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**BUSINESS AND MANAGEMENT**

**9771/02**

Paper 2 Strategic Decisions

**May/June 2010**

Additional Materials: Answer Booklet/Paper

**3 hours**

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**READ THESE INSTRUCTIONS FIRST**

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.

Write your Centre number, candidate number and name on all the work you hand in.

Write in dark blue or black pen.

You may use a soft pencil for any diagrams, graphs or rough working.

Do not use staples, paper clips, highlighters, glue or correction fluid.

Answer **all** questions.

At the end of the examination, fasten all your work securely together.

The number of marks is given in brackets [ ] at the end of each question or part question.



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This document consists of **7** printed pages and **1** blank page.



## BT Group (BT)

### Introduction

BT Group is a British telecommunications company that was privatised in 1984. It serves customers in 170 countries around the world. The company has a market capitalisation of £5747m and is a member of the FT 100 index (largest 100 companies in the UK by market capitalisation). BT provides many products and services including local, national and international telecoms services and infrastructure such as Internet access, fixed line telephone services and information technology products and consultancy. 5

It is February 2009. BT currently commands approximately three-quarters of the UK fixed line residential telephone market and is also the UK's most popular broadband Internet provider. To give some indication of the market penetration of BT, consider that approximately one million businesses rely on the company worldwide and this includes 65% of all FT 100 companies. 10

BT has 4 key areas of business. These are:

BT Retail (BTR) – this is a major force in the UK communications market. It employs over 18000 people and has 18.3 million customers. It predominantly serves the UK household market and offers products such as BT Talk Together and BT Broadband.

BT Wholesale (BTW) – this gives businesses access to BT's telecoms infrastructure. It brings economies of scale to over 700 communication companies. This division runs BT's networks and provides network services and solutions to other communications companies. This area of business handles more than 300 million calls every day and 350 million Internet connections every month for more than 600 customers.

BT Openreach (BTO) – this area of the company is responsible for keeping customers connected to their local telephone exchange. Openreach is not a communications retailer. It does not deal with residential and business customers. It only deals with communication providers.

BT Global Services (BTGS) – this division serves companies and government organisations in the UK and around the world, providing high-performance managed networked information technology services. It employs around 30000 people in 50 countries and delivers services in nearly 200 countries.

In 2008, Ian Livingston the Chief Executive of BT identified three key priorities for the company:

- 1 Accelerate the focus on customer service.
- 2 Expand BT's operations in international markets.
- 3 Increase the speed at which BT reacts to and anticipates market changes. 15

### Challenges facing BT

BT has already announced that it is to reduce its total global workforce from 160 000 at the end of 2008 to approximately 150 000 or less by mid 2009. The company stated that the job losses were not a 'direct result' of the economic downturn. Ian Livingston said that the job cuts were 'a reflection of the fact we have to become leaner'. In the UK the unemployment rate has soared to over 2 million (6.5%) for the first time since 1997 and some analysts feel it could peak at approximately 3 million people unemployed. 20

The reduced labour costs could be seen as part of a broader cost reduction strategy. BT aims to reduce its costs by approximately 7% by the end of 2009. It plans to do this through labour force reductions and reduced overtime, improved network reliability, increased automation in fault handling and general overhead savings. 25

Another area of concern for BT is its pension fund deficit. This currently stands at £2.4bn. The company is paying in an extra £280m a year to pay off the deficit. In April 2010 the company hopes to save £100m in pension contributions per year when it adopts radical changes to its final salary pension scheme. This change will reduce the pension entitlements of 65 000 employees. The final salary scheme was closed to new joiners after 2001. In addition to this policy, some employees will need to make larger pension contributions, and the standard retirement age will rise from 60 to 65 years old. The policy to amend or stop the final salary scheme is not unusual for large UK companies as these schemes are very expensive. Additionally, the deficit on the pension fund has been increased by record low interest rates and falling global stock markets. 30 35

The telecoms market is very competitive and BT faces competition from fast growing rivals such as BSkyB and the Carphone Warehouse TalkTalk package. It is becoming increasingly popular for customers to purchase a bundle of products from one provider. This usually includes phone line rental, broadband, satellite television access and various other products. BT has found it difficult to penetrate the digital media market with its product called BT Vision. The company is hoping to partially insulate itself from price competition by concentrating on customer service and increased marketing efforts but the present climate of economic recession is making some customers far more price sensitive and BT is already engaging in some price discounting. The level of competition has increased with the proliferation of comparison websites that allow consumers to compare the price and features of rival providers. 40 45

In the broadband market BT offers 3 options, ranging from the entry level Option 1 to the premium Option 3. The different packages represent different download allowances, connection speeds and additional features such as anti-virus software. This segmentation is also used in the landline telephone market where 3 differentiated products are also offered.

