiative alone has allowed us to write €7 million of EBITDA into the 2007 budget.

It's a nice illustration of how technology is not the real differentiator. Yes, you want to be on par on the technology side, but your key to long-term success is other stuff.

Communications Review: What approach are you taking to ensure KPN's profitability?

Smits: For the Netherlands, our view is that we need to get a grip on marketing and distribution. For the countries in which we operate as challengers, we're trying to be leaders in a few niche markets.

In the Netherlands, we want to get into such a position that in Spain, Paris, and Germany, they keep saying to themselves, don't launch anything into the Dutch market. We have 250 stores with 2,500 employees, 1,000 technicians, 1,000 franchisees, 300 distribution partners for small and medium enterprises, six brands, and 12 Web sites—and this entire distribution network is going to go after the competition. We want them to think that they have no chance of winning in our market because we have a hold on distribution and branding.

On branding, we are great believers in choice because consumers want choices. There is no single market where people are willing to be confined to four brands, whether it's insurance or cars or toothpaste. There is always a wide offering of differing brands and positions. That's core to our thinking. If we want to keep a strong grip on the Dutch market, we have to make sure that we cover those differing positions. We're present in the youth market with a brand. We're present in the value-for-money market with a brand. We try to occupy whatever segments we think are relevant from a differentiation point of view, so as to leave very little room for people to come in.

I think the best illustration is Easy Mobile. They were going to enter the market in the Netherlands. We launched Simyo two months beforehand, which is essentially the same thing, an Internet-only offer. We didn't have great success with Simyo, which is fine because it just sits there as part of a family. Easy Mobile didn't have a lot of success with its offering either, and three months after the launch they found that the Netherlands is a tough market and left.

Internationally, we have smaller positions as the challengers and our strategy is to pick out a niche. In Germany, for example, we think that there is a huge market for simple mobile telephony service: voice and a bit of SMS at a reasonable price. It may be that this is only 40% of the total market and that in the long term it will become smaller. But if it's 40% of the market and we get half of that, we're still doing extremely well. In Germany, nobody can copy our Simyo brand anymore because it has too much of a head start. We have carved out that niche and we have become the leader there. In the markets where we challenge, we try to focus.

Communications Review: What do you see as the most promising new revenue opportunities—IPTV, mobile TV, advertising?

Smits: I don't know. We are certainly trying everything—IPTV, mobile TV, advertising—but I think we are different. Let's assume that there aren't going to be many new revenue opportunities. What is it, then, that we have to do? The answer is simple. We have to cut our costs, improve execution, and simplify things so that we can improve the quality of our execution at a much lower cost point. Then we'll continue to create value. And if it turns out that mobile TV is going to be the next big thing, we will have a very lean cost base to which we can bolt on the new service.

We don't think that some new service will solve all the problems. We'll make every effort to make IPTV and mobile TV popular in the Netherlands. We own the infrastructure for mobile TV in the Netherlands. We own the DTTH [direct to the home] network, and we have put that network into our wholesale and operations unit and told them to sell it on equal conditions to everybody in the market—Vodafone, T-Mobile, Orange. They all get access to it under exactly the same conditions as our own service provider is getting access.

Communications Review: Who do you think will be your competitors in five years?

Smits: Another consequence of the ubiquity of IP is that services have now been decoupled from the infrastructure and new players are entering the market. Microsoft is entering with a whole suite of voice applications, which will come out in the next year. There are big, international players who are entering into the services side. This is probably the biggest long-term challenge for us. We're going to try to make sure that these people find it worth their while to work with us because of our distribution capabilities, our customer insights, and our billing capabilities.

We are now making a big push in application service provisioning in a variety of markets. For instance, we've just launched a bookkeeping package online, bundling it with a DSL subscription. We always make sure the application is up to the latest release and data continuity is guaranteed so that our service is an attractive way of dealing with that piece of functionality.

On the TV side, for example, I would love to think that two or three years from now when you go into our shops, you will see TV from KPN over DTT, which is called Digitenne, and you will see IPTV from KPN. Perhaps we will also be able to offer Google TV or MSNTV or the Xbox with a TV functionality. I'd love to offer all of those different services in our stores. Then we could work with Google or MSN to do the billing for them.

