**INTRODUCTION**

American Telephone and Telegraph Company (AT&T) is a legacy company from the days when communication was conducted exclusively across telephone lines. Today, the company is a leading telecommunications firm with global reach for the full spectrum of modern communications devices. This case is an in-depth depiction of the evolving organization and of the strategic issues confronting CEO Randall Stephenson.

The purpose of this case is to become familiar with AT&T’s current situation in order to explore a distinct set of challenges faced by the company’s leadership team (whose ultimate objective is to maximize returns for investors in the upcoming years). Beginning with a review of the firm’s key strategic issues, the analysis should proceed with an assessment of the internal and external environmental factors relevant to establishing an effective strategy.

* Clearly define the foremost strategic challenges confronting AT&T at this time. What tools or steps are needed for the company to satisfy stakeholder expectations?
* Examine AT&T’s internal capabilities. What are the important considerations for shaping an effective business strategy?
* Examine the external environmental forces affecting the company’s strategic decisions. Highlight the most relevant considerations.
* Is the company’s current strategy suitable for the existing situation and conditions? What recommendations can be made to address strategic concerns and safeguard AT&T’s financial stability?

**ANALYSIS**

* ***Clearly define the important strategic challenges confronting AT&T at this time. What tools or steps are needed for the company to satisfy stakeholder expectations?***

Stephenson faces a complex set of problems that have strategic implications for AT&T. Following the framework presented in the case, the critical issues requiring attention from the firm’s leadership team are outlined below, along with suggested measures to address these pressing concerns.

|  |  |  |
| --- | --- | --- |
|  | Strategic Concern | Needed Measures |
| Firm-Wide | Business transformation | Growth strategy aimed at new revenue sources |
|  | Rebalance of diversified product mix |
|  | Infrastructure and resources to support growing segments |
| Multipoint competition | Brand management |
|  | Improved service quality image |
|  | Resource and competency sharing |

|  |  |  |
| --- | --- | --- |
|  | Strategic Concern | Needed Measures |
| Wireless Division | Saturated US markets | Global strategy |
|  | Increased domestic appeal |
| Loss of iPhone exclusivity | Competitive strategy |
|  | Defensive posture |
|  | New competitive advantages |
| Wireless capacity | Infrastructure advancements |
|  | Variable pricing model |
| Service quality | Enhanced brand image |
| Wireline Division | Government regulation of legacy phone lines and video streaming | Lobbying efforts to reduce regulatory burdens |
|  | Define cost structure and video strategy to address state and local cable laws |
| Media delivery methods | Improve infrastructure for multiple delivery methods |
|  | Acquisitions in entertainment/media industry |

* ***Examine AT&T’s internal capabilities. What are the important considerations for shaping an effective business strategy?***

AT&T’s rich history of innovation goes back to the founding of the company. Through keen leadership, AT&T’s response to the evolving industry and regulatory modifications over the years has transformed the business into the nation’s largest provider of wireless, broadband, and telephone services. Now, the company is again tasked with redefining the enterprise, as it faces a steady decline in landline revenues and a host of threats to the Wireless Division.

Despite the rapidly changing composition of sales, AT&T has been able to achieve stable revenue growth, matching traditional segment declines with the expansion of its wireless segment. The table below breaks down revenues by business segment and illustrates the dramatic change in revenue structure over the past few years.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| **Segment** | **Rev. Share 2007** | **Tot. Rev. 2007** | **Rev. Share 2010** | **Tot. Rev. 2010** | **Rev. 2007** | **Rev. 2010** | **Rev. % Change** |
| Wireless | 32.4% | $119 | 43.1% | $124 | $38.6 | $53.5 | 38.6% |
| Wireline\* | 53.8% | $119 | 44.9% | $124 | $64.0 | $55.7 | -13.0% |
| Ad Services | 4.0% | $119 | 3.2% | $124 | $4.8 | $4.0 | -16.6% |
| Other | 9.7% | $119 | 8.9% | $124 | $11.5 | $11.0 | -4.4% |
|  |  |  |  |  |  |  |  |
|  |  |  | Voice\* | | $40.8 | $28.3 | -30.6% |
| *$Revenue in billions* | |  | U-verse\* | | $23.2 | $27.4 | 17.9% |