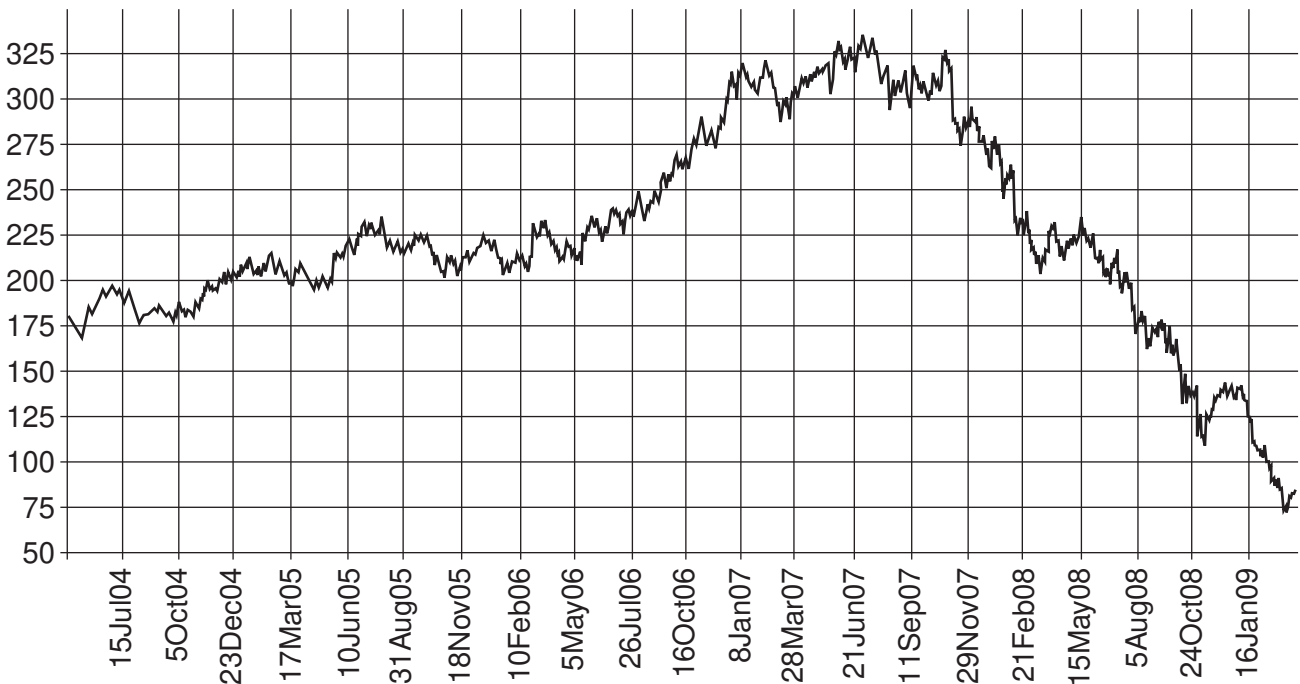
The worldwide nature of the current economic crisis has particularly hurt BT's Global Services Division (BTGS). The recent financial results of this division were described as 'particularly disappointing' by the Chief Executive and the head of the BTGS division resigned as a result. This division has been hindered by the sustained and widespread nature of the current economic slowdown and a failure to fully implement cost saving measures. Global Services has 17 major contracts and 2 have performed very badly with major cost overruns. One of the very poor results came from BT's contract with the National Health Service (NHS) in the UK. 50 55

Two profits warnings have been issued by BT in response to the poor performance of BTGS and this has had a major impact on the share price. Additionally, stock markets in general have been in decline since the beginning of the sub-prime induced credit crunch. In line with this, a number of share analysts have re-rated BT shares. Cazenove reported that 'given current stock market conditions, sentiment towards BT is likely to remain depressed for some time'. Other analysts have suggested that the BT dividend yield is also under threat. (Dividend per share: 2008: 15.8p, 2007: 15.1p, 2006: 11.9p.) 60

## Opportunities for BT

The outlook for BT is not all doom and gloom. The performance of the divisions (excluding BTGS) 65 has been ahead of expectations. Indeed the other three divisions delivered the best year-on-year profit growth for five years.