Our view is that it's inevitable that new people will come in, and we should embrace them rather than try to throw sand into their machinery. We're very different from the cable operators who, basically, do not want to open their infrastructure at all.

Communications Review: Many people say that content is king. Do you think that you have to own content to win the customer?

Smits: Our view is that content actually needs to be billed and billing is what we do, so we like to work together with content players rather than work against them. We are not set on trying to make our services more attractive by acquiring exclusive content. We have a little bit of it, but not a lot. At this point in time—when we are relatively small in the content game and cable is huge—we are not positioned well competitively to start bidding up the soccer rights, for example.

We are somewhat careful. We didn't bid aggressively when the soccer rights came along. We ended up sharing the soccer rights with Tele2, who spent a lot on the content.

We also have a new initiative with PCM, a newspaper company. We will do the multimedia distribution side—the Internet and mobile phone distribution—and the billing for it, and we will share the revenue. It's a nice illustration: Somebody else writes the newspaper and wants to have an additional source of revenue, and because we are equipped well and positioned well to generate some revenue out of those types of initiatives, we work together.

Communications Review: How can you cut costs while going through a transformation of the business? Does outsourcing play a role?

Smits: Again, I think our view is different here. Our own staff numbers are coming down quite dramatically, by 1,500 or so per year. Over the last two or three years, our third-party staff has increased. Our view is that once we've done the next generation network, we'll probably go through a fairly steep decline in our total staffing level. We will do well if we prepare ourselves for that by having a variable cost base. We do all sorts of projects where we outsource bits and pieces to make our costs variable, so that when we actually have the next generation network in place we won't have big issues with redundancies.

There are nice ways of reducing staffing levels. For example, main distribution frames are not featured in our next generation plan, and three or four years from now the people who pull wires will not be needed. So we outsourced 200 of our technicians who were working on the main distribution frame to a technical installation company. The technical installation company was very happy to have those 200 people because it is a growing business, for example for cable and electricity companies, and needs more technologically schooled people.

Communications Review: Customer service is going to be critical to keeping customers, who have grown less loyal as more options have become available to them. What are you doing to reduce churn and keep customers happy?

Smits: We're simplifying our product portfolio, our processes, and IT. We want to get to a stage where we have an integrated view of the customer, which we currently don't have. If you go into a shop and have a question about your fixed number, your mobile, and your Internet, they are all individual views. We want to be able to talk to our customers with full knowledge as to what they're buying from us and since when, what their usage is, how they pay us, and what interaction they have with us. The good news is that we are very focused on such information. The bad news is that it will be another two or three years before we've got it all in place.

We are obsessed with gaining an integrated view of the customer. I have to say that wherever we actually make our customer interaction more data intensive, we are more successful. We have colossal gains in terms of reducing customer acquisition costs when we have targeted propositions.

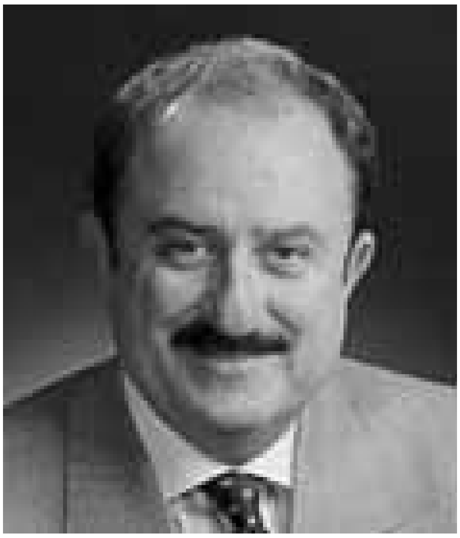
Communications Review: What role do you think regulation will play in the future of this industry?

