

BT GROUP PLC  
Form 6-K  
May 23, 2013  
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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## Form 6-K

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16 of

the Securities Exchange Act 1934

Report on Form 6-K dated May 23, 2013

## BT Group plc

(Translation of registrant's name into English)

BT Centre

81 Newgate Street

London EC1A 7AJ

England

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F  Form 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

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Yes  No

**Enclosure: BT Group plc Annual Report & Form 20-F 2013 as sent to shareholders**

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**BT Group plc**

By: /s/ Dan Fitz

Name: Dan Fitz

Title: Company Secretary

Date: May 23, 2013

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**Welcome to BT Group plc's Annual Report & Form 20-F 2013**

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business

This is the BT Annual Report for the year ended 31 March 2013. It complies with UK regulations and comprises part of the Annual Report on Form 20-F for the US Securities and Exchange Commission to meet US regulations. This annual report has been sent to shareholders who have elected to receive a copy. The separate Summary financial statement & notice of meeting 2013 has been issued to shareholders who have elected to receive a shorter document.

Please see cautionary statement regarding forward-looking statements on page 177.

In this document, references to BT Group , BT , the group , the company , we or our are to BT Group plc (which includes the activities of British Telecommunications plc) and its subsidiaries and lines of business, internal service unit, or any of them as the context may require.

A reference to a year expressed as 2012/13 is to the financial year ended 31 March 2013 and a reference to a year expressed as 2013 is to the calendar year. This convention applies similarly to any reference to a previous or subsequent year. References to this year , the year and the current year are to the financial year ended 31 March 2013. References to last year and the prior year are to the financial year ended 31 March 2012.

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### **Chairman's introduction**

We are making long-term investments in our future, and that of the UK.

### **Our shareholders**

We have made good progress this year in a number of areas and delivered strong financial results. For 2012/13 the Board is proposing a final dividend of 6.5p, up 14%. This gives a full year dividend of 9.5p, also up 14% reflecting our performance this year. We continue to pursue a prudent financial strategy. As well as investing in the future of our business, we will continue to reduce net debt, support our pension fund and pay progressive dividends to you, our shareholders. We expect dividends to grow by 10%-15% per year for the next two years.

### **Our contribution**

In the current uncertain environment, it is tempting for companies to focus on short-term targets rather than the long-term health of their business. At BT, we have continued to make strategic investments that position us well for the future. In the last four years, we have invested over £10bn in our capital investment programmes, with much of this supporting the national infrastructure upon which the UK relies.

Our fibre broadband network will bring significant economic benefits to the UK. The investments we are making in TV and mobile will bring new and innovative services for people to enjoy. We are creating jobs at the same time. This year we hired around 1,600 engineers to help with our fibre programme and we insourced around 4,000 jobs.

We played a vital role in making London 2012 the most connected Olympic and Paralympic Games ever and are supporting the British Paralympic team as they prepare for the next Games. During the year we also set ourselves three stretching Better Future goals to achieve by the end of 2020. By extending the reach of fibre broadband, helping our customers reduce their carbon footprint and using our skills and technology to help generate money for good causes, we will make a major contribution to both society and the environment.

### **Our global presence**

We aim to support our multinational customers wherever they are. But to do this most effectively we need fair access to telecoms networks around the world. We continue to lobby to reduce trade barriers and press for policy and regulatory change to ensure a more level competitive playing field. This includes working with the European Commission on current initiatives to complete the digital Single Market, and on bilateral trade liberalisation



negotiations. We hope the EU-US trade talks will deepen transatlantic economic integration, reduce non-tariff barriers and ensure fair access to the US telecoms market. Truly competitive telecoms markets will boost trade in all business sectors and support growth, innovation and jobs.

### **Our people**

Our performance in the year reflects the expertise, hard work and commitment of our people. I am delighted that around 20,000 of them were able to benefit from employee share option plans, each making a gain of around £8,400 on average. We are investing more than ever in our people, making sure they have the skills and support they need to better serve our customers.

### **The Board**

The Board has a key role in setting the strategic direction of the company and played a full part in assessing and approving the major investments we made this year. You can read about the Board's activities in the Governance section.

### **Our future**

Our aim remains to drive profitable revenue growth. The investments we are making support this ambition. We believe our strategy of improving customer service, transforming our cost base and investing for the future will continue to deliver long-term value for our shareholders.

### **Sir Michael Rake**

#### **Chairman**

9 May 2013

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**Strategy**

In this section we explain our aim and the strategy we are following to achieve it. We set out our business model and the key role that our people play. We describe our assets and resources and how we measure our progress using three key performance indicators. Finally, we describe the principal risks our business faces and what we do to mitigate these.

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#### **Chief Executive's introduction**

We have a lot more to do, but we are now a lot better positioned to do it.

#### **Making a difference**

Communications services are increasingly important in today's world. Our customers rely more and more on our services and our networks whether they are one of the 10m households we serve, our hundreds of wholesale providers, or the largest global businesses. This is a big opportunity for BT; it is also a big responsibility. All of us in BT recognise that what we do as a business makes a real difference to our customers and the societies in which we operate. That is why we are investing in new infrastructure, technology and services. We are proud to make a difference and I'd like to thank our people for making it happen.

#### **Opportunities across the whole business**

At the start of the global economic downturn we made a bold commitment to invest in fibre broadband. That £2.5bn investment programme has already brought fibre within reach of more than half of the UK's homes and businesses increasing by more than 100,000 premises per week. Delivery is on budget and 18 months ahead of our schedule. We believe that, together with government support and subject to an acceptable investment environment, we can pass more than 90% of premises with our network in the next three to four years.

We are also investing in the next generation of TV. We will offer a complete package of phone, broadband and TV. We are rolling out new services and providing new channels and on-demand content. The launch of BT Sport this summer will bring real competition to the pay-TV market. Our three channels – BT Sport 1, BT Sport 2 and ESPN – will provide premium sports content including Premier League first picks, exclusive rugby coverage and women's tennis. By offering BT Sport for free with BT broadband, we are making world-class sport affordable. Superb production facilities, backed up by a team of top sporting and broadcasting talent, promise to make this a great service.

We have also invested in 4G mobile spectrum which will allow us to offer enhanced mobile broadband services to consumers and businesses – helping our customers to stay best connected wherever they are. The spectrum allows us to build on our existing strength in wi-fi where usage of our 5m wi-fi hot spots tripled in the year to 13bn minutes.

We are seeing the benefits of our investments in the high-growth regions of Asia Pacific, Latin America, Turkey, the Middle East and Africa – with double-digit growth in revenue across these markets in the year. Our services are helping multinationals expand into these regions, and local companies become better connected internationally. BT Global Services won total orders of £6.3bn in the year despite tough conditions in Europe and the financial services sector.

## **Customer service**

While our global customer service improved during the year, some of the wettest weather on record triggered a surge of faults in our UK network. Despite significantly more resources in our engineering teams, customers sometimes waited longer than they should for repairs and provision.

While such exceptional weather is unlikely again, we're making investments in customer service to make us more responsive and better equipped to deal with variable weather and increased demand. This will help us get back on track with the improved service levels we delivered in the previous few years.

Overall in the year, we did what we said we would do. We delivered strong financial results, and made substantial investments. BT is a better and stronger company than a year ago.

There's a lot more to do, and many challenges, but BT's future has rarely looked so exciting.

## **Ian Livingston**

### **Chief Executive**

9 May 2013

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**Strategy**

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### **Our strategy**

Our aim is to drive shareholder value by making BT a better business with a better future. This year we made further progress towards this goal, and the investments we are making position us well for the future. Our strategy is delivering results.

We are a leading communications services provider. In the UK, we sell products and services to consumers and small and medium-sized enterprises (SMEs). Around the world, as well as in the UK, we provide managed networked IT services for large multinational corporations, domestic businesses and national and local government organisations. We also sell wholesale telecoms services to communications providers (CPs) in the UK and internationally.

Our strategy is built on Customer service delivery, Cost transformation and Investing for the future.

These are the foundations for making BT a better business. They build on one another. The better we serve our customers, the less time and money we need to spend fixing faults and the things that go wrong. The more we save through transforming our costs, the more we can invest in giving customers what they need now and in the future. By investing in the six strategic priorities shown above we aim to grow the value of our business.

### **Customer service delivery**

We constantly try to improve the service we provide to our customers. In practice that means understanding what they need, making it easy for them to deal with us, keeping our promises, keeping them informed, and acting quickly to fix things if they go wrong.

Right First Time (RFT) is our key metric for customer service (see page 22). It is simply about getting it right for the customer, first time.

RFT improved each year from 2006/07 to 2011/12 and we made further progress in the first quarter of this financial year. But record rainfall then led to flooding across the UK, causing a higher number of faults in the network. To make sure we fixed these faults as quickly as possible, we had to transfer resources away from provisioning new orders. As a result, customers had to wait longer for those orders, we had more calls from customers than we forecast and it took us longer than normal to answer those calls. We did, however, hire extra engineers to help with repair work and new orders (see page 60) and by February 2013 we had managed to get provision lead times back to the levels we have committed to.

Overall, we did not improve our service as we aimed to this year, and our RFT measure declined by 4%. While we did not achieve our group RFT target, BT Global Services achieved its target helped by an increase in the number of

major contract milestones delivered on time and fewer reported customer incidents.

Copper cable theft remains a problem. This year we have worked more closely with the police and government to tackle it. We have set up a nationwide cable alarming system and taken other measures such as forensically marking our cables. Because of this work, we have had 28% fewer customer faults due to cable theft this year, and 50% fewer attacks on our network. A new Scrap Metal Dealers Act should clamp down further on the illegal trade in stolen metal when it comes into effect later this year.

We are improving processes across the business to make sure we keep appointment slots, repair faults more quickly and fulfil new orders faster. We are also working to improve how we interact with our customers through the use of better quality contact information, customer portals and self-service channels that give customers more ways to resolve their problems quickly. We have successfully piloted new voice recognition capabilities to make it easier for customers to get the right help when calling us. We are now rolling this service out more widely.

Improved BT Home Hub diagnostics for our TV and broadband services will locate and resolve faults more quickly with fewer calls and engineering visits. We will also create an integrated customer experience across our consumer channels – voice, social media, email, chat forums and videos.

We encourage our customers to provide us with feedback so that we can serve them better. We believe that the changes we are making will deliver a better customer experience and lead to further cost transformation benefits.

**You can read more about customer service delivery across our lines of business in the Performance section on page  
Cost transformation**

We achieved further efficiency savings across our business. We have cut waste, applied best practice and freed up resources to invest in our future. More and more, we have focused on end-to-end processes that span our whole business. We also started the next phase of our group-wide restructuring programme which will generate further savings and improve customer service.

Specific activities during the year included:

reviewing our entire stock and supply chain. This has given us better controls over our stock as well as improving how we distribute and store it

improving our process for fixing faults for BT Global Services and BT Wholesale customers. We have upgraded our systems, migrated work to four strategic service centres and made it easier for different teams to work together rationalising our network and IT infrastructure. For example, we closed a major legacy network which served the financial services sector and migrated those customers onto our global MPLS platform, giving them improved service and reliability. We have also put programmes in place to rationalise our legacy UK backhaul and global IP networks

combining BT Innovate & Design and BT Operate into our new BT Technology, Service & Operations unit (BT TSO)

improving product and software development across all lines of business through better prioritisation, quality and automation of testing



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improving the productivity of our field engineers by reducing the number of administrative tasks they have to do reducing our travel and subsistence spend by £14m or 12%. Buying more efficiently and reducing travel by using our own conferencing services has saved us time and money, and reduced carbon emissions. Overall, we cut operating costs by £1.2bn or 9%, with savings across all our main cost categories. Together with capital expenditure (excluding purchases of telecommunications licences), we have achieved total savings of £4.7bn over the last four years.

We will continue our drive on cost transformation. In 2013/14 we will launch a pan-BT Continuous Improvement Initiative to help our people take more responsibility for improving the processes around them. We want to transform the service we deliver, analysing and improving the end-to-end processes that span lines of business, operational platforms and products. This will help us to drive out failures in these processes. We are focusing on seven priority areas, targeting issues including early life failures (those that occur near the start of a new service), repeat visits and how we respond to major incidents.

To find more opportunities to reduce costs and to run our business better we will keep benchmarking ourselves against other large telecoms operators and the best companies in other industries around the world.

