Sir Michael Rake: future growth at BT Group

Sir Michael Rake has been chairman of BT Group plc since September 2007. He is chairman of the UK Commission for Employment and Skills, as well as a director of Barclays PLC, McGraw Hill Inc. and the Financial Reporting Council. He is also chairman of the Guidelines Monitoring Committee, the private equity oversight group.

From May 2002 to September 2007 Sir Michael was chairman of KPMG International. Prior to his appointment as chairman of KPMG International he was chairman of KPMG in Europe and senior partner of KPMG in the UK.

He joined KPMG in 1974 and worked in continental Europe before transferring to the Middle East to run the practice for three years in 1986. He transferred to London in 1989, became a member of the UK board in 1991, and had a number of leadership roles in the UK before being elected UK senior partner in 1998.

Q: What prompted you to take up the position of Chairman of BT?

Sir Michael Rake:

I spent five years as International Chairman of KPMG and I wanted to do something completely different. I had an ambition to move into the Chairmanship of a public company, and to my surprise BT came along. Timing is very important and this just happened to be a new challenge that presented itself just as I was coming to the end of my term with KPMG. BT is a complex company, it is challenging and its technology affects everybody: individuals, companies, education, hospitals, and government, in the UK and around the world. Basically, I just thought it would be really interesting and that is how I got involved.

Q: Was it a big change from running an advisory company like KPMG?

Sir Michael Rake:

No, not really, I left KPMG at 5.30 pm one evening and arrived at BT at 8.30 am the next morning, having to chair a board meeting at 10am. You come to realize that people are people and business is all about relationships. Chairing the board at BT was no different from chairing the board at KPMG.

The Chairman is in a unique position to set and to exemplify the values of an organization and to motivate (or at worst demotivate) its people. It is easy to forget, if you have been doing the job some time, how much your own behaviour, encouragement or criticism can influence the behaviours of others right across the organization. So, I would say that the importance of leadership does not change. However, structurally there are important differences, and I would identify four in particular.

“The chairman of a company like BT is more like the role of an ambassador, representing the company to regulators, governments and major customers.”
The first is that the alignment of shareholders with the management of a publicly listed company is not the same as the relationship between partners and their Chairman. In a firm like KPMG it was possible to discuss issues and come to a conclusion by engaging with your partners directly. After all, they elect their leaders and can remove them when they want, but underlying the relationship is a clear alignment of interests. In a public company like BT with over a million shareholders, the alignment is much more complicated. Shareholders have differing expectations, some have short-term time frames, some have expectations of dividends, some are investing for the longer term, some are hedge funds or short-sellers. Reconciling those differences is not always easy.

The second difference is the complex remuneration structures in public companies (and I am not restricting my comments just to BT here). In my view, these systems are too formulaic and do not deal adequately with behaviour. At worst they force the wrong kind of decision making, and we have seen this in some spheres of investment banking. It is important that rewards are linked to a company's core values, and publicly listed companies have not always been good at achieving that.

Third, I think that the quarterly reporting required of major publicly listed companies defines a very significant difference with a partnership, and in all honesty I would say is unhelpful. It results in too much energy being devoted to reporting too often, and implies an assumption of precision which really cannot exist in a large and complex business.

Finally, there is a subtle difference in the power and role of the chairman. In a partnership, you are elected as the leader of a team. That gives you real authority. In a large public company, you have influence and responsibility but not necessarily the same authority, other than in the one huge power to remove the chief executive.

The chairman of a company like BT is more like the role of an ambassador, representing the company to regulators, governments and major customers. In addition, it is the chairman's role to make sure the board operates in the right way, so people are engaged, can give their point of view and are not dominated by the chief executive (or even the chairman!), and where everybody is encouraged to ask the right questions.

Q: Do you think that the focus on short-term performance detracts from the long-term perspective?

Sir Michael Rake:

Absolutely, as I said before, quarterly reporting encourages a short-term view of the business and a pressure to grow every quarter. BT had been obsessed with earnings per share going up for 25 quarters in a row. Share buyback programmes – which I am pleased to say BT suspended last summer – have not been helpful and in my view are not the way that one should be building earnings per share.

Q: The last two quarters performance has not been great and the share price is currently below the offer price. Is this a direct result of the economic climate or are they fundamental issues affecting the company?

Sir Michael Rake:

First of all, you need to remember that when O2 was demerged, every BT shareholder was given shares in O2 – subsequently bought at a very healthy premium by Telefonica. So, the straight comparison of the BT share price at flotation and now is not a fair one! That said, clearly the performance of BT's share price over the last year has been disappointing.
Certainly, the economic downturn has had a negative affect on BT, but it has not been the fundamental issue. Three of our four market facing divisions are performing well. But the performance of our Global Services business – which sells complex networked IT services of multinational organizations – has been unacceptable, and has led us to take very substantial charges. The issue has been one of the cost controls, and the accounting assumptions we have made on a number of our long-term contracts. Without going into too much detail I would say that we have changed the management of BT Global Services, we have taken a long hard look at our costs, and I believe we have taken the tough action necessary to put the business back onto a path towards profitable growth.