Smits: A huge role—and we worry because we can see the going is getting tougher for incumbents. Governments are back with a vengeance to come to their rescue. In Belgium and Germany you can clearly see that the government is worried about layoffs and unrest, etc. Therefore, it has started to stack the regulatory landscape against the challengers. We think that's very much to the detriment of consumers and certainly to the detriment of the industry.

The challengers are bringing competition to life. We've not had a huge economic impact in Germany in terms of shift of value from one company to another. Yes, we've gone up by a couple of billion and Vodafone and T-Mobile have come down by a couple of billion; but our real impact in the German market is the fact that prices have declined for consumers by 10% to 15% per annum over the last two or three years. The drive toward more cost-effectiveness is coming from the smaller players, so regulation is a big issue for us.

Marcel Smits became a member of KPN's board of management in August 2004 and was appointed chief financial officer in September 2004. Mr. Smits is a former member of the board of management and former chief financial officer of Vendex KBB N.V. Before working with Vendex, he held various (financial) management positions at Unilever. He is a member of the supervisory board of Delta Lloyd N.V. and of the supervisory board of the Dutch Philharmonic Orchestra.

For more information, visit the company's Web site at www.kpn.com.



An Interview with Sol Trujillo, Telstra

Telstra is Australia's leading telecommunications and information services company. Telstra offers a full range of services in all telecommunications markets throughout Australia—providing nearly 10 million fixed line and 9 million mobile services as well as operating Telstra BigPond,® the largest ISP in Australia. Telstra also owns Sensis,® Australia's largest directories, advertising, and local search business, and has a 50% interest in FOXTEL,® Australia's largest cable subscription TV business.

Sol Trujillo joined Telstra as CEO in July 2005. Over the following five months, he undertook a comprehensive review of the company and announced a strategy to transform and revitalize Telstra from a 20th century telephone company in decline to a 21st century digital communications powerhouse that provides truly integrated services. Here, Mr. Trujillo discusses the progress made in implementing his vision of integrating all of Telstra's businesses and transforming Telstra into a best-in-class media communications company.

Communications Review: After 18 months, how is Telstra's transformation progressing?

Trujillo: It's going very well. And I can use those words, but the progress is really as measured by shareholders, as measured by customers, and as measured by employees. In the case of the shareholders, since we completed our T3, the government sell-down, the share price is up pretty dramatically. From a customer standpoint, all of our brand surveys and our sales results are above plan. And from an employee standpoint, in the employee engagement surveys we do our results are at an all-time high as well. So, from a facts and data standpoint, we are doing very well.

Communications Review: Given where you are and the progress you have made, is there anything that you would have done differently?

Trujillo: So far, no. Some people hearing me say no might say, "Well, gee, Sol, you got a rough go with the government in terms of all the battles over regulation. All that, and you're not the most popular guy in Canberra." The answer is, I don't get paid by the people in Canberra. I get paid by my shareholders, ultimately by my customers, and I represent our employees. In the case of the regulatory piece, we have to do that. We have to change the game, because the old way hasn't worked for Telstra for the last 10 years.

Communications Review: A lot is being written and said about fiber to the node, unbundling of the local loop, and the whole regulatory landscape. How value destroying will that be if it doesn't go the way it should go for Telstra?

Trujillo: For Telstra, not doing fiber to the node is not necessarily value destroying, because it means we just won't invest. The tragedy of it will be for the Australian people, because Australia is so far away geographically from the rest of the world. Look at the investments that are happening in all parts of the world: Japan has a 100-megabits-to-every-home kind of policy, and the same is true in Singapore, South Korea, Taiwan, all those countries. In the US, you see the war going on between the telecom companies and the cable companies. They're talking about 30 megabits.

Just recently, at a cable conference, we were shown 100 megabits to a home, with technology that's now in place and being deployed. In Western Europe you see the same thing, and meanwhile here in Australia, we have people debating over things that other countries already decided. If we don't get that infrastructure in Australia for the long term, the economy is going to be harmed. The cost to deliver services—whether education, health care, or whatever—will continue to rise and you won't be competitive over time. Now, the good fortune for Australia has been that we have a booming economy associated with natural resources. As long as that's there, people think everything's all right.