These figures show that Voice products are down significantly, due to the replacement of traditional landline service with mobile phones. In an effort to discover new avenues of growth beyond the saturated cellular phone market, AT&T is now pursuing opportunities to provide data and entertainment content through its existing communications networks. But despite increased penetration rates of 1% per month, Data product growth has been modest. In fact, just 501,000 new broadband connections were made in the past year, which represents only a 2.9% growth rate in this priority market. Wireless is the only AT&T division to experience consistent growth in recent years. This rapid growth is attributed to the company’s exclusive agreement with Apple to provide service for the widely popular iPhone and to the high-speed data transfer capabilities of its 3G Network.

However, the large amount of wireless traffic generated by iPhone and other new mobile computing devices has tested AT&T’s capacity limits. Handling up to half of all wireless traffic to satisfy iPhone’s data requirements has resulted in poor service quality and left the company vulnerable to customer defections—especially with the entry of Verizon as an additional service provider for the iPhone and other Apple devices. Customer satisfaction ratings and poor service quality scores are beginning to damage the AT&T brand. Unless negative customer perceptions of cell phone service quality are corrected, image deterioration could extend to all of the company’s product lines.

A review of key performance measurements reveals the following facts about AT&T’s financial and operating status:

* Expenses are growing at a faster rate than revenues, including cost of revenues and SG&A.
* Net income is up substantially from 2009 due to an income tax advantage incurred last year.
* Total debt is down a respectable 8.2%, and the company’s debt ratio remains very healthy.
* Current assets are down more than 20%.
* $934 million spent in R&D over the last 3 years was invested only to support AT&T’s wireline business; no internal research is conducted to develop wireless technologies.
* Major construction and capital investments totaled $18.9 billion/year since 2007.

Though AT&T stock is underperforming in the capital markets, several financial measurements show results that should please investors. In 2010, book value per common share was up 9.6%. EPS shadowed earnings gains by growing 63% from $2.06 to $3.36. Shareholders’ equity in the form of retained earnings went up 44% in the past year, and total stockholders’ equity grew by nearly 10%. Even though the economy is still fragile, the company anticipates financial stability and steady revenues from promising business sector trends.

Finally, AT&T enjoys a considerable degree of social capital through the close relationships it maintains, both with dominant suppliers for the global network equipment industry and with the US Justice Department and regulatory agencies. As a result, the company should be able to leverage this intangible asset to oversee industry happenings and to protect its interests.

* ***Examine the external environmental forces affecting the company’s strategic decisions. Highlight the most relevant considerations.***

The magnitude and reach of the telecommunications industry is great. The challenges posited above are exacerbated by enormous changes in consumer preferences and a continuous stream of new technologies entering the marketplace. Major trends with strategic implications for AT&T are outlined and discussed below.