We also face some really important regulatory issues. We have more competition and lower prices in the UK than in any comparable country in the world. This has been fantastic for customers, and great for the UK which has world leading broadband availability and take-up, but very clearly it has not been good for our shareholders who have been denied a proper return on their regulated asset value.

The markets in which we operate are changing fast and regulation needs to respond to the threat of new monopolies rather than just focusing on issues from the past. An example is the entirely unacceptable position we find ourselves in, where BSkyB can deny us reasonable access to premium TV content over which it has monopoly control, whilst BSkyB is allowed unfettered access to our own broadband infrastructure.

In summary, we have had two profit warnings in two quarters, and that has been painful, but, we have responded with a sharp focus on the implementation of our strategy. The CEO, Ian Livingston, has a clear understanding of the issues and is entirely focused on making BT a better business with a better future. I feel very positive about BT – we know what we need to do.

Q: Do you share the analysts’ view on the future of the BT share price?

Sir Michael Rake:

While undoubtedly we got some things wrong, we also got many things right. We were right to see the potential of broadband in the UK, we were right to see the huge potential of delivering networked IT services to companies who are seizing the opportunities of globalization – even though we got our cost control wrong. Now, I am convinced we are right to be investing in fibre which will make superfast broadband available to 40 per cent of the homes in Britain by 2012. So, the analysts can make their own minds up, but I am certain there are legitimate grounds for confidence in the business fundamentals.

In the coming months, we will see less expectation of high capital growth and a real focus on good sustainable and reliable dividend stocks. So, we have to get an element of utility into our dividend and to be clear that we are a dividend stock and that we will pay a good dividend. By rebasing our dividend and giving very clear guidance on our expectation of cash flow in the years ahead, I believe we have now described a dividend policy which investors can have confidence in.

Q: Compared to other large telecommunications companies, BT is the only major provider that does not have a mobile arm. Is this a disadvantage? And is there really a future for fixed line providers?

“We have had two profit warnings in two quarters, and that has been painful, but, we have responded with a sharp focus on the implementation of our strategy.”
Sir Michael Rake:

As you know, BT had to sell Cellnet – that was a judgment made at the time to reduce the £30 billion debt mountain to a manageable level. BT, more than any other company in the world, has reinvented itself – and that is a big tribute to the last chief executive, Ben Verwaayen.

The future will bring a mixture of copper, fibre and Wi-Fi based communications. We absolutely believe that BT needs to be in mobility, but that does not mean owning a mobile network. There are plenty of deals that we can do to create mobility through other networks.

Q: What is needed for increased performance from BT?

Sir Michael Rake:

Four things. We need to continue to improve customer service. We need to invest in future networks. BT has to become more agile – a big business acting like a small business, and we need to continue to fight for fairer markets so that we can enjoy the same access to networks outside the UK as a rival communication provider from anywhere in the world enjoys in the UK. In the past year, we have made clear progress on these priorities, but in all four there is a lot more to do.

Q: You recently bought two IT companies – do you see yourself as a telecommunications company?

Sir Michael Rake:

BT sees itself as a communications company as opposed to a telecommunications company. Our job is to make it easier for people to communicate with fast and effective systems – ground or wireless or indeed managing people’s networks or be it at the consumer or corporate levels. We want to make our customers’ lives richer at home, and more effective at work.

Q: How do you feel that management in general is prepared for the environment that we face today?

Sir Michael Rake:

Nobody foresaw the extent of the downturn – what many expected to be a “hard” landing turned out to be a “crash” landing. The downfall of Lehman Brothers was a defining moment when panic set in – and that will take some time to get over. The force of the downturn was compounded by the efficiency in manufacturing which has adopted the just-in-time mechanism thus allowing everything to close down pretty quickly as production was suspended or factories went on a two or three day week. In a sense management reacted very quickly to the downturn although this in itself created a downward spiral. Many of the younger generation of management had never seen a downturn and these events took them by surprise.

Q: What should the younger generation of management be focusing on?

Sir Michael Rake:

I would offer this advice: invest in culture, skills and technology and understand that the future of the world is going to be much less one of high growth, and one of greater government interference.
Q: What lies ahead for you?

Sir Michael Rake:

During the last 18 months I have learned more than I learned in the previous ten years. Life is about learning, and I have learned so much in my various board roles in companies such as Barclays, McGraw-Hill and so forth. In BT, I have had to work hard to understand the issues and it has been a fascinating journey and great fun.

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This is a shortened version of “Interview with Sir Mike Rake, Chairman of BT” which originally appeared in the Journal of Strategy and Management, Volume 2 Number 3, 2009.

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