I've been through some of those booms and busts, and so we're trying to encourage appropriate debate and discussion. If it happens, great, great for everybody, I think, and if it doesn't happen, it will be a tragedy for all Australians.

Communications Review: Your customers have seen lots of changes, such as the launch of your 3G 850 network. What will be the next big thing for your customers?

Trujillo: The integration of capabilities across all of our networks, across all of our platforms, is part of the mantra of making it simple for our customers. We absolutely changed the game in terms of wireless with the launch of our Next G™ 850mhz network. We have the most advanced wireless broadband network in the world. It's operating at 14.4 megabits per second already. We just announced the completion of our Next IPTM network, which is our single IP/MPLS core and multiservice edge network for fixed-line customers. We are the only company in the world that can provide literally end-to-end service on an IP wireless and wireline network where services will work seamlessly. For example, if you have your mobile Next G™ service from Telstra, when you make a video call it can actually be terminated on a fixed line. Or you can make a call from your fixed line onto a mobile.

Communications Review: Would you say that you have embedded your market-based management strategy into the Telstra culture yet?

Trujillo: I would say it's absolutely in the process of being embedded. If you look at the consumer part of our business, it is embedded. Our team that has been implementing has seen a doubling of strike rates. That means when I approach a customer, I am twice as likely now to close a sale as before in the old way of doing business.

I've done this in every company that I've ever run and it works every single time. Why? Because what we do is to put the customer at the center. We don't just say that. We know customers' underlying, driving needs so that when we talk to them, we talk to them about what they care about, and we talk to them at the times and through the channels and ways of reaching them that they want. That's part of this experience that we're driving inside our company, and it is evident throughout our company. As we continue our transformation and get our information technology portion of our transformation completed, it's only going to get better.

Communications Review: Has it been easy to attract talent into Australia and to grow the local talent to meet your needs?

Trujillo: When I first came to Australia, it was hard to attract some talent because Australia, to be quite frank, is a long way away from everywhere else in the world. But now that people have seen what we're doing in our transformation, they want to come and be part of it. That makes it easier to attract people. We have recruited a lot of people from Europe, from the US, and some from Asia and have mixed them with the Australian talent we have.

The Australian talent is also growing. What I mean by that is that the competition set in Australia is not the same and not as intense as it would be in the US or

Western Europe. In some of the markets where you have all the big brands, all the big companies go at it every day. If you're not competing at that level every day, your skill sets aren't quite up to that level. So now we're driving Telstra not just to be the best in Australia, but also to be the best in the world—to be truly world class. That's bringing some of our talent up to levels they never thought they could achieve.

The best example I can give you is when we rolled out our Next G™ network. We built that in 10 months from the day we made our decision to the time of turning it on. Nobody in the world has ever done that. And I have to tell you, quite frankly, when I set those kinds of targets for the company, everybody looked at me like I was nuts. Well, people proved to themselves what they are capable of, and, to me, that was the exciting part. When I talked to people, they said, "Sol, I never thought it was possible. I never thought I could do this. But now I know that when you give us a challenge, anything's possible."

Communications Review: How do you retain valuable talent, and what have been the key challenges for you?

Trujillo: With people who are talented, generally they like to be challenged. They like to know that they're doing meaningful work and that when they do achieve, they're rewarded. Sometimes rewarded in a sense of the internal gratification, sometimes it's external gratification, and then sometimes it's money. The harsh part is that we all like being rewarded in different ways, and the one public score card is compensation—the benchmark you can look across the world on. And that's part of life.

So, retaining people is about the challenge and the reward, expecting performance, and knowing the rules. I am a believer that sometimes people forget that within an environment, if they don't know the rules of the game they are competing in, then it's awfully hard for them to be successful. But if you show them, as talented persons, the rules and give them the mission they really find challenging and rewarding, they'll go for it and they'll give you the numbers. They'll deliver the results you are looking for. To me, that's the fun part.

Communications Review: Telstra has investments in New Zealand and Asia. Are there any plans to take Telstra outside of Australia on a bigger scale?