* *Significant shift from landlines to portable cellular devices and other new technology solutions* Landlines are being cancelled at the rate of 700,000 per month in favor of wireless communication solutions. This raises questions about the continued maintenance and upgrade of existing landline assets. All of AT&T’s research and development costs ($934 million since 2007) go to support its wireline business. In addition, regulatory requirements to make service available for low-income and rural populations impact AT&T’s decisions. At the same time, the company has made substantial investments in its 3G network to compete successfully in the wireless market.
* *Increased pressure to expand network infrastructures* Due to the dramatic change in usage patterns, providers are struggling to handle new sources of traffic. Newer devices continue to push the technological limits of the Internet. Steadily increasing demand for bandwidth is testing already-strained networks and frustrated customers. And potential regulation over the ability of broadband providers to restrict or control transmissions threatens to lock telecom companies into an unprofitable “neutrality” business model.
* *Consumer demands for advanced network capabilities and for lower wireless rates* Demand for better network service is outpacing progress to expand North America’s communication infrastructure. Support of a massive subscriber base, changing user expectations, and growing device functionality requires a significant commitment in provider resources. Sluggish expansion is further hampered by interest groups trying to control the rate of technology integration. Meanwhile, price-sensitive customers are discontented over the price of contract plans, which are designed to increase network switching costs. As a result, new prepaid, short-period providers are introducing a new business model with more competitive rate structures.
* *Trend to stream data and content over the Internet fueled by broadband and cable advances*  As fiber optic line transfer rates increase, streaming voice services through the Internet (known as VoIP) is becoming a popular substitute for landline phone wires. AT&T’s upgraded wire services enable the company to deliver phone services through this channel, as well as Internet access, video content, and other business services. Its U-verse service puts the company into direct competition with cable and satellite firms, in addition to other phone service companies. This trend marks cable companies as a major competitive force that AT&T will have to contend with in the near future.
* *Saturated US markets*  With 91% of Americans owning cell phones, subscriber gains in AT&T’s fastest growing segment now rely on the ability to attract users from competitor networks and on global expansion efforts. Limitations in the domestic market are reflected in the company’s (and in major competitor, Verizon’s) stock market performance. As wireless expansion into previously unreachable markets rapidly occurs, significant opportunities to capture new business do exist in the worldwide cellular phone market, where compounded annual growth is 23.2% and total market penetration is at 59.3%. By 2012, over 5.5 billion people are expected to be wireless subscribers. To support this massive subscriber base, telecom companies are increasing the development of wireless network infrastructures with capital expenditures valued at $224.5 billion (through 2015). This, of course, will diminish as global market saturation follows (although maintenance and network upgrade expenses will continue). If AT&T invests at its current rate, the company’s share of this infrastructure expense will be 1/10th of that total.

AT&T’s competitive field is dominated by its largest rival, Verizon. Verizon and AT&T control the fragmented wireline market with a combined 53.9% market share. The wireless market is slightly more concentrated. 2010 shares are broken down according to the number of subscribers in the following table.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Wireless Subscribers | | | ARPU | Operating Margins |
| Verizon | 32.1% | 102.2 | -1.6% | 4.3% |
| AT&T | 30.0% | \*95.5 | constant | 12.1% |
| Sprint | 16.9% | 53.8 | constant |  |
| T-Mobile | 11.9% | 37.9 | -8.10% |  |
| Other | 9.1% | 29.0 |  |  |
|  | 100.0% | 318.3 |  |  |

\*from 60.9 million at the end of 2006; 57% growth in a near-saturated US market

The parallels between these two telecom companies are great. Both have experienced healthy growth during the explosive wireless revolution and have seen declining revenues in the wireline market. Whereas AT&T relies a little more heavily on these wireline revenues than Verizon does (47% share of revenues vs. 42.7% for Verizon), AT&T has a distinct advantage over Verizon in terms of operating margins in the wireless segment. Also, AT&T has been able to sustain its average revenue per user, but Verizon’s ARPU is slipping. Both firms attempt to distract the conversation from premium price points by advertising about the power of their networks. However, Verizon engages in aggressive marketing tactics to take advantage of the negative customer perceptions stemming from AT&T’s cellular service quality. The competitor currently has a greater number of subscribers, and with its new iPhone contract, this advantage is likely to grow. Looking ahead, AT&T’s biggest competition is expected to come from cable companies and Verizon (who now also offers video services over its FiOS network).