Additionally, the BT brand was recently awarded a 'Trusted Brand' accolade by Reader's Digest magazine. BT has the largest market share in the UK fixed line telephone and broadband Internet markets (broadband market share 35%). The company is winning back customers who had 70 transferred to other companies because BT has become far more price competitive and is seen to offer a more reliable service with better customer support.



**Figure 1: BT share price in pence (5 years).**

BT has also managed to secure a minimum 10% return on its network that is used by competing telecoms firms. This ruling by Ofcom (the national telecoms regulator) is certainly welcome news for BT. 75

The company is also committed to implementing its superfast fibre optic broadband in many areas of the UK. Ofcom considers this a potentially risky strategy requiring large set-up costs and will allow BT to set its own reasonable rate of return on this product.

The future of this former state owned monopoly seems uncertain. If the company can survive this major economic downturn it will emerge leaner and more customer focused than at any time in its history. Many challenges still remain and it will be a stern test of the leadership skills of Ian Livingstone and his Board of Directors. 80

| Year | Advertising spend £m | Sales change<br>(on previous year) |
|------|----------------------|------------------------------------|
| 2006 | £56m                 | +8%                                |
| 2007 | £64m                 | +12%                               |
| 2008 | £71m                 | +8%                                |
| 2009 | –                    | –                                  |

**Table 1: Advertising spend on BT Broadband Option 1**

| Product                  | Average income<br>2008 | Average income<br>2009 (forecast) | Estimated change in<br>quantity demanded |
|--------------------------|------------------------|-----------------------------------|--|
| BT Broadband<br>Option 1 | £31 000                | £30 320                           | +3%                                      |

**Table 2: Average gross income of BT Broadband Option 1 customers**

|  | <b>2008</b><br>£m | <b>2007</b><br>£m |
|--|-------------------|-------------------|
| <b>Fixed assets</b>                            |                   |                   |
| Investments in subsidiary undertakings         | 10 182            | 10 064            |
| <b>Total fixed assets</b>                      | 10 182            | 10 064            |
| <b>Current assets</b>                          |                   |                   |
| Debtors  | 996               | 137               |
| Cash at bank and in hand                       | 16                | 17                |
| <b>Total current assets</b>                    | 1 012             | 154               |
| Creditors: amounts falling due within one year | 184               | 40                |
| <b>Net current assets</b>                      | 828               | 114               |
| <b>Total assets less current liabilities</b>   | 11 010            | 10 178            |
| <b>Capital and reserves</b>                    |                   |                   |
| Called up share capital                        | 420               | 432               |
| Share premium account                          | 62                | 31                |
| Capital redemption reserve                     | 15                | 2                 |
| Treasury shares reserve                        | (1 843)           | (884)             |
| Profit and loss account                        | 12 356            | 10 597            |
| <b>Total equity shareholders' funds</b>        | 11 010            | 10 178            |

**Table 3: Extract from BT Group plc Balance Sheet as at end of financial year 2008**

|                    | <b>2008</b><br>£m | <b>2007</b><br>£m |
|--------------------|-------------------|-------------------|
| Revenue            | 21 011.8          | 20 396.6          |
| Cost of Goods Sold | 4 633.7           | 10 631.5          |
| Gross Profit       | 16 378.1          | 9 765.1           |
| Overheads          | 11 133.4          | 4 336.7           |
| Depreciation       | 2 888.8           | 2 911.1           |
| Operating Income   | 2 355.9           | 2 517.3           |

**Table 4: Extract from BT Group plc Income Statement as at end of financial year 2008**

**Read all the case study material and then answer all the following questions.**

**Section 1**

- 1 (a) Using the information in Table 1, calculate the advertising elasticity of demand from 2007 to 2008 for BT's Broadband Option 1. [3]
- (b) Using the information in Table 2, calculate the income elasticity of demand for BT's Broadband Option 1. [3]
- (c) Comment on the significance of these elasticity values for the strategic direction of BT. [6]
- (d) 'In the Broadband market BT offers three options, ranging from the entry level Option 1 to the premium Option 3. The different packages represent different download allowances, connection speeds and additional features such as anti-virus software.' (lines 46-48)
- Analyse potential pricing strategies for BT's Broadband Option 1. [13]

**Section 2**

- 2 To what extent is BT a successful company? [25]
- 3 Evaluate the strategies which BT could adopt in response to a prolonged worldwide economic slowdown. [25]
- 4 Discuss how BT could maintain and improve its reputation for good customer service, while trying to reduce costs. [25]

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