Trujillo: That may be longer term for us because right now our focus is Australia as our first, second, and third priorities. We do have a major presence in Asia. We have the largest wireless operator in Hong Kong [CSL], and it is premier, best in class. We have an undersea cable business called Reach and an investment made recently in China called Soufun, which is the largest online real estate business in China. Just being one of the top 10 Web sites in China makes it one of the top 100 in the world.

The question is, now that we have strategic positioning, can we expand it and can we extend it? That is yet to be determined. We think we have capabilities that perhaps not a lot of companies around the world have.

Communications Review: You often talk about Telstra as a media communications company, and you are passionate about the whole media communications story. Can you explain what that means to Telstra?

Trujillo: I have to start answering that question by referring to my core definition of our business today. Our business is about being a truly integrated company, not a bunch of silos within a company. Our customers want to make voice calls. They now make video calls. They send data and they receive data. They do all kinds of things. They are entertained, and sometimes they just work. The question is—how can we create platforms and services that are simple, easy to use?

There are some world-class media businesses and some world-class telecom businesses, but we think we can become the first to merge the capabilities of both around content, around services, around communications capabilities, wherever you might be.

If you are in Australia today, wherever you are, you can get access to content. I can watch FOXTEL [cable TV] almost anywhere in Australia only with Telstra. That's part of the media side. We have the most advanced wireless broadband network in the world, operating at 14.4 megabits per second already. If I want to download attachments or send attachments or a presentation, I need upload speeds that our Next G™ wireless broadband network provides.

We are bringing the two together so that you can, from a business standpoint, take your desktop with you wherever you go or, from a personal standpoint, take your life with you. Your photos, the entertainment you like, the music downloads, whatever it is that you like doing you can take with you on devices or have in your home or in your office.

Communications Review: Do you think you have to own content to succeed?

Trujillo: I don't know that you necessarily have to own all content. You might want to own some content. Content comes in a lot of forms. Through Sensis [Telstra's directories, advertising, and search business] we have knowledge of Australian businesses—information, location, maps, all kinds of content—that others don't have. We're creating a lot of content and knowledge around consumer behavior by using our market-based management techniques and all the data extractions we are doing. If you look at our BigPond [broadband] business, we are sometimes acquiring content and also repackaging content.

We also have a new phenomenon in this whole media communications game, called user-generated content. We are looking at how we facilitate those people who create content, so that they have delivery vehicles, and at how we can monetize some of that.

The good news for Telstra in Australia is that we have now built the biggest, farthest-reaching distribution system of anybody, anywhere in Australia. And that's a strength. Content partnered with distribution is obviously a winning combination. So, yes, we'll own some content, and some we'll acquire.

Communications Review: What do you see on the horizon that might change the future of the industry?

Trujillo: The one thing in the world today, or 10,000 years ago, that we can all do is give a voice command. It doesn't matter what culture, what country, what part of the world we are from, we can all give a voice command. I think about a world with technology available to us such that if I heard a song somewhere and wanted to download the song, I could just speak into a device and say this is what I want. Or if I had just landed in Sydney and wanted to find or get a reservation at my favorite Italian restaurant, I could simply give a command.

When you start merging this notion of search with voice and the databases and the content packaged together in a simple, easy-to-use way, there is no more digital divide that people like to talk about. Whether you have a Ph.D. or you never finished high school doesn't matter because you know what you want, you can give a command, and now you can take advantage of it.

Communications Review: Fast forward to five years from now. What are your views on the competitive landscape, and who will be your competitors?

Trujillo: Our competitors are the people you see today if you pull up the newspaper and look at the various ads. We have the classic telecom type of competitors, but we also have new competitors that are emerging, whether Microsoft, Google, Yahoo!, or companies that are in spaces where they attack the market from a different angle. They look at what we do as a commodity and what they do as added value. Our job is to bring it all together, bring everything to life in front of a customer. If we didn't do what we do, none of this would work. That's the value of what we do, but we have to be mindful of how other people view the space that we can be in.

Communications Review: Do any of them give you cause for concern?