**STRATEGY**

* ***Is the company’s current strategy suitable for the existing situation and conditions? What recommendations can be made to address strategic concerns and safeguard AT&T’s financial stability?***

AT&T is a full-service telecommunications and media firm using innovation and a differentiation strategy to command a premium price and compete with other phone, cable, and satellite providers. It has a moderately related diversified portfolio of communications products and services with a wide variety of price points, options, features, and service bundles offering consumers flexibility and convenience. The company uses a single brand approach, and its slogan (“Your World – Delivered”) symbolizes AT&T’s goal of delivering limitless content, one-stop shopping, and complementary offerings. The AT&T brand is the centerpiece of the company’s marketing strategy because it portrays the firm’s rich history of innovation and tradition of reliable quality and service. AT&T has a strong advertising presence in print, media, and Internet media, and a prominent sports sponsorship to enhance brand exposure.

In an effort to discover new avenues of growth beyond saturation in the cellular phone market, AT&T is now pursuing opportunities to provide a variety of easy-to-use data and entertainment content through its existing communications networks. Because the company continued to innovate and adopt new technologies for its softening wireline business and invested heavily in fiber optics to upgrade its wire network, AT&T is now able to expand into Internet and video home services in its 22-state domestic region. This provides a full spectrum of voice, data, and video services to support its business strategy. To address the blurred distinctions between telephone services, online computing, and entertainment, the company plans to offer new services that combine traditional wireless and wireline services to improve conveniences and productivity for customers.

The company has a successful history of building cooperative relationships to facilitate growth in new segments, gain a position in emerging markets, and generate a steady stream of income for shareholders. AT&T has been willing to “reinvent” itself over the years and has used mergers and acquisitions to create synergies between computers and communication during the rapid expansion of new technologies. By adopting technology standards that are compatible with the majority of global carriers, the company can deliver global coverage and device flexibility for its subscriber base that is not matched by Verizon or Sprint. And having a larger geographic market attracts the best phones offered by device manufacturers.

AT&T’s organizational structure is aligned to serve and support broad market profiles: mobility and consumer markets, business solutions, and diversified businesses. Operating separate business units in this manner, or using a cooperative form of the multidivisional structure, is suitable for facilitating interdivisional cooperation at firms executing a related constrained diversification strategy. It allows AT&T to share capabilities across divisions and supports the company’s efforts to develop economies of scope.

Taking AT&T’s strategy and strengths into account, along with the evaluation of the company’s markets, competition, and industry environment, the suitability of the company’s strategy can be assessed and recommendations to address strategic concerns can be made. Though suggestions from students will vary, the following topics play a critical role in formulating strategic measures for AT&T to ensure future revenues, maximize returns, and meet shareholder expectations.

Full Spectrum Delivery AT&T’s business transformation plan requires a growth strategy aimed at new revenue sources, a rebalance of the company’s product mix, and adequate infrastructure and resources to support growing segments. The company’s strategies and investments to expand into Internet media satisfy these requirements and proffer multiple seamless delivery options for a broad consumer market. They also address saturated US markets and the loss of iPhone exclusivity by giving the company a new competitive angle. In addition, the ability to share or transfer the firm’s resources and competencies across business units can enable the company to create value and exploit economies of scope between its businesses.

Marketing Strategy As the competitive landscape evolves, the need for a revised and powerful marketing strategy is critical to AT&T on several fronts.

* The AT&T brand has been damaged by service issues in the wireless segment.
* The company’s positioning as a premium-priced, high quality services provider is inconsistent with its current service reputation.
* Increased competition in the saturated domestic market requires new methods of attracting users from competing providers.
* Verizon attacks must be answered less defensively and with an emphasis on AT&T’s competitive advantages.
* Newer services require a different approach, aimed more at Internet users and first-time users.

Cooperative Strategy Strategic alliances can play a significant role in addressing some of the competitive challenges facing AT&T. International partnerships can increase the speed of market penetration in overseas markets. Relationships with dominant global suppliers in the network equipment industry can serve to provide substantial advantages in the race to expand wireless network capacity. Perhaps most importantly, AT&T could use cooperative partnerships to improve the rate of growth for U-verse, which is essential to compensate for saturated markets and the loss of landline subscribers. A valuable collaborative advantage could be gained by partnering with a major Internet content delivery firm, such as Google, Amazon, or Microsoft.