**You can read about the contributions our lines of business have made to our cost transformation in the Performance section on page Investing for the future**

We are investing in the future of our business to help drive profitable revenue growth and deliver long-term value for our shareholders. The more we can save through our cost transformation activities, the more we can invest in the long-term value of our business without affecting our financial performance in the short-term.

In 2012/13 we made a number of key investments around our six strategic priorities which position us well for the future.

TV and broadband are increasingly complementary as viewing becomes more interactive. We are making significant investments in TV to improve what we offer, rolling out new services and providing new channels and on-demand content.

For SMEs, we have invested in improving our range of IT services and acquired Tikit (one of the largest independent suppliers of technology services to legal and accountancy firms).

We also successfully bid for 4G mobile spectrum which will allow us to offer an enhanced range of converged fixed and mobile broadband services to both consumer and business customers, building on our existing strength in wi-fi.

We continued to invest in our IP Exchange platform to meet the growing demand for IP interconnect services resulting from the massive growth in voice over IP (VoIP) traffic worldwide.

We have made further investments in the high-growth regions of the world. We improved our product portfolio and invested in people and infrastructure in Asia Pacific, Latin America, Turkey, the Middle East and Africa. These investments are helping our multinational customers expand into these regions and support local companies as they grow internationally.

We are supporting the launch of 4G services in the UK by investing in backhaul capacity at key mobile base station sites.

We have invested in expanding our Ethernet portfolio and footprint in response to growing data traffic and demand for higher capacity and greater flexibility in our wholesale customers' networks.

And we have accelerated our fibre rollout. It should be available to two-thirds of UK homes and businesses during spring 2014, more than 18 months ahead of our original schedule.

We believe our fibre investment will support a more connected society, transforming the way people use the internet, giving them better access to information, education and jobs. We are also investing in products and services that will allow our customers to reduce their own carbon footprints.

**[You can read about how our lines of business have been investing for the future in the Performance section on page Our strategic priorities](#)**

[We made further progress against our six strategic priorities in the year.](#)

**[You can read more about how our lines of business did in the Performance section on page Driving broadband-based consumer services](#)**

Broadband is now available to virtually all UK homes and businesses and is increasingly at the centre of people's lives. Our investments in broadband-based services are helping everyone get much more from it.

We differentiate our products from those of competitors by offering the most comprehensive broadband service with a range of packages to choose from. For example, our newly-launched BT Totally Unlimited Broadband lets people download as much as they like with no speed restrictions.

We provide lots of extra features, like our free BT Home Hub, free BT Wi-fi connectivity over the world's largest in-country wi-fi network and free BT Cloud storage. We offer our broadband service together with voice and TV in competitively-priced bundles. Bundling helps us keep existing customers and attract new ones.

Fibre broadband lets people do even more. BT Infinity sales have accelerated and we are selling faster and higher tier options to existing customers while attracting people away from other providers.

Broadband will increasingly be at the heart of how people watch TV. We are extending our appeal to all segments of the TV market. We have launched YouView from BT to allow customers who currently only take Freeview to try pay-TV. Extra TV, our package of 22 TV channels, targets households currently subscribing to basic pay-TV channels from Sky or Virgin. And we are launching our BT Sport channels this summer, for customers who want a wide choice of premium sports but at much better value than currently available.

Our future plans include:

- launching BT Sport

- completing the rollout of Extra TV across our multicast IP network

- further improving our TV channel line-up and on-demand content

- encouraging customers to switch to BT Infinity through marketing campaigns, competitive pricing and by offering

- Extra TV and BT Sport to BT Infinity customers over their broadband connection.

#### **Being the Brand for Business for UK SMEs**

We want to be the first choice for SMEs for all their fixed and mobile communications and IT needs. We aim to offer a wide range of products and services so they do not have to rely on multiple suppliers.

In fixed communications we face stiff competition in a fragmented market, but we have maintained a clear leading position.

We are still ahead because we consciously build on our advantages: the national coverage of our services and sales teams; the breadth of our portfolio of services; the strength of our sales channels; and our brand. We are looking to improve the products and services we sell (and how we sell them) to defend and grow our position in the market. We are developing new IP-based voice and data products, which will help drive penetration of fibre broadband. We are also improving processes and systems so our people can give our customers a better service.

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In our IT services businesses, our focus is on providing service, rather than hardware alone (which tends to be low margin). Where we can, we will cross-sell our networking and IT solutions. We also encourage customers to take higher-value products and services such as managed hosted data and applications, and cloud services.

Our future plans include:

- strengthening our product portfolio in unified communications and VoIP so SMEs can make the most of these growing technologies
- developing our mobile services capabilities, in particular building on our investment in 4G spectrum. We will combine fixed and mobile services to give our customers the best possible connection wherever they are
- growing our IT services businesses, building on synergies between them to improve their positions in the market.

#### **BT Global Services a global leader**

We are a leader in the worldwide market for managed networked IT services. We are truly global with one of the largest networks in the world and more than 60% of our people based outside the UK.

Our customers tell us there are a number of things which make us stand out: our global assets, people and technology; industry experience and solutions; our consulting capability; our innovation; and our strength in the UK.

Our future plans are to invest and build on these strengths.

- We are supporting our multinational customers by investing in high-growth regions
- We are developing our industry expertise. For example, we will build on years of experience supporting the financial services sector where our award-winning products and services support millions of financial transactions every day
- We will invest in our BT Advise team of around 4,000 experts who share their knowledge and skills with our customers
- We will use our strength in the UK, including our fibre broadband network, to keep innovating our products and services. For example, we are improving our conferencing services by using Dolby's high-definition audio technology.

We will use feedback from our customers to improve our service to them. And we plan to drive down cost and become a more agile and competitive organisation. That way, we will be able to take advantage of opportunities in the managed networked IT services market more quickly.

By building a better business, we will strengthen our position as a global leader.

## **The wholesaler of choice**

We want to be the wholesaler of choice in the UK and international telecoms services markets. We give CPs access to our platforms, skills and technology, making our investments and economies of scale work for them. Our approach promotes competition, gives end-customers more choice, avoids duplicating infrastructure and encourages innovation by helping CPs find new ways to serve their customers.

We are Europe's largest telecoms wholesaler and BT Global Services sells our wholesale services to more than 1,200 telecoms companies around the world.

Openreach provides local access and backhaul services; its networks are already the most extensive in Great Britain, allowing CPs to provide ADSL broadband to 99% of homes and businesses and fibre broadband to over half.

BT Wholesale aims to meet CPs' needs where they cannot be met by Openreach's products alone. This typically involves using our network coverage and scale to provide nationwide voice, broadband and data end-to-end products. We also create managed services which combine those products with third-party components and professional services, using our deep expertise in solution design, build, delivery and operation.

BT Wholesale leads the market in mobile Ethernet backhaul services and in wholesale broadband. Our Wholesale Broadband Connect (WBC) next generation copper broadband product is now in exchanges serving more than 90% of UK premises. More than 70 CPs are now trialling or selling its fibre-based variant.

A key area of investment over the past few years has been IP Exchange which was developed in our Adastral Park research and development centre. IP Exchange provides a common gateway to allow interworking between different CPs' IP voice, data and multimedia services. This year it handled 7.75bn voice minutes globally.

We expect a variety of issues, such as regulatory charge controls and competitive pressures, to affect our wholesale business in 2013/14. So we are working to identify growth opportunities that will help us offset their impact.

Our future plans include:

- launching new hosted communications services that will expand our IP voice portfolio and combine it with our data and broadband products
- extending our broadband, Ethernet and Mobile Ethernet Access Service (MEAS) footprints
- adding new features to IP Exchange, including the support of video and 4G mobile services, and introducing more global nodes
- improving our customers' experience, for example, by introducing a new online portal that will offer better tools for pricing, ordering and support
- further reducing our cost base
- increasing the skills and productivity of our people.

## **The best network provider**

Our network in the UK is a critical national asset and we take our guardianship of it seriously. We aim to be the best network provider in the UK by investing in it and by providing the best services over it. We continue to upgrade capacity, offer new services and make it more efficient and reliable.

More than 15m premises can now get our fibre broadband, giving us the largest fibre broadband footprint in the UK. These premises have access to download and upload speeds of up to 80Mbps and 20Mbps respectively using fibre-to-the-cabinet (FTTC), or 330Mbps and 30Mbps using fibre-to-the-premises (FTTP).

We will bring fibre to two-thirds of UK premises during spring 2014. With EU, national and regional government funding, we believe we can bring fibre to more than 90% of UK premises in the next three to four years.

We are rolling out national Ethernet products, with a wide range of ways to connect to our network. These include high bandwidth Ethernet fibre connections, cost-effective Ethernet bonded copper solutions (Ethernet in the First Mile) and more recently, Ethernet over our fibre broadband network. High levels of service availability and flexibility, combined with nationwide coverage, make our Ethernet services an attractive choice for customers.

Our future plans include:

making FTTP available throughout the fibre broadband footprint with our FTTP-on-Demand service. We launched this service in April 2013 in a subset of our footprint  
increasing FTTC speeds above 80Mbps using vectoring, a technology we will be trialling further during 2013/14

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further increasing FTTP speeds building on trials conducted in 2012/13  
extending the choices available to CPs for the delivery of fibre broadband. We plan to introduce a new option in 2013/14 that will allow CPs to use their own modem rather than an Openreach one  
assessing the longer-term opportunities for wider and deeper fibre deployment in the access network  
extending our Ethernet footprint  
upgrading our core network with the latest generation of high-speed optical equipment that provides multiple 100Gbps connections.

#### **A responsible and sustainable business leader**

Our aim is to create a better future by generating value for our business and our stakeholders. Doing this in a responsible and sustainable way contributes to this aim. Our customers want to buy services from a company they can trust to act responsibly and sustainably. This year corporate and government customers asked us about our sustainability credentials in over £2.8bn worth of contracts that we bid for.

During the year we set ourselves three stretching goals to achieve by the end of 2020. They will help us make a major contribution to both society and the environment.

The *Committee for Sustainable and Responsible Business* oversees our corporate responsibility, environment and community activities, and our Better Future programme. It is supported by our Sustainable Business Leadership team which comprises senior executives from across our business units and is charged with delivering our programme and embedding it throughout the group.

#### **You can read more in the Report of the Committee for Sustainable and Responsible Business on page**

Each year we use a materiality process to work out the social and environmental issues that are important to our stakeholders and relevant to our business. It helps us focus on the right things. We measure and report our progress against seven non-financial performance indicators which reflect these issues. They are summarised on page 61.

**To find out more, take a look at our Better Future report at [www.bt.com/betterfuture](http://www.bt.com/betterfuture)**

#### Better business

Our stakeholders expect us to invest in our networks, community and people and to run our business with high ethical, environmental and supply chain standards. You will see from much of what we describe elsewhere in our report, that it is our people and values that help us achieve this.

Working ethically is not just the right thing to do, it is also important to regulators and customers. Our statement of business practice, *The Way We Work* ([www.bt.com/twww](http://www.bt.com/twww)), is available in several languages. We are currently revising it to provide more guidance and examples. We also have a number of ethical policies including

Anti-Corruption and Bribery , Gifts and Hospitality and Charitable Donations and Sponsorship .

We encourage our people to get involved in their local communities and we run a volunteering programme to help them do so. In 2012/13 our people volunteered 43,600 days, worth an estimated £13m to those communities. Overall we invested £27m in responsible and sustainable business activities this year, meeting our target to invest at least 1% of our prior year's adjusted profit before taxation.

Our payroll giving scheme has over 11,000 BT members and donated to more than 2,000 charities in 2011/12. Payroll donations from the UK, Ireland and the United States, rose to £2.9m, which was supported by an additional £1m contribution by BT.

#### Creating a better future

Our society faces the challenge of living within immediate financial constraints and the planet's ever-tighter resources.

Communication technology has a significant role to play in helping businesses and people do this. It helps them swap physical products with their virtual, streamed or digital equivalents. It helps avoid travel. And it provides solutions that help businesses manage their resources as efficiently as possible.

It also has the power to make a difference to people's lives; giving them better access to information, education and jobs and helping them work together. Our people, networks and technology can make these connections happen.

#### Connected Society

We aim to help improve society through the power of digital connections.

We want everyone to be part of a connected society. By the end of 2012/13 over half the people in the UK could access fibre-based products and services. Our goal is for more than nine out of ten people to have access by the end of 2020. We now believe that we can achieve this much sooner.

For years, our digital inclusion programmes have helped people overcome any fears of moving online. Our Get IT Together campaign helps people in the UK discover the digital world with the help of a friend or family member. Our Including You website offers help and support to customers with impairments, helping them and their carers get more out of our products and services.



**Read more**

[www.bt.com/ngb](http://www.bt.com/ngb)

[www.bt.com/getittogether](http://www.bt.com/getittogether)

[www.bt.com/includingyou](http://www.bt.com/includingyou)

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### Net Good

Our vision is to help society live within the constraints of our planet's resources through our products and people.

Our 2020 goal is to help our customers reduce carbon emissions by at least three times the end-to-end carbon impact of our business.

We have calculated our end-to-end impact as 5.0 megatonnes (Mt) of CO<sub>2</sub> equivalent (CO<sub>2</sub>e) emissions. This is made up of 3.2Mt (64%) from our supply chain, 0.4Mt (8%) from our operations and 1.4Mt (28%) from the BT products used by our customers.

Today, we estimate that customers using our products and services avoid generating at least 5.0Mt of carbon emissions through travelling less, for example. This is equivalent to our current business impact. We plan to achieve our 2020 goal by growing our product portfolio in this area whilst cutting our end-to-end emissions.

This year, we set up the Better Future Supplier Forum ([www.bt.com/betterfuturesupplierforum](http://www.bt.com/betterfuturesupplierforum)) to encourage our suppliers to develop products and propositions more sustainably.

BT TSO is responsible for managing our energy consumption and direct carbon emissions – see page 35. We have signed contracts delivering 100% renewable electricity in the UK and Spain. We have met our target to reduce our UK emissions by 80% from our 1996/97 base year, three years early.

### Improving Lives

We believe our people and products can help improve the lives of hundreds of millions of people around the world. Our 2020 goal is to use our skills and technology to help generate more than £1bn for good causes. In 2012/13 we helped raise £59m.

We have a long history of working with amazing causes to improve lives. We have supported ChildLine for more than 25 years. Our technology and people are the backbone of telethons such as the annual Children in Need appeal and UNICEF's Soccer Aid.

Last year, supporting our £1bn goal, our people helped raise £25m across our MyDonate telethon platform for our charity partners including Comic Relief and Children in Need. We have been working with Comic Relief since the charity was formed in 1985 and this year we managed 458,000 incoming donation calls and co-ordinated more than 10,000 volunteers across 147 UK call centres, including around 1,000 BT volunteers in seven BT call centres.

Our MyDonate website is changing the way people give to charity online. We are helping UK charities and their supporters to fundraise online free of charge, with every penny donated going to their cause. This year 3,600 charities used it to raise funds.

## **Read more**

[www.bt.com/mydonate](http://www.bt.com/mydonate)

[www.rednoseday.com/partners/bt](http://www.rednoseday.com/partners/bt)

## **Our business model**

We have a sustainable business model which supports our aim to deliver value to shareholders and customers. It is built around our strategy of Customer service delivery, Cost transformation and Investing for the future.

We make money by selling our services in the UK and around the world through our customer-facing lines of business. These services often use the same underlying networks, platforms and people. The communications market is very competitive, particularly in the UK. We never forget that customers have a choice.

We sell our services through a range of channels including online, contact centres and desk or field-based account managers. Our revenue is largely subscription or contract based. People, households and SMEs pay for standalone or bundled services monthly, quarterly or annually (typically on 12-24 month contracts). Large corporate and public sector customers typically buy managed networked IT services, usually on contracts spanning several years. Contract durations with our wholesale customers range from just one month for regulated products, to five years or more for major managed services deals.

## **What sets us apart**

We have a unique combination of people, brand, networks and technology. And we have the financial strength to make long-term investments in the future of our business.

A committed, skilled and engaged group of employees is key to our business. We have launched a new long-term initiative to make our people feel more empowered, invest in their skills and capabilities and improve our ways of working.

Our assets and resources that help us to deliver our strategy are described on page 20. As well as our brand and networks they include the innovation activities we undertake to maintain our technology advantage. They also include our platforms, our properties and suppliers.



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#### **Delivering value**

Combining the things that set us apart with our products and our customer service delivers value to our customers.

Improving our customer service helps our customers but also allows us to cut the cost of serving them. By reducing the number of times things go wrong, we spend less time and money putting things right. This reinforces our financial strength and helps us to invest in the things that set us apart. A virtuous circle.

That is why the three foundations of our strategy – Customer service delivery, Cost transformation and Investing for the future – are at the heart of the way we run our business.

The cash that we generate from our customers and cost transformation helps us reward our shareholders. And it means we can fulfil our financial obligations to our people and the pension scheme, and to our lenders and suppliers.

What we do matters. We make connections, create possibilities and deliver value. And we give back to the communities we work in.

We measure how we are doing using three Key Performance Indicators (KPIs): adjusted earnings per share; normalised free cash flow; and customer service improvement (see page 4).

#### **We believe our business model is sustainable**

We are confident our business model is sustainable and that we will be able to deliver value in the long-term.

Our Enterprise Risk Management framework (see page 23) helps us to mitigate the challenges that we face, based on our view of the markets in which we operate. Our knowledge of market trends is maintained through dedicated – insight teams. Governance committees make sure that the investments we make are appropriate and will deliver products and services that are attractive to customers.

We see more and more demand for our products and services because they play such an integral role in modern life. Customers rely on us. They trust us with their confidential information and their businesses. We take this responsibility seriously.

#### **Our people**

Every day our people touch the lives of millions, helping them communicate, do business and be entertained and informed. We are investing not only in our future but more than ever in our people.

At 31 March 2013, we had 87,900 full-time equivalent employees of which 73,200 were based in the UK.

## Building our strengths and capabilities

We are introducing new ways of working that will equip and empower our people to continuously improve their work and better serve our customers. We are setting up a BT Academy to be the vehicle for delivering world-class leadership and critical skills development, as well as being an enabler of cultural change. It will allow us to quickly share the BT way which are the methods based on BT at its best.

In Openreach we invested in tools and improved the skills of more than 11,000 engineers, delivering more than 200,000 hours of classroom or simulated workplace training.

We have particularly focused on training to support the planning and rollout of our fibre network across the UK. This investment in skills and capabilities will help our people do things better every day to meet our performance targets and improve quality and customer service.

## Engagement

Our employee engagement index is one of the seven performance indicators that we use to measure how we are doing as a responsible and sustainable business leader (see page 61). It is based on a five point scale and measured 3.69, a small improvement on our score last year. We will continue our wide-ranging programme of activities to support and involve our people and aim to further improve engagement in the coming years.

	2012/13	2011/12	2010/11
Employee engagement index	3.69	3.68	3.61

Our communication with BT people is based on two-way conversation. Proper dialogue helps us keep them engaged about where we are heading as a business, and makes it easier to track their feedback.

We keep our people informed about company results, major business decisions and other things that affect them. We use a variety of print and digital communication channels to do this. We give our people plenty of chances for direct discussion with leaders, so they can ask questions that matter to them. These are either online chats, town hall meetings or round-table events.

We also carry out surveys to ask our people for their opinion. These help us measure how engaged they are overall, so we can spot issues that we need to look into. In April 2013 we updated our company values to better reflect the type of company our people think we are and should be.

We have a record of stable industrial relations and constructive relationships with the recognised unions in the UK and with works councils elsewhere in Europe. In the UK, we recognise two main trade unions – the Communication Workers Union (CWU), which represents people in engineering, administrative and clerical positions, and Prospect, which represents managerial and professional employees. We also deal with unions around the world and operate a pan-European works council, the BT European Consultative Committee.

## Talent and diversity

We gain significant advantage by spotting and developing our own talent as well as bringing in the best skills from outside.

We offer employees who show significant potential a range of support mechanisms and development opportunities. These include access to senior leaders, talent events designed to build knowledge, visibility and networks, and support from Human Resources in creating tailored development plans.

Our customer and supplier base is incredibly diverse and our diverse mix of employees helps us to understand their needs. We demonstrate our commitment to equality from board-level down: 30% of our Board is female, exceeding our aim of at least 25%. We were ranked in The Times Top 50 Employers for Women but recognise we need to do more to increase the proportion of our people that are female, particularly in senior executive roles.

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**Safety and wellbeing**

We aim to improve the overall wellbeing of the company by providing information, guidance and instruction to make sure our people are protected and work together to protect others. We provide safe systems of work, equipment, support services and access to specialist advice, all of which allow our people to understand the way in which they need to work and any risks associated with their activities.

Through our wellbeing framework, we create workplaces which support our employees and where we can each contribute to the health of our business, and of society as a whole.

This year, we continued to partner with Business in the Community (BITC) to develop our wellbeing framework and in April 2013 we were ranked as a top five company by BITC for public reporting of employee engagement and wellbeing. Through this initiative we aim to remain at the forefront of good people management.

We track our performance in lots of different ways. But our sickness absence rate (SAR) is a key measure. In 2012/13 we missed our target to cut our SAR to 2.05% after some of our people experienced more strain caused in part by the bad weather. Our sick pay costs were £84.6m in the year.

**Sickness absence rate (SAR<sup>a</sup>)**

	2012/13	2011/12	2010/11
Sickness absence rate	2.29%	2.16%	2.41%
Sick pay costs	£84.6m	£80.0m	£90.1m

<sup>a</sup> SAR is a 12-month rolling average of the percentage of calendar days lost.

**Recruitment and flexibility**

As our markets and environment change, the skills we need change too. If we no longer need a particular skill or role, our transition centre helps people learn new things and look for alternative roles in the business. Since April 2006, more than 21,000 BT people have gone through the centre.

This year we recruited around 1,600 engineers to help with our accelerated fibre rollout and to improve customer service. We have created new roles by bringing work into BT which we used to outsource. This year we brought around 4,000 roles back into the business.

We have also created our own recruitment team, which advertises vacancies and deploys people across the business.

We want to foster a culture where everyone can do well. So we work with agencies to help recruit people with disabilities. And we cover the cost of rehabilitation and retention services to help our people stay with us when their



circumstances change. We supported nearly 1,000 existing employees with disabilities through our Enable programme, which provides specialist advice with tailored adjustments to keep people in productive work.

Apprentices are a core part of our recruitment strategy. They bring new skills and innovation to the business and help shape the future workforce of the company. Through the apprenticeship scheme young people are able to join career paths that can, and often do, lead to senior management roles within the company. Our apprentices regularly receive external recognition. This year three of our apprentices won regional apprentice of the year with the National Apprenticeship Service and we also had two national winners in the STEMNET and ITP awards.

### **Pay and benefits**

We pay our people competitively. We compare salaries with other companies in the markets we work in, so we know we pay fairly too.

Engineers and support people get paid in the same way across-the-board. Managers' pay and bonuses are linked to how we are performing as a business and how they contribute to that personally.

We offer our most senior managers long-term incentives. This approach strengthens further the alignment of rewards for executives with the creation of shareholder value. The amount we pay out in these plans depends on our corporate performance over a three-year period. In accordance with our regulatory obligations, there are different arrangements for the most senior managers in Openreach whose incentives are tied to the business performance of Openreach rather than the wider BT Group.

We operate savings-related share option plans (saveshare) in over 25 countries. Around 60% of our people take part in one or more of these. This year around 20,000 of our people benefited from saveshare receiving, on average, BT shares worth over £12,000, a gain of around £8,400. Over the next two years, around 34,500 of our people could each receive shares worth over £28,000 on average (based on the share price as at 31 March 2013).

We also provide pension and retirement benefits as well as statutory retirement arrangements.

### **You can find details of the BT Pension Scheme on page Volunteering**

The BT Volunteering Programme is recognised for its range and diversity and in 2012 received a Big Society Award from the Prime Minister. All our people can volunteer and in the year BT people volunteered 43,600 days in work time to activities like digital inclusion and helping the vulnerable get online.

The programme includes a number of projects which help us apply our skills and services to support communities and it also encourages people to choose activities they are passionate about. For example, more than 800 employees serve their communities as school governors, more than 150 as military reservists, more than 70 as special constables, and more than 1,000 as youth leaders.



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#### **Our assets and resources**

These are what we need to help us deliver our strategy. Many of them set us apart from our competitors and give us an advantage in our markets.

#### **Brand and reputation**

The BT brand is an important business asset. Superbrands, a respected assessment of brand strength, ranked BT as the UK's 62nd strongest Consumer Superbrand in 2013 (up more than 100 places from 2012) and the 12th strongest Business Superbrand (17th in 2012). In both cases, we came top in our category.

Our partnership with London 2012 strengthened our brand. As a sponsorship programme, we benefited in a number of ways. First, the Games network we built showcased our expertise on the world's biggest stage and was vital to the success of the event.

Second, our communications services for the Games showed the world what we do in the UK every day, helping to bring people together to share in occasions big and small.

Third, our sponsorship – and in particular our work with the British Paralympic Association – demonstrated our belief in the power of communication to make a better world.

Independent research by Nielsen (London 2012's official market research provider) showed that we were the domestic sponsor most associated with the Games and the single sponsor most recognised for providing expertise and services to support the event.

Our own research showed that consumers and BT people valued our brand more because of our involvement. In September 2012 more than 70% of our people said that the London 2012 sponsorship made them proud to work for BT.

Our brand health research shows an increase in emotional engagement with the BT brand amongst consumers and SMEs in the year. Brand engagement amongst large corporate and public sector customers also improved, driven by a particularly strong performance in non-UK markets.

Some of the highest scores in our surveys indicate that our brand strengths are around being trusted and liked, and being seen as relevant and innovative.

#### **Networks and platforms**

##### **Networks**

Our networks are the foundation of the products and services our customers rely on around the world. We have domestic network assets, which provide in-country services, and global assets, which provide international services.

Our largest assets are in the UK where we offer the widest range of network services, access technologies and coverage. Our UK fixed-line network is one of our most valuable assets and our fibre broadband investment is key to sustaining its value for the UK.

We are growing our Ethernet footprint in response to strong demand and growing data traffic. We have around 1,170 Ethernet fibre nodes located across the UK with BT Wholesale increasing the number of Ethernet circuits installed in the year by 63%. The total number of Ethernet circuits provided by Openreach increased by 15%, with growth strongest at speeds of 1Gbps and above. We also deployed the world's largest high-density wi-fi service at the London 2012 Olympic Park and installed more than 1,500 wireless access points across all of the Olympic venues.

We also have deep in-country networks in Germany, Italy, the Netherlands, the Republic of Ireland and Spain. In Latin America we operate networks in Argentina, Brazil, Colombia and Mexico.

Our major global asset is our MPLS platform, which is designed to carry different network services over one common infrastructure. This lowers costs and reduces the time to offer new services.

From this platform we offer our two most popular virtual private network (VPN) services: IP Connect and Ethernet Connect. IP Connect is available in more than 170 countries. This year we invested in 10 new IP Connect points of presence (POPs), six new Ethernet access countries and five new network-to-network interfaces. Ethernet Connect has grown substantially in the last year. We invested in 10 new Ethernet Connect POPs, and the service is now available in 43 countries.

Our internet platform is available in 38 countries. We have also invested in six new gateways from our internet platform to IP Connect, increasing coverage and reducing the cost of internet access.

We have a large broadband satellite network as shown on the map on page 21.

We are expanding our UK and global IP Exchange service (GIPX). We have more than 150 customers in the UK alone on this product and we have plans in place to add new features to support services such as HD voice and video calling.

This year we:

- expanded further in the high-growth regions of Asia Pacific, Latin America, Turkey, the Middle East and Africa
- upgraded capacity in Europe and around the world
- simplified our networks – closing some legacy services and migrating customers onto newer and better services, and lowering our costs
- upgraded our European fibre backbone that is the foundation of our services in nine European countries and 77 cities
- invested in a new fibre backbone in South Africa.

To make sure their own networks are performing at their best, customers can use our BT Connect Applications portfolio. This is available globally and can be used to accelerate, optimise and monitor traffic across their networks.

## Platforms

Our platforms are the processes and technology that deliver our network products and services. They are critical to running our business.

For example, our service management platform comprises our service delivery and workflow management processes. It lets us co-ordinate everything we need to do to give our customers their service. It also keeps our customers updated on the progress of their orders.

Our billing and payments platform is made up of the systems and processes that work out charges, produce bills and collect payments from our customers.

The number of platforms we own has grown over time as we have bought companies, won outsourced contracts and brought in new technologies. We continue to improve our platforms. We modernise and rationalise them, make them simpler, more reliable and more flexible and make them cheaper to run.

While our UK data centre and IT infrastructure grew in the year, we spent 8% less on associated energy costs. We have programmes in place to help us cut our IT energy use over the coming years including using fewer IT applications.

## Properties

At 31 March 2013 we occupied around 6,400 properties in the UK and around 1,750 in the rest of the world. Most of our UK properties are owned by and leased from Telereal Trillium, part of the William Pears Group.

Of our UK properties, around 90% are operational telephone exchanges housing telecoms equipment. Our general purpose properties are mainly offices, engineering depots and data centres. Outside the UK, around 90% of our properties are operational sites housing data hosting and telecoms equipment.

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As part of our cost transformation, we continued to consolidate office space and dispose of redundant premises. This property rationalisation will continue under our restructuring programme.

### **Innovation**

We have to create propositions that our customers find attractive and want to buy. Innovation, supported by our global research and development, has therefore always been at the core of our business.

Our open innovation model gives us access to thinking from outside BT, from small, start-up companies to some of the best universities around the world. We have teams working with customers, partners and universities in the US, Asia, Europe and the Middle East. They help us to maintain our view of global developments in new technologies, business propositions and market trends. This year we opened a new research laboratory with Tsinghua University in China.

In 2012/13 we filed patent applications for 69 inventions. We routinely seek patent protection in different countries and at 31 March 2013 we had a worldwide portfolio of more than 4,400<sup>a</sup> patents and applications. We support the UK Government's new Patent Box initiative that recognises those companies investing in UK research, patents and innovation. This initiative could provide tax relief on profits from certain BT products which are based on our patented inventions.

This year we invested £544m (2011/12: £560m) in research and development to cultivate innovation. Our research, development and testing is done at global development centres located in the UK, US and Asia, and is headquartered at Adastral Park in the UK. These centres help us draw together complementary skills and resources more easily (both our own and third-party). They reduce turnaround time, ensure tighter feedback loops and help us get products and services into the market sooner.

<sup>a</sup> On average, we file with four member states of The Patent Cooperation Treaty and three member states of the European Patent Convention.

This year we opened a new development centre in Kuala Lumpur, Malaysia, and recently opened a new building for our centre in Bangalore, India. These complement our existing centres in Belfast, Glasgow, Cardiff, Adastral Park and Dallas and give us local technical expertise and spread our development more evenly around the world.

Our people help us innovate and improve our service to customers. This year our award-winning internal New Ideas Scheme received more than 1,000 submissions to improve service, generate revenue or reduce costs. Our My Customer Challenge Cup competition encourages our people to identify areas where customer service is not as good as it should be, and work together to make improvements.

Our customers also play a part. We run innovation showcases allowing them to discuss applications and solutions with our experts. In turn, we get to hear firsthand what they need.

This year, our research and development focused on:

improving broadband coverage. We have field-tested broadband amplifiers and regenerators to extend the reach of our ADSL2+ and fibre services. We have also trialled TV white space radio technology to connect remote communities cost-effectively

improving broadband speed. We have been trialling new techniques such as vectoring on FTTC lines (a solution which improves speed and stability by reducing interference) and bonding. We have been researching solutions for delivering ultra high-speed broadband (up to 1Gbps) over the final copper drop. And we have trialled the world's first 10Gbps XGPON technology to a customer over a fibre network

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transforming our costs. We have built tools to help us speed up network design, use equipment in the best possible way and minimise the cost of build. We are using them to design our FTTP network and support the sale of Ethernet products. We also used them to speed up the design of the London 2012 venue networks improving video delivery. We have changed the way we deliver TV content. This means we avoid having to duplicate TV content streams over our network, so we will be able to cut costs and give our customers more channels.

#### **Suppliers**

Our suppliers from across the world play a vital role in helping us to provide our products and services and deliver our strategy. We work with around 17,400 suppliers, spending approximately £9.7bn a year with them. The top 100 account for around 62% of our annual spend.

The number of suppliers we use is broadly the same as last year. However, the mix of suppliers is constantly evolving as we look to benefit from new and improved products and services.

#### **Our approach to procurement**

We want to get the most from our suppliers – especially from their diversity, skills and innovation. As part of our cost transformation programme we have concentrated on generating the best value from our largest suppliers. A category approach for the majority of other spend, using competition and supplier negotiations, has achieved cost savings.

We also have a programme looking at our smaller suppliers. This seeks to make sure we get the most from them and that we are not taking on suppliers we do not need.

We have a team of around 300 procurement people in 27 countries working with suppliers on this strategy.

#### **Supplier selection**

It is important to us that we know who we are doing business with and who is acting on our behalf. So we choose suppliers using an established set of principles that makes sure both we and the supplier act ethically and responsibly.

We check that the goods and services we buy are made, delivered and disposed of in a socially and environmentally responsible way, by measuring factors such as energy use, environmental impact and labour standards.

**You can find out more at** [www.selling2bt.bt.com](http://www.selling2bt.bt.com)  
**Supply chain human rights**



We want our suppliers' employees to experience workplace conditions that meet the standards we have developed. We send our suppliers an ethical standards questionnaire and follow up with any suppliers identified as high or medium risk. This year we again met our target to achieve 100% follow-up within three months.

### Payment of suppliers

This year the average number of days between invoice date and supplier payment was 60 days (2011/12: 61 days).

In the UK we have a financing scheme that offers contracted suppliers the chance to be paid early. This can be particularly attractive for SMEs. We also follow the Better Payment Practice Code.

**You can find out more about the Better Payment Practice Code at [www.payontime.co.uk](http://www.payontime.co.uk)**

### How we measure our progress

We have three key performance indicators: adjusted earnings per share, normalised free cash flow and customer service improvement.

### Adjusted earnings per share

This is the adjusted profit after taxation attributable to our shareholders divided by the weighted average number of shares in issue. As it excludes the impact of specific items it provides a measure of our financial performance in a consistent manner over time.

### Read more about adjusted earnings per share on page

### Normalised free cash flow

Free cash flow represents the cash we generate from operations after capital expenditure and finance costs. It shows what cash is available to invest in the business, repay debt, support the pension scheme and pay dividends.

Our key free cash flow measure changed from adjusted free cash flow to normalised free cash flow in 2012/13 following the £2.0bn lump sum pension deficit payment made in March 2012. The £520m tax credit relating to the deficit payment would have distorted our cash flow in 2012/13, as would the £202m payment for the 4G spectrum licence.

Normalised free cash flow is therefore before the impact of specific items, purchases of telecommunications licences, pension deficit payments and the tax benefit from pension deficit payments.

**[Read more about normalised free cash flow on page  
Customer service improvement](#)**

Our strategy starts with customer service. **Right First Time** is our key measure and tracks how often we keep the promises we make to our customers. As well as improving service, keeping our promises means there is less work to put things right and so reduces our costs.

**[Read more about customer service improvement on page](#)**

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### **Our risks**

Like all businesses, we are affected by a number of risks and uncertainties. These may be impacted by internal and external factors, some of which we cannot control. Many of our risks are akin to those felt by similar companies in terms of scale and operation.

### **Principal risks and uncertainties**

This section sets out the principal risks and uncertainties affecting us, but it is not exhaustive. These risks have the potential to impact our business, revenue, profits, assets, liquidity or capital resources.

As in the prior year, the uncertainties in the global economy and credit markets continue to present challenges, both to our business and to others. These challenges drive a number of the risks that we face and we focus our efforts on predicting and mitigating them. The principal risks we described last year have evolved, and so has our response to them.

Our Enterprise Risk Management framework provides reasonable (but cannot give absolute) assurance that significant risks are identified and addressed. There may be risks which are unknown or which are presently judged not to be significant but later prove to be significant.

In our principal risks section below, we explain what we are doing to prevent our main risks materialising, or to limit their impact.

Our principal risks and uncertainties should be considered in conjunction with the risk management process, the forward-looking statements for this document, and the cautionary statement regarding forward-looking statements.

**You can read the cautionary statement regarding forward-looking statements on page**

### **How we manage risk**

We need to manage risk so we can meet our objectives, build shareholder value and promote our stakeholders interests. We have a group-wide risk management process. It has four stages which are summarised below.

### Changes over the last year

Last year we improved the way we manage risk through better reporting, evaluation and training. This year we have further developed our approach including:

**Scenario planning and war gaming** . We have already used these techniques to good effect in understanding traditional physical business continuity threats. This year we have also applied them to some of the risks we highlight below

**Assurance**. Our line of business and service unit audit & risk committees have extended their focus on risk management across their business units. Their advice, analysis and reviews have helped us get better at dealing with risks inside our business

**Guidance and toolkit refresh**. We have updated our risk management policy and guidance. We have also added to the toolkit that our risk management specialists (and the wider business) use to put our risk management process into action.

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#### **Our principal risks**

##### **Security and resilience**

In keeping with other organisations that process and store data, we have a responsibility to many millions of customers, both business and consumer, to safeguard their electronic information and to maintain the continuity of services. This requires the highest levels of operational security and resilience, which can be threatened at any time by incidents such as malicious cyber-attacks, theft of copper cable and equipment, vandalism, sabotage, extreme weather, component overload, loss of power and human error. The volume of traffic through our systems and networks is increasing, and customer tolerance of interruptions reduces as the world becomes ever more dependent on information technology.

##### **Changes over the last year**

Concerted efforts to deter cable theft, supported by legislative changes and the well publicised arrest and prosecution of thieves, are beginning to reduce the number of service interruptions in the network. Theft of equipment from our premises has also fallen significantly. However, we are detecting more cyber-attacks aimed at stealing data or disrupting our own and our customers' websites.

We have strengthened our defences against these cyber-attacks and now routinely cope with attacks

##### **Major contracts**

We have a number of complex and high-value national and multinational contracts with certain customers. The revenue arising from, and the profitability of these contracts are subject to a number of factors including: variation in cost; achievement of cost reductions anticipated in the contract pricing, both in terms of scale and time; delays in the delivery or achievement of agreed milestones owing to factors either within or outside of our control; changes in customers' requirements, budgets, strategies or businesses; and the performance of our suppliers. Any of these factors could make a contract less profitable or even loss-making.

The degree of risk generally varies in proportion to the scope and life of the contract and is typically higher in the early stages of the contract. Some customer contracts require investment in the early stages, which is expected to be recovered over the life of the contract. Major contracts often involve the implementation of new systems and communications networks, transformation of legacy networks and the development of new technologies. The recoverability of these upfront costs may be impacted by delays or failure to meet milestones. Substantial performance risk exists in these contracts.

##### **Changes over the last year**

that a few years ago would have caused considerable risk of data loss. Our segregation and encryption of data has increased. In further recognition of the importance of people and behaviours in managing this risk, a campaign to raise staff and supplier awareness of cyber threats is proceeding in response to the increasing sophistication of attacks. We have also refreshed our data protection governance with the appointment of a Chief Privacy Officer.

We are upgrading much of our equipment to improve reliability, increase capacity and reduce energy consumption. Severe flooding across the UK in the year caused several service outages that demanded urgent action and resources to be diverted.

### **Impact**

A breach of our security, or compromise of data and/or resilience affecting our operations, or those of our customers, could lead to an extended interruption to network services or even affect national infrastructure. Such failure may lead to a loss of customer confidence, termination of contracts, loss of revenue, and reduced cash generation through penalties and unplanned costs of restoration and improvement. Additional reputational damage and financial loss may arise from a legal or contractual failing such as breaching data protection or handling requirements. Failure or interruption of data transfer could also have a significant adverse effect on our business.

### **Risk mitigation**

Our strategy for resilience is to combine formal business continuity planning with well-tested, rapid and flexible responses. We have a rolling programme of major incident simulations to test and refine our crisis management procedures. Our security defences range from physical protection of our assets, access controls, real-time analysis and sharing of intelligence, and continuous monitoring

The difficult economic and market conditions, particularly in Europe, have increased financial and operational pressures on our customers and have made the environment even more competitive. With our investment and expansion into high-growth regions, the landscape of our risks and opportunities naturally changes as we must deal with rapidly evolving geo-political risks and different trading environments and business practices. Our control and governance framework has been extended to include contracts between BT and UK local authorities seeking to extend the reach of fibre broadband in their regions.

For larger contracts, we have recently expanded the scope of independent reviews to critical stages of the contract lifecycle to help identify any key issues, risks and actions which need to be monitored.

### **Impact**

Failure to manage and meet our commitments under these contracts, as well as changes in customers requirements, budgets, strategies or businesses, may lead to a reduction in our expected future revenue, profitability and cash generation. Unexpectedly high costs associated with the delivery of contracts could also negatively impact profitability. We may lose revenue due to the merger or acquisition of customers, business failure or contract termination and contracts may become loss-making. Failure to replace the revenue and earnings lost from such customers could lead to an overall reduction in group revenue, profitability and cash flow.

### **Risk mitigation**

We have in place business processes that support each stage of a major contract's lifecycle: bid; in-life; renewal; and termination. Our programme of in-life reviews is designed to validate financial and non-financial controls over delivery of the contract. It incorporates tiered levels of defined reviews according to the scale and complexity of the contract. Controls are applied and regularly

for intrusion and anomalies, through to rapid modification of firewalls and automated blocking of malicious data traffic. Together, these measures increase the likelihood that any potential incidents can be contained and dealt with as quickly as possible.

monitored across our major contracts. All our major contracts are subject to regular management review and many are subject to independent review (both internal and external) as part of that governance. Our independent review programme helps us apply lessons learned and to promote best practice through the business.

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**Pensions**

We have a significant funding obligation in relation to our defined benefit pension schemes. Low investment returns, high inflation, longer life expectancy and regulatory changes may result in the cost of funding BT's main defined benefit pension scheme, the BT Pension Scheme (BTPS), becoming a significant burden on our financial resources.

**Changes over the last year**

Following the conclusion of the 30 June 2011 triennial funding valuation of the BTPS in May 2012, the valuation documentation was submitted to the Pensions Regulator for their review. The final Court decision in the Crown Guarantee case, after any appeals, will give greater clarity as to the extent to which the liabilities of the BTPS are covered by a Crown Guarantee. This will inform the Pensions Regulator's next steps with regard to the valuation of the Scheme. Accordingly, as matters stand, it is uncertain as to when they will conclude their review.

Government bond yields have fallen since the valuation at 30 June 2011, with real yields being negative at times. This has been caused by a number of factors, including the Bank of England's Quantitative Easing programme. If the fall in yields is maintained and reflected in the next funding valuation, due as at 30 June 2014, this would increase the value of the BTPS liabilities.

**Growth in a competitive market**

We operate in markets which are characterised by: high levels of change; strong competition; declining prices; technology substitution; market and service convergence; customer churn; declining revenues; new competitors; and regulatory intervention to promote competition and reduce wholesale prices.

A significant proportion of our revenue and profit is generated in the UK where the overall telecoms market has been in decline in real terms, despite strong volume growth in new services. Revenue from our calls and lines services to consumers and businesses has historically been in decline but new broadband and connectivity markets are growing. Our ability to deliver profitable revenue growth in a responsible and sustainable manner depends on us delivering on our strategic priorities (see page 14).

**Changes over the last year**

The level of risk facing our business increased as the economic situation in the UK and other key markets deteriorated in the year. Depressed business activity together with lower disposable incomes continues to be a major barrier to growing revenues, particularly among business customers.

Regulatory decisions made during the year also contributed adversely to our risk profile, revenue and profits. These decisions failed to address imbalances in the competitive playing field. This means that



The European Commission is reviewing the current Directive for pensions and we responded to a relevant consultation during the year. The Commission's aim is to issue new draft legislation in summer 2013. Depending on its scope, there is potential for any legislative change to have an impact on BT's funding liabilities in the future. We will continue to monitor developments in this area.

### **Impact**

An increase in the pension deficit and associated funding requirements may have an impact on the level of deficit payments we are required to make into the scheme. Indirectly it may also have an adverse impact on our share price and credit rating. Any deterioration in our credit rating would increase our cost of borrowing and may limit the availability or flexibility of future funding, thereby affecting our ability to invest, pay dividends or repay debt as it matures.

### **Risk mitigation**

The investment performance and liability experience, as well as the associated risks and any mitigation, are regularly reviewed and monitored by both us and the BTPS Trustee.

The BTPS has a well-diversified investment strategy, which reduces the risk of adverse movements in the value of individual asset classes and helps ensure that an efficient balance of risk and return is maintained.

Our financial strength and cash generation provide a level of protection that enables variations in the funding position of the BTPS to be managed without having a material impact on the ongoing performance of our business.

some of our competitors in the consumer space benefit from limited regulation on their core business combined with extensive sector-specific regulation being applied to our UK fixed-line business.

A number of competitor-related developments have contributed to the risk increasing. These include, but are not limited to: the acquisition of Cable & Wireless Worldwide by Vodafone; the decision by Vodafone and O2 to establish a joint venture to consolidate existing network infrastructure and local transmission; the agreement which brought forward the timetable for 4G mobile services being launched in the UK; and increased competitive activity around over-the-top video-on-demand services in the UK.

### **Impact**

Failure to achieve profitable revenue growth from our strategic priorities may lead to a continued decline in revenue, erosion of our competitive position and might also lead to a reduction in profitability and cash flow in the future.

### **Risk mitigation**

Our mitigation of this risk centres on successfully executing our strategy. We believe that delivering this strategy, with its focus on Customer service delivery, Cost transformation and Investing for the future, as well as investing in our existing business and offering new services in adjacent markets, will together help us drive profitable revenue growth.

We have a well-developed cost transformation programme in place which should provide future savings to support profitability trends. We also believe risks can be mitigated by seeking changes in regulation to level the playing field so that we can compete effectively, and for the benefit of our customers.



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### 26 Strategy

#### Communications industry regulation

Our activities across all the jurisdictions in which we operate can be impacted by regulation. Regulatory requirements and constraints can directly impact our ability to compete effectively and earn revenues.

In the UK where, following detailed market analysis, we are found to have significant market power, Ofcom requires us to provide wholesale services at regulated prices. It can also require us to make retrospective repayments to other CPs where we are found to have set prices outside regulatory requirements, and can impose fines on us for non-compliance with the regulatory rules, including competition law.

Outside the UK, general licensing requirements can restrict the extent to which we can enter markets and compete. Regulation will also define the terms on which we can purchase key wholesale services from others.

In the UK, risks can come from, for example, periodic market reviews which might introduce tighter regulatory constraints from new charge controls or from CPs disputing or complaining about our pricing, products or services. Outside the UK, regulators can investigate our licensing requirements and whether our services comply with their rules.

#### Business integrity and ethics

We are committed to maintaining high standards of ethical behaviour, and have a zero tolerance approach to bribery and corruption. We have to comply with a wide range of local and international anti-corruption and bribery laws. In particular the UK Bribery Act and US Foreign and Corrupt Practices Act (FCPA) provide comprehensive anti-bribery legislation. Both have extraterritorial reach and thereby cover our global operations. As we expand internationally, we are increasingly operating in countries identified as having a higher risk of bribery and corruption.

We also have to ensure compliance with trade sanctions, and import and export controls.

#### Changes over the last year

The Serious Fraud Office (SFO) has produced revised guidance on the UK Bribery Act. The SFO has indicated it will now focus on its role as an investigator and prosecutor of serious and/or complex fraud and where there is sufficient evidence and it is in the public interest, prosecutions rather than civil settlements will now be pursued, even where companies have self-reported. This represents a change to its previous stance where self-reporting may have led to more lenient treatment. It has further confirmed that it considers facilitation payments to be bribes.

## Changes over the last year

Over the last year, we have seen regulatory activity in a number of areas which are summarised in **Regulation** on page 38. A number of these rulings have resulted in a negative impact either through retrospective price reductions or on our future pricing.

## Impact

Risks from regulation are most significant in the UK.

Around £5.8bn of our revenue (of which £3.3bn is to downstream parts of BT) is from wholesale markets where we have been found to hold significant market power and which are currently subject to regulatory charge controls. Most of these controls require us to reduce our prices annually to reflect expected reductions in unit costs through efficiency savings. Controls are usually set for three years and will therefore constrain revenues during that period.

Other CPs can ask Ofcom to resolve disputes with us about current or historic prices. Where Ofcom finds that these prices are, or have been, set at levels above those required under the regulatory framework, we may need to make retrospective payments to CPs.

We may from time-to-time be required to provide new services, or existing services on improved terms, to wholesale customers on a non-discriminatory basis. This could increase our costs.

The US Department of Justice and Securities and Exchange Commission have also produced guidance on the FCPA giving information about the US government's approach to FCPA enforcement.

In addition, sanctions regulations in Europe and the US have been extended.

## Impact

Failure by our employees, suppliers or agents to comply with anti-corruption and bribery and sanctions legislation could result in substantial penalties, criminal prosecution and significant damage to our reputation. This could in turn impact our future revenue and cash flow, the extent of which would depend on the nature of the breach, the legislation concerned and any associated penalties. Allegations of corruption or bribery or violation of sanctions regulations could also lead to reputation and brand damage with investors, regulators and customers.

## Risk mitigation

We have in place a number of controls to address risk in this area. These include a comprehensive anti-corruption and bribery programme, *The Way We Work*, which is our statement of business practice and is being refreshed to give greater guidance to our people. We ask all BT employees to sign up to its principles and our anti-corruption and bribery policy. We have specific policies covering gifts and hospitality and charitable donations and sponsorship. We run a training programme with a particular focus on roles such as procurement and sales.

We regularly assess our business integrity risks to make sure that the appropriate mitigation is in place. We operate a confidential hotline. Our internal audit team regularly runs checks on our business. We also use external providers to carry out assessments in

Regulation outside the UK can impact our revenue by restricting our ability to compete through overly-restrictive licensing requirements or ineffective regulation of access to other CP networks.

### **Risk mitigation**

We employ a team of regulatory specialists (including accountants and economists) who, together with legal experts and external advisors, continuously monitor and review the scope for regulatory changes and potential future disputes. This team maintains a dialogue with regulators and with other key influencers to ensure our positions are understood and to drive for fair and proportionate regulation. We are also able to appeal any regulatory decisions where we believe errors have been made.

areas we believe to be higher risk, to ensure our policies are understood and the controls are functioning.

We conduct due diligence checks on third parties including suppliers and agents. Procurement contracts include anti-corruption and bribery clauses. A trade sanctions policy and sign-off procedure are also in place.

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#### **Supply chain**

The integrity and continuity of our supply chain is critical to our operations. Our aim is to harness the capability, diversity and innovation of the global supply market to add value to our business and customers. We are committed to ensuring that all dealings with suppliers, from selection and consultation to contracting and payment, are conducted in accordance with our trading and ethical policies. See **Suppliers** on page 22.

The failure of a critical third-party supplier to meet its obligations could cause significant harm to our business and the BT brand, as well as potentially impact our cost transformation and efficiency plans.

#### **Changes over the last year**

Many suppliers continue to be impacted by the global economic downturn and as a result we have seen an increase in the number of suppliers suffering from financial distress. The downturn has also increased the risk of suppliers applying less focus on key areas such as business continuity management or corporate and social responsibility in an effort to reduce their costs.

#### **Impact**

Whilst the size of the impact from a supplier failure can vary, all supplier failures typically result in an increased cost to our business and have the potential

to negatively impact the service we provide to customers. In many cases the cost associated with supplier failure is significant, particularly if it then results in us having to change technology. If we are unable to contract with an alternative supplier, our customer commitments could also be compromised, possibly leading to contractual breach, loss of revenue, penalties or increased costs.

A failure in our supply chain to meet legal obligations or ethical expectations could adversely impact our reputation or possibly lead to censure, legal action and financial loss.

### **Risk mitigation**

We conduct supplier risk analysis as part of our sourcing strategy, and where possible, take actions to reduce risk, such as through dual-sourcing where appropriate. We operate a comprehensive in-life risk mitigation programme that classifies our suppliers into appropriate risk categories and then aims proactively to build risk mitigation plans and detect potential supplier failures before they happen. For our critical suppliers this mitigation strategy considers a range of risks including: financial failure; supplier capability and capacity; sole sourcing; corporate and social responsibility; business continuity; security; location; and the overall supplier relationship.

This approach has been complemented by a programme specifically looking at our low spend suppliers, to ensure we achieve maximum business benefit but at the same time do not contract with too many suppliers, exposing us to unnecessary risk.

By adopting this approach, we seek to minimise the risk of not being able to meet our customer and legal commitments or comply with our ethical policies. This helps to minimise our exposure to loss of revenue, financial penalty and any adverse impact on our brand and reputation.

We work closely with our suppliers to ensure that the goods and services that we buy are made, delivered and disposed of in a socially and environmentally responsible manner.



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**Business**

In this section we explain how we are organised to deliver our strategy. We provide information on the products and services we sell. We explain the different customers and markets we serve and the trends we are seeing in our markets. We also explain the regulatory environment that affects us.

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34	<u>BT Wholesale</u>
34	<u>Openreach</u>
35	<u>BT Technology, Service &amp; Operations</u>
<b>36</b>	<b><u>Our customers and markets</u></b>
36	<u>UK consumers</u>
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37	<u>Large corporate and public sector customers</u>
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<b>38</b>	<b><u>Regulation</u></b>
38	<u>European Union regulation</u>
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### **Operating Committee**

The key management committee is the *Operating Committee*, which meets weekly and is chaired by the Chief Executive. Its members are set out below.

The *Operating Committee* has responsibility for running our business and delivering our strategy. It monitors the group's financial, operational and customer service performance and has cross-business oversight of the lines of business. It also reviews the group's key risks and considers the potential threats and opportunities for the business. You can read more about the *Operating Committee* on page 67.

#### **1. Ian Livingston<sup>a</sup>**

##### **Chief Executive**

Appointed Chief Executive in June 2008. Ian was formerly CEO, BT Retail and prior to that, Group Finance Director.

#### **2. Tony Chanmugam<sup>a</sup>**

##### **Group Finance Director**

Appointed Group Finance Director in December 2008. Tony was formerly CFO, BT Retail and Managing Director, BT Enterprises.

#### **3. Gavin Patterson<sup>a</sup>**

##### **CEO, BT Retail**

Appointed CEO, BT Retail in May 2008. Gavin was formerly Managing Director, Consumer Division, BT Retail.

#### **4. Luis Alvarez**

##### **CEO, BT Global Services**

Appointed CEO, BT Global Services in October 2012. Luis was formerly president of the Europe, Middle East, Africa and Latin America operations of BT Global Services.

#### **5. Clare Chapman**

##### **Group People Director**

Appointed Group People Director in October 2011. Before joining BT, Clare was director general of workforce for the NHS and Social Care at the Department of Health. Clare was also previously group personnel director at Tesco.

#### **6. Clive Selley**

##### **CEO, BT Technology,**

##### **Service & Operations & Group CIO**

Appointed CEO, BT Technology, Service & Operations in January 2013. Clive was formerly CEO, BT Innovate & Design and prior to that President of Portfolio & Service Design.

## 7. Nigel Stagg

### CEO, BT Wholesale

Appointed CEO, BT Wholesale in September 2011. Nigel was formerly BT Business Managing Director, BT Retail and prior to that Managing Director, Customer Service, BT Retail.

## 8. Olivia Garfield

### Invitee

### CEO, Openreach

Appointed CEO, Openreach in April 2011. Olivia was formerly Group Director, Strategy, Policy and Portfolio and prior to that held roles in BT Global Services. The CEO of Openreach cannot be a member of the *Operating Committee* under the provisions of the Undertakings.<sup>b</sup>

## Members

<sup>a</sup> Directors of BT Group plc. You will find their full biographies on pages 65 and 66.

<sup>b</sup> You will find more information on the Undertakings on page 39.

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### **How we deliver our strategy**

Our business is built around our customers serving their needs and delivering value to them.

### **How we are organised**

We have four customer-facing lines of business: BT Global Services, BT Retail, BT Wholesale and Openreach. They are supported by our internal service unit, BT Technology, Service & Operations.

### **BT Global Services**

We are a global leader in managed networked IT services. We work for around 7,000 large corporate and public sector customers in more than 170 countries worldwide. We focus on serving the following key industries and regions.

Our customers benefit from our global reach and our ability to deliver services locally in the countries they are in. They also gain from our ability to tailor products and services to their industry. During the year we increased the number of industries we focus on to include global systems integrators, logistics and mining, oil & gas.

The UK is our largest region by revenue. We have a large base of customers in the corporate sector and serve public sector bodies such as central government and local councils.

In continental Europe, we run large businesses in key countries such as Belgium, France, Germany, Italy, the Netherlands and Spain. Current Analysis ranked us second in the German market for pan-European and global IP and data services.<sup>a</sup> In Italy, we are the main country-wide operator exclusively focused on business-to-business services.<sup>b</sup> In Spain, the telecoms regulator ranked BT as the leading alternative to the incumbent operator in the enterprise data

market.<sup>c</sup> We also support customers in Central and Eastern Europe, the Nordics and Russia.

In the United States and Canada, we serve customers from offices in more than 25 key cities.

We have an increasing presence in the high-growth regions of Asia Pacific, Latin America, Turkey, the Middle East and Africa. We operate in 85 countries in these markets, helping multinationals expand into these regions and supporting local companies as they grow internationally. We continue to invest in these markets, hiring more people, improving our products and services and building network and IT infrastructure.

<sup>a</sup> Current Analysis, *BT Germany: company assessment* (August 2012), page 2.

<sup>b</sup> AGCOM, *Relazione annuale 2012: sull'attività svolta e sui programmi di lavoro* (July 2012), page 98.

<sup>c</sup> CMT, *Industry Sector Report 2011* (June 2012), page 60.

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#### Products and services

We combine our products and services with industry expertise and consulting services. We have simplified our products – categorising them around what our customers need and making them more straightforward to buy and link together. Those categories are:

#### **BT Assure** – Security that protects

People and businesses are using more mobile devices, social media and cloud services. Together with the growth in cyber-attacks, this means that customers are prioritising security. We provide a range of security products and services including firewalls, web security, intrusion prevention and threat monitoring.

#### **BT Compute** – Services that adapt

Businesses want reliable but flexible IT platforms and services for their applications, data storage and security. We provide IT services in our worldwide data centres and deliver them over our global network.

#### **BT Connect** – Networks that think

Our network services connect our customers to their people, their own customers and to the world. We offer a range of IP, Ethernet and web-based network services. We deliver these in more than 170 countries over a range of access technologies including DSL, VPN and satellite.

#### **BT Contact** – Relationships that grow

We provide a range of contact centre services to help our customers build stronger relationships with their customers. Our services provide the option of using email, web chat, social media and the phone – either via automated systems or dedicated advisors. Our cloud solution gives customers more flexibility and control over their costs by allowing capacity to change in response to demand.

#### **BT One** – Communications that unify

Businesses communicate in a number of different ways – by phone, SMS, voicemail, instant messaging, email, video conferencing and data-sharing solutions. They want these channels to be integrated and work together. Our collaboration services help customers simplify their communications and transform the way they interact with their customers, colleagues, partners and suppliers.

#### **BT Advise** – Knowledge that delivers



Our experts around the world provide consulting, integration and managed services to our customers. They help solve business problems. They have a range of specialisms, certifications and accreditations to make sure customers get the best out of our products and services.

### Industry-specific solutions

As every industry has its unique needs and challenges, we provide a range of industry-specific solutions. For example, BT Radianz links financial institutions from around the world, giving them access to hundreds of critical applications. BT for Life Sciences R&D lets research scientists collaborate on a secure platform. BT Trace helps organisations manage increasingly complex global supply chains by giving them a single real-time view of their operations.

### BT Retail

BT Retail has four customer-facing divisions: BT Consumer, BT Business, BT Ireland and BT Enterprises.

#### BT Consumer

We are the leading consumer voice and broadband provider in Great Britain and have a growing pay-TV service. We sell our services under the BT and Plusnet brands.

We help our BT-branded services stand out from the competition by offering a range of extra features. Plusnet provides voice and broadband services for more cost-conscious customers who value our highly-regarded customer service. We are a member of the YouView TV consortium and during the year secured a wide range of sports content to show on our BT Sport channels.

#### BT Business

We supply SMEs in Great Britain with fixed calls and lines, broadband, mobility and IT services as well as data and voice networks. We also have specialist arms within BT Business including:

<b>BT iNet</b>	A Cisco centre of excellence specialising in infrastructure, security and unified communications
<b>BT Engage IT</b>	A leading provider of business-to-business IT equipment and services
<b>BT Business Direct</b>	An online store providing IT, computing and networking equipment plus associated installation and support services

#### BT Ireland

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In Northern Ireland, we are the leading communications services provider for consumers, SMEs and the public sector. We run the copper access network and our fibre rollout has reached over 90% coverage, making Northern Ireland one of the best connected regions in Europe.

In the Republic of Ireland, we serve corporate and public sector customers and are one of the country's largest providers of wholesale network services.

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**BT Enterprises**

BT Enterprises consists of seven separate divisions, each one operating as a standalone business. BT Fleet was moved into BT Enterprises in April 2013.

<b>BT Conferencing</b>	Audio, video and web conferencing and collaboration services for business customers in the UK and around the world
<b>BT Directories</b>	Directory Enquiries (118500), operator and emergency services. Marketing services including The Phone Book, website design and web-based promotion (to help customers advertise online)
<b>BT Expedite &amp; Fresca</b>	Services for the retail sector including store point of sale systems, back-office applications like merchandising and sales analytics, and software and platforms for web commerce
<b>BT Redcare</b>	Fire and intruder alarm signalling services, CCTV and surveillance networks, and control room services. Mobile-to-mobile services for vending machines, cash machines and payment terminals, taxis and fleet management
<b>BT Payphones</b>	Public payphones and managed prison, card and private payphones

<b>BT Wi-fi</b>	More than five million UK hotspots offering broadband on the move to consumers and small businesses and to wholesale customers like mobile network operators
<b>BT Tikit</b>	IT products and services for legal and accountancy firms

## Products and services for Consumers

We mainly sell three things to consumers: fixed-voice, broadband and TV. To win and keep customers we must offer all three in flexible bundles. We offer a wide choice of good-value packages that encourage customers to take extra services. Most of our sales are through our call centres or online, with some through our customer service team.

### Voice services

We provide customers with fixed-lines and a choice of calling plans, including unlimited options for evening, weekend and peak-time calling. All our plans include features such as call waiting and free calls to 0845/0870 numbers.

We offer different ways to pay. Line Rental Saver gives a large discount on line rental to customers who pay for a year upfront.

We offer BT Basic, a simple, low-cost phone service for people on low incomes. We are the only company to offer such a service.

This year we launched the SmartTalk app. Customers can use it to make calls on their smartphones over wi-fi (in the UK and abroad) which are billed as part of their home calling plan.

We also launched a new phone which lets customers reduce nuisance calls by allowing them to block international, withheld, or specific numbers.

### Broadband

BT Broadband is our standard service delivered over copper lines. BT Infinity is fibre-based using FTTC and FTTP technology. BT Broadband and BT Infinity come in a range of options with different usage limits and bundles of call plans. They also include our free BT Home Hub, free BT Cloud online storage, BT NetProtect Plus security software and free access to our wi-fi hotspots.

### TV services

We have two on-demand subscription packages: TV Essential and TV Unlimited. Customers can also get linear channels and extra features depending on which set-top box they choose and whether or not they have BT Infinity.

We started offering customers our YouView set-top box in October 2012. It gives them standard definition (SD) and HD Freeview channels and the ability to pause, record and rewind live TV and on-demand content. YouView's programme guide scrolls back seven days to give customers easy access to catch-up TV from BBC iPlayer, ITV Player, 4oD and Demand 5. Customers with our Vision 2.0 set-top box get advanced search and recommendation facilities in addition to the same basic features.

BT Infinity customers with a Vision 2.0 set-top box can buy our Extra TV service, giving them 18 extra SD channels and four HD channels, including popular channels such as National Geographic and Comedy Central. We will be bringing these channels to YouView boxes in the summer.

### Products and services for UK SMEs

We sell fixed-voice, broadband, networking, IT and mobility products and services. These range from simple standalone products to managed services and complex customised solutions. Our bigger customers buy from us through desk-based and field-based account managers. Smaller customers use four channels: call centres; 40 Local Businesses partners (not part of BT but exclusively selling our products and services); non-exclusive relationships with indirect partners; and bt.com.

### Voice services

Our fixed-voice services range from standard calls and lines to fully-managed office phone systems and contact centre solutions. As well as traditional voice, we are increasingly selling VoIP services.

### Broadband and internet

We provide a range of internet access options including BT Business Broadband over copper, BT Infinity for business (over FTTC and FTTP) and BTnet dedicated internet access. We also sell email, hosted Microsoft collaboration services and web-hosting.

### Networking services

Our voice and data networking services support customers who need to connect different sites. We design, install and manage leased lines, Ethernet services, IP virtual private network (IPVPN) services, SIP trunking, structured cabling and local area networking solutions.

### IT services

We offer IT services through five businesses.

BT iNet and BT Engage IT sell cloud and data centre services, unified communications, security solutions, end-user support services, hardware, software and consultancy services. They partner with most leading vendors – companies like Cisco, Microsoft, Citrix, HP, EMC, VMware, Oracle, NetApp, Apple and Symantec. BT Business Direct sells hardware and software from a wide range of suppliers. BT Expedite & Fresca specialises in the retail sector. BT Tikit combines its specialist legal and accountancy software products with the best technologies from multiple partners to give customers a fully-integrated solution, supported by a single supplier.

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#### **Mobility**

We sell mobile voice and broadband data services through a mobile virtual network operator (MVNO) agreement with Vodafone. Our 4G mobile spectrum licence will help us build on our existing proposition and offer an even better range of mobile services.

#### **BT Wholesale**

BT Wholesale sells voice, broadband and data communications products to fixed and mobile network operators (MNOs), internet service providers (ISPs) and telecoms resellers in Great Britain. Our managed network services combine BT products with third-party components and our own professional services, which include network solution design, field services, network migration, programme management and risk management. We also offer industry-specific services to media companies and broadcasters.

#### **Products and services**

##### **Wholesale broadband**

CPs buy wholesale fibre and copper broadband services from us. Our WBC portfolio includes three FTTC options, eight FTTP options and our ADSL2+ copper broadband service.

The rollout of ADSL2+ and fibre broadband is well advanced in the UK. This means that from autumn 2013 we will be retiring our legacy wholesale broadband services within the WBC footprint. We are working closely with CPs to help them migrate their customers smoothly.

##### **Wholesale Ethernet**

We design high-bandwidth Ethernet services to help CPs extend their networks and give their own customers high-quality services. With speeds of 2Mbps to 10Gbps, we have the widest range of Ethernet access options on offer.

##### **Partial private circuits**

We are a major provider of partial private data circuits which enable our customers to complete their own networks and help them extend the reach of their services.

##### **Voice services**

We offer managed voice solutions for CPs who do not want to invest in their own PSTN or IP voice networks. Our Wholesale Calls product is an end-to-end PSTN voice service and in 2013/14 we will be launching new IP hosted communications services including SIP trunking, IP Centrex and hosted contact centre solutions.

## **IP Exchange (IPX)**

We offer voice interconnect services so that a phone call will reach its destination at an agreed level of quality. The migration of voice calls to IP requires new interconnect arrangements which are made simple by IPX. It enables fixed and mobile operators with differing VoIP networks to connect VoIP-to-VoIP and VoIP-to-traditional voice calls by seamlessly translating them in an electronic clearing house and it supports emerging services such as HD voice.

We sell IPX through BT Wholesale in Great Britain and internationally through BT Global Services.

## **Transit**

We route voice services between CPs across our network, both in the UK and internationally, but this is a low-margin product with declining demand.

## **Managed Network Services (MNS)**

Our managed network services give CPs access to our expertise and economies of scale and help them reduce their operational and future capital spending.

We design, build, manage and transform networks for them, while our white-label managed services help them offer products like voice and broadband without the need to make large investments. Our solutions can be either dedicated to one customer or shared amongst several. We can offer a complete service, from accepting and processing new orders through to customer service and billing the end-user.

## **Media and broadcast services**

Our global media network links all the main locations around the world where producers create or distribute broadcast content. We have a number of strategic alliances which extend our portfolio and customer reach. In the UK, digital terrestrial TV delivery is underpinned by our media-specific MPLS network and we deliver TV outside broadcast services over our network connecting 155 sports and news locations.

In addition, BT Agilemedia offers high-quality solutions to enable mass viewer participation in TV voting and competitions.

## **Openreach**

At Openreach we want to improve access to broadband across Britain. We believe this will support economic growth.

We are responsible for providing services over the local loop (sometimes known as the local access network and the last mile). This is made up of the copper and fibre connections between our exchanges, and homes and businesses. We are in charge of BT's fibre broadband rollout. We also offer backhaul products to connect exchanges to CPs' networks.

BT's Undertakings (more on page 39) commit us to selling our main products and services to all CPs openly and equally and on the same terms as we do to our own lines of business. To make this work properly, Openreach's operational, engineering and systems capabilities are separate from those of the rest of BT. Around 96% of Openreach revenue is subject to this regulation.

## **Products and services**

Openreach sells three main products: fibre broadband, copper-based services and Ethernet.

## **Fibre broadband**

This is either FTTC, which offers speeds of up to 80Mbps, or FTTP, which offers faster speeds of up to 330Mbps when fibre is connected all the way to the customer premises.

In April 2013 we launched FTTP-on-Demand, which will initially be available within a subset of the FTTC footprint. It will let end-users in FTTC areas get a FTTP connection if they need one – we think SMEs will be especially interested in the faster speeds.

With our Fibre Voice Access product, CPs can offer voice services over fibre which offer similar functionality to copper voice services.

Our fibre broadband network can also carry broadcast Internet Protocol television (IPTV) services. We have launched a multicast capability which cuts the costs of delivering broadcast TV over our network and means CPs (generally triple play providers) can prioritise broadcast TV over other web traffic.

## **Passive Infrastructure Access (PIA)**

PIA products allow CPs to rent space in Openreach's ducts or on telegraph poles. CPs can use this space for their own fibre instead of buying fibre-based broadband from us.



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### **Wholesale Line Rental (WLR)**

WLR lets CPs offer own-branded phone services (with their own pricing and billing) using our equipment and network. They pay to use the copper line between our exchanges and customer premises but can avoid investing in extra network equipment or infrastructure.

### **Local Loop Unbundling (LLU)**

LLU allows CPs to offer DSL-broadband services by installing their own equipment in our exchanges and renting the copper line. CPs can use our shared metallic path facility (SMPF) product to offer broadband over a WLR line or our metallic path facility (MPF) product to offer both phone and broadband services using their own equipment.

### **Ethernet**

Our Ethernet products offer dedicated, symmetric, fibre-connectivity. CPs use them in their own networks and to provide high-quality, high-bandwidth services to businesses and the public sector.

### **You can read more about these services at**

[www.openreach.co.uk](http://www.openreach.co.uk)

### **BT Technology, Service & Operations**

During the year we brought together BT Innovate & Design and BT Operate, our two internal service units, to form BT Technology, Service & Operations (BT TSO). There were around 17,000 people in BT TSO at 31 March 2013, supporting our customer-facing lines of business.

We created it to simplify the way we work, help us further transform our cost base and speed up and improve delivery to BT customers. It is a simpler organisation with more efficient processes and fewer hand-offs. This means our design and development teams can react more quickly to operational changes and events.

### **Products and services**

BT TSO is responsible for the whole lifecycle of our global networks and systems – from innovation, design, test and build through to operational management. We manage BT’s voice, data and TV networks and IT applications which make up the core infrastructure for BT’s products and services. Our people also design and deliver the networks and platforms which are used by our customer-facing lines of business, and the large-scale global managed network services which are sold to customers in the UK and internationally.

We manage and deliver BT's long-term technology strategy and research and innovation programmes, including managing BT's worldwide patent portfolio (see page 21).

We are also responsible for managing the group's energy consumption and for putting strategies in place to cut our future carbon footprint.

### **Reducing our energy use**

In the UK, we spent £274m on energy this year. Even though business volumes have increased, we have achieved our fourth consecutive year of worldwide energy reduction, using 3.3% less energy this year against our target of 1.5%. The energy saving programmes we ran in 2012/13 are expected to generate £33m in annualised cost benefits.

### **Climate stabilising intensity**

We track how we are doing on climate change with a climate stabilising intensity performance indicator.

We want to cut BT's CO<sub>2</sub> intensity by 80% by December 2020 (compared with 1996/97). This year we achieved a 77% cumulative reduction.

### **Security**

Our physical and cyber security operations were previously managed by BT Operate. We now manage these through a separate security enterprise, BT Security, which is supported by BT TSO engineers. This business is in charge of protecting our own and customers' data and assets. We believe that it differentiates the services we can offer and will help us win in the market.

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#### **Our customers and markets**

We serve a number of different types of customers in the UK and around the world. In this section we explain who our customers are and the trends we see in the markets where we operate.

#### **UK consumers**

We serve UK consumers through BT Consumer and BT Ireland (both parts of BT Retail).

There are around 26m households in the UK and our consumer products and services can reach almost all of them.

The market for fixed calls and lines, broadband and TV is very competitive. There are around 114 companies offering voice and/or broadband services. The market has concentrated over the last few years with several strong players emerging. The four largest providers are BT, Virgin Media, Sky and TalkTalk.

#### **Fixed calls and lines**

Around 22m, or 84% of homes in the UK have a fixed phone line. That proportion has stayed steady for the past three years. Around 15% of UK homes only have a mobile phone with around 1% having no phone at all.

There were 24.4m home phone lines in the UK as at December 2012 (including some homes which have more than one phone line and some SMEs who buy consumer services). That is up 2% compared with last year. An overall rise in the total number of homes in the UK coupled with more demand for fixed broadband connections played a part in that growth.

At 31 March 2013 we had a total of 10.2m consumer fixed-lines in the UK, with around 9.8m active voice lines (where a customer buys calls from us as well as paying for the line).

We have the largest share of fixed-lines to homes in the UK at 42%, compared with 47% last year. Our share has been declining over the last few years as competitors have taken advantage of the favourable regulatory regime in the UK.

The number of minutes spent on calls from fixed-lines has been falling for some time. Customers are increasingly using mobiles, email, social networking and other kinds of communication instead. Our total call volumes declined 9% in the year, compared with an 11% decline last year.

## Broadband

The UK has one of the highest levels of broadband availability in Europe. Almost all homes can get a fixed broadband connection and around three-quarters do so.

The UK also compares favourably on broadband pricing. Ofcom research ranks the UK the seventh cheapest out of 25 European countries for standalone broadband and sixth cheapest out of 23 countries for broadband and voice bundles.

At 31 March 2013 there were around 21.9m DSL, fibre and cable broadband connections to homes and businesses in the UK, up by 5% over last year.

Fibre penetration has grown significantly during the year. There are more connected devices and people are using more bandwidth-intensive applications such as watching video, streaming music and playing online games. More than half of households now own web-connected games consoles, over 40% of individuals connect their TV to the internet, and 15% of households own a tablet device.

According to Ofcom research, the average broadband download speed for the UK was 12.0Mbps in November 2012. That is up from 7.6Mbps a year earlier. Plusnet was ranked highest for average download speeds over copper. BT Infinity offers the most consistent speeds over a 24-hour period, with the lowest network congestion at peak times, and the fastest upload speeds in the country.

We have around 6.7m retail broadband customers (including business customers). We are the UK's biggest broadband provider with a 31% share of the total broadband market at 31 March 2013. Excluding cable, we have a 38% share. As with fixed calls and lines, Sky, Virgin Media and TalkTalk are the other big players. Mobile operator O2 left the fixed broadband market during the year.

We now have around 1.3m retail fibre broadband customers representing 19% of our retail broadband customer base.

## TV services

Broadcast TV is currently the most common way for people to watch television. There are three main platforms satellite, cable and digital terrestrial.

But broadband is revolutionising the way people watch, especially with interactivity and on-demand TV. The public sector broadcasters offer free on-demand content services such as BBC iPlayer, ITV Player, 4oD and Demand 5. All the UK's main pay-TV providers also offer on-demand services. These are either free as part of a monthly subscription for broadcast channels, covered by an extra subscription or are on a pay-per-view basis.

There are other subscription-based providers such as Netflix and LOVEFiLM and pay-per-view providers such as Blinkbox. These over-the-top providers stream content over the web without owning any of the distribution infrastructure.

There are 14.8m UK pay-TV subscribers, making up 54% of TV households. The rest typically receive free digital terrestrial channels via Freeview or Freesat.



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Sky has the largest market share of pay-TV subscriptions at 66%. We have a 5% share. During the year we grew our TV customer base by 15% compared with 1% for Sky and 0% for Virgin Media.

### UK SMEs

We serve the UK SME market through BT Business and BT Ireland, which both sit within BT Retail. We also deliver specialist services to SMEs (as well as larger corporates) through BT Conferencing, BT Expedite & Fresca, and other divisions in BT Enterprises.

There are an estimated 4.8m UK SMEs, from sole traders to businesses with up to 1,000 people. Their communications and IT needs vary widely, depending on factors such as size, number of sites, industry and maturity.

At the smaller end of the market, customers' needs are simple and they sometimes buy services from consumer-orientated providers. Larger customers have more complex needs, typically buying a range of voice, data, IT and mobile services.

We have around 1m SME customers in the UK. Small businesses with fewer than 50 people make up more than 90% of these.

The SME market for fixed and mobile communications and IT services in Great Britain is fragmented and highly competitive. It is worth around £30bn of which we have a 7% share.

### Fixed calls and lines

The SME market for fixed-voice is declining, with call volumes falling due to substitution by mobile, email and VoIP.

There are 8.8m business lines in the UK – many SMEs take more than one line. We have a 47% market share of business lines, down two percentage points in the year. Our share of access and calls revenue was flat in the year. We compete against more than 300 resellers and fixed network operators. Daisy, TalkTalk, Virgin Media, XLN, Alternative Networks, Cable & Wireless Worldwide (now owned by Vodafone), Colt Group and KCOM Group are our main competitors.

### IT services

The IT services market stayed broadly flat this year. There has been more interest in both cloud-based services (like managed hosting of IT applications and data) and unified communications services, which give businesses better flexibility over their costs. Our biggest competitors in IT services are SCC, Computacenter, Phoenix IT, Kelway,

Dimension Data and Logicalis.

### Mobile

Revenue in the UK mobile market has fallen, impacted by mobile termination rate reductions and price erosion. Call volumes have fallen slightly but data volumes are increasing strongly due to the growth in smartphones and tablets. We have focused on a few specific mobile

opportunities. We have a small market share but our subscriber base is growing. The main operators in the UK mobile market are Vodafone, O2 and EE.

### Conferencing

Demand for conferencing services is growing, particularly as companies seek to reduce their travel costs. We sell conferencing services both in the UK and overseas. The global audio conferencing market has continued to expand, with volume growth more than offsetting declining prices. In video conferencing, growth is particularly strong in the personal (desktop) market.

### Large corporate and public sector customers

Large corporate and public sector customers are served by BT Global Services. They are our biggest segment by external revenue.

Gartner, a leading information technology research and advisory company, estimates that the global business ICT market is worth around £647bn.

The market consists of a wide range of products and services. Suppliers range from large network-based vendors like us through to niche technology players. Vendors specialise in different services such as systems integration, software development, IT hardware and telecoms solutions.

Gartner expects the global business ICT market to grow at a compound annual growth rate of 3.1% over the next three years.

Demand for network-based services, such as data, mobility, social networking, cloud and security is driving that growth as businesses seek to tap into key technology trends and global opportunities. Demand for more traditional services is declining as customers switch to newer technologies.

<sup>a</sup> The Gartner Report described herein, Gartner, Forecast: Enterprise IT Spending by Vertical Industry Market, Worldwide, 2011-2017, 1Q13 Update represents data, research opinion or viewpoints published, as part of a syndicated subscription service, by Gartner, Inc. ( Gartner ), and are not representations of fact. Each Gartner Report speaks as of its original publication date (and not as of the date of this Report) and the opinions expressed in the Gartner Report(s) are subject to change without notice.





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Gartner expects the market to grow in all the regions we operate in – albeit at different rates. Continental Europe is expected to experience the lowest rate of growth at 2.0% a year over the next three years. In contrast, Asia Pacific, Latin America, Turkey, the Middle East and Africa should grow at 3.3% a year.

In the global business ICT market, we are focused on delivering major managed networked IT services securely, efficiently and globally.

According to ISG Research, BT has the highest standalone managed network services (MNS) market share globally, is the only provider with double-digit share for standalone MNS services in each of the three major regions (Americas, Asia Pacific and EMEA), and is the standalone MNS market share leader in EMEA.

We experienced tough conditions in Europe and the financial services sector during the year. But we are increasing our market share in the high-growth regions.

The public sector generated 26% of our revenue. In the UK, we are one of the Government's largest suppliers of networked IT services – as a whole, they are our biggest customer. Except as described on page 39, we have a normal customer and supplier relationship with them. Of our corporate customers, financial institutions are our largest customer segment, generating 19% of our revenue in the year. We also supply a range of services to other telecoms companies.

We serve:

- 94% of the FTSE 100 companies

- 74% of the Fortune 500 companies

- 100% of Interbrand's top 50 annual ranking of the world's most valuable brands

- the world's top stock exchanges, leading broker-dealers and biggest banks

- national and local government organisations and other public sector bodies in 26 countries around the world.

As well as pursuing new customers, we aim to grow our share of existing customers' spending through increasing the number of products and services we sell to them.

#### **Wholesale customers**

We serve the wholesale telecoms customer segment in Great Britain through Openreach and BT Wholesale. In Northern Ireland and the Republic of Ireland, we serve wholesale customers through BT Ireland. Everywhere else in the world, we serve the wholesale market through the wholesale arm of BT Global Services.

Openreach sells local loop and backhaul services to around 500 CPs – the largest being Sky, TalkTalk and BT lines of business.

BT Wholesale works with more than 1,400 CPs, including all the big fixed and mobile operators, ISPs and broadcasters. We manage and support the network and services needs of many UK operators including EE, KCOM Group, MBNL, O2, Virgin Media and Vodafone. Our biggest competitors are Cable & Wireless Worldwide, Colt Group, TalkTalk and Virgin Media, as well as Ericsson for managed services.

Outside the UK, we offer wholesale telecoms services to more than 1,200 CPs around the world. We compete with the wholesale divisions of local incumbents, alternative network operators and global wholesale telecoms companies like BICS and Level3.

We are Europe's largest telecoms services wholesaler by revenue.

## Regulation

Communications services are vital in a modern world. This means the industry sometimes needs to be controlled and monitored. In nearly all our markets, these services are subject to regulation by governmental and non-governmental bodies. In this section we explain some of the recent and upcoming decisions taken by regulators and how they affect us.

### European Union (EU) regulation

In EU countries, electronic communications services are governed by a number of European directives and regulations. These create a Europe-wide framework covering services including fixed and mobile voice, broadband, cable and satellite TV.

Different countries have implemented the existing directives in different ways. The directives include rules covering access and interconnection, universal service obligations, and how often national regulators should review markets for significant market power (SMP). They also cover how regulators set price controls. They require regulators to consult with the European Commission (EC) on any price control decisions before they are finalised to make sure they are consistent with the European regulations.

During 2013/14 the EC is expected to issue guidance on regulating next generation fibre access networks. We expect this to align the rest of Europe more closely with the existing UK approach. The EC is also expected to review the scope of the relevant market segments covered by telecoms regulation.

### UK regulation

The telecoms industry is regulated through various European directives, the Communications Act 2003 (the Communications Act) and Ofcom (the UK's independent regulator) as well as other regulations and recommendations.

#### The Communications Act

The Communications Act gives Ofcom legal powers and sets out the legal requirements for how electronic communications services should be regulated in the UK. It includes the conditions imposed by the European directives. The Government is currently reviewing our sector's regulatory regime, with a new framework planned for 2015. The review is looking into how to encourage growth and innovation and how to remove unnecessary regulation.



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### **Ofcom**

Ofcom is the independent regulator and competition authority for the whole UK communications market. Its main duties are:

- to further the interests of citizens in relation to communications matters

- to further the interests of consumers in relevant markets, where appropriate by promoting competition.

Under the powers of the Communications Act, Ofcom