Trujillo: I never underestimate a competitor. I'm a believer in the title of Andrew Grove's book *Only the Paranoid Survive.* I actually encouraged our leadership in the company to read the book, because you should never, ever let your guard down and should never assume that somebody's either finished or done as a competitor. You should never assume that because somebody's in the distance, they can't become significant.

This paranoia doesn't mean that you operate from a fear-based way of managing; it means that you are fully cognizant and always looking with your peripheral vision, and then you go on the offense and act pre-emptively. In our case, I believe a truly integrated strategy that we are pursuing is a pre-emptive strategy, as is this notion of simplicity. One button, one click, one touch is something easy to say, very hard to do.

Communications Review: In Australia, and globally, we have seen some big private equity plays recently. What do you say to the story that Telstra is a private equity target?

Trujillo: My answer, simply, is that private equity likes looking for undervalued assets. Do I think that there's more value to be created here? The answer's yes. But in their case, most of their undervalue activity tends to be about cutting costs and slicing up things that shouldn't be done. We've already been through most of that. Most of the value increase that's going to be coming from Telstra is the continuation of some of that which is under way. However, value also will be based on growth and on the innovation we're bringing, and that's not something most private equity firms bring to the market.

Now we've got both the cost-cutting side and the value-creating side in terms of innovation and growth. That's an advantage for our shareholders—but, as I will always say, we look at anything that creates value for our shareholders. That's our duty, our job; the board will always do that. At the end of the day, we're driving it hard, and I doubt that there are many private equity companies that could drive it the way the current management is.

Communications Review: What advice would you give to incumbent telcos or others that are currently pursuing or thinking about embarking on a transformation program? How do you maintain courage under fire?

Trujillo: First of all, if you've watched our team, we operate on what I call a principle-based style of leadership. We have principles around customers that drive everything we do. We have principles around shareholders that drive everything we do. And also principles around the engagement of our people in almost everything we do. When you have a passion about that and a conviction, you don't buckle under fire or under adversity, because you have those beliefs. Then you have to have a logical strategy. You have to have a plan and a set of tactical execution elements that allow people to have confidence that the plan's objective is doable. Even though it may be very hard and very stretched, they have to have confidence that they have the leaders who will stay the course and know what they're doing.

So my advice is, first, to make sure you're clear on your principles so that people know and they can test you. Do you really do what you say? And do you live it? The second thing is, do you have a plan to get us there so that we know the beginning, the middle, and the end and can look for the milestones along the way? The final thing is, when crises hit—and every business has its crises because there is always something that doesn't go right—how do you handle them?

We've had some tests, and I've been so proud of our team because they pass every test with flying colors. But you're never done.

Communications Review: You talked earlier about "driving it hard." How do you stay fit and healthy and keep focused, given all the travel and the hours this transformation demands?

Trujillo: Well, I actually wish I were more fit than I am, because I haven't been able to be as active as I'd like to be. I'd like to make sure that I always schedule physical workouts so that I am still able to do the things that are more physical. When I work out, I don't like to sweat—I like to drip, because it's that intensity of how you do things. But it's the discipline of scheduling and doing workouts that keeps you fresh. Sound mind and body—I think we all need that. Physical fitness and mental fitness have to go together. When you have them aligned, then you can charge hard and you can charge long. Part of competing is outlasting your competitors.

Sol Trujillo joined Telstra Corporation Limited as its chief executive officer on July 1, 2005. Prior to joining Telstra, he was CEO of London-based Orange; president and CEO of US West Dex Inc.; president and CEO of US West Communications; and CEO and chairman of US West Inc.

He holds a bachelor of science with a major in business and a master's of business administration from the University of Wyoming. He was granted honorary doctorates from both the University of Wyoming and the University of Colorado.

Mr. Trujillo was the first native-born Hispanic American to serve as CEO of a Fortune 150 company. He is a director of Target Corporation and has served on the boards of PepsiCo, EDS, Gannett, and the Bank of America. Mr. Trujillo has also served as a trade policy advisor to the Clinton and Bush administrations.

For more information, visit the company's Web site at www.telstra.com.

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