Wireless Division AT&T has depended heavily on wireless/3G profits to replace losses in the landline business. Threats identified in the analysis above demonstrate considerable risk to this very important growth segment. Saturated domestic wireless markets, loss of iPhone exclusivity, service quality issues, and increased VoIP solutions all signify that competitive pressures will intensify in the cellular phone market. As mentioned above, meeting this challenge requires a successful marketing strategy, aggressive global expansion before saturation in international markets occurs, and continued infrastructure development. It also requires a competitive strategy and new competitive advantages designed to protect this critical revenue haven until a strong position can be gained in the Internet streaming segment.

New Competitive Advantages Creating new competitive advantages over rivals is necessary for navigating the increasingly competitive communications industry, especially to protect the company’s vital wireless market position. Former CEO Whitacre believes that the organization’s future success depends on possessing the assets that connect customers (assets that cannot be duplicated). He claims that the key is to reach more customers than AT&T’s rivals. Some other potential sources of competitive advantage are noted below.

* Diversification synergies gained from intangible assets can expand the company’s market power while evading competitor imitation.
* Relationships with global network suppliers can be used to establish a cost advantage for infrastructure development.
* Global connections and device flexibility can be leveraged to provide greater value to customers and to strengthen the company’s global market share. And access to better mobile devices may be a way to make up for the loss of iPhone exclusivity.
* Regulatory influence can be used to prevent “Net Neutrality” forces from gaining ground.
* Recognizing a slight advantage over Verizon in retaining its ARPU rate, AT&T should focus on methods to further strengthen this performance measure. Coupled with better control over rising costs, the company can also reinforce its advantageous operating margin.

Variable Pricing Model It appears inevitable that heavy bandwidth users should pay more for network services than low-level users. To fend off Internet neutrality, AT&T needs to go on the offense (and should waste no time doing so). Of any industry participant, AT&T is in the best position to influence the direction of regulatory decisions, due to its long-time associations with the Justice department and other legal authorities. There are benefits that American commerce gains from an enhanced network infrastructure. This fact should engender cooperation from government agencies to fuel telecom expansion, which currently trails behind growing demand. If the company can shift charges to content providers or heavy users, it could also provide some relief to price-conscious average or low-level users. Securing such a pricing model will not only give the company a temporary advantage over rivals, but will help “future-proof” the business as appetites for bandwidth grow. While engaging regulatory agencies in this conversation, AT&T should also address the need to distribute the burden of maintaining wirelines (to ensure access to all citizens) across the entire industry to keep the playing field level. On the regulatory front, the company should, however, expect to be subject to state and local cable laws to deliver video content.

U-verse Growth Strategy The growth rate of AT&T’s new U-verse service does not reflect the potential for this new entertainment and data delivery format or fulfill expectations for this priority market. Providing Internet access and video services across the company’s fiber optics network is an important growth area for the company. Marketing should be focused on raising awareness among potential subscribers, and new forms of promotion should be explored to improve marketing effectiveness. Rather than appealing to cell phone users, advertising messages should be aimed at current landline users and offer upgrades to their services. This may also help to reduce AT&T’s landline cancellation rate. Additionally, the company should consider acquisitions in the entertainment or media industry to gain new capabilities and resources to facilitate growth and create additional value.

***Additional Discussion Points***

In analyzing AT&T’s strategic options, some areas of uncertainty are revealed. The following questions are worthy of further discussion and can be used to enrich classroom dialogue about the case.

* Should AT&T have divested its broadband business to Comcast?
  + Comcast is now a significant rival.
* Do you agree with AT&T’s decision to only support the wireline business with research and development funding?
  + Because wireless technologies are developed by others, AT&T does not have an opportunity to lead the industry or to achieve first mover advantages from innovative advancements.
* How will competition with cable and satellite companies differ from AT&T’s rivalry with conventional telecommunications and phone companies?
  + The analysis points out that AT&T’s biggest competition in the future will come from cable companies, whose resources and reach are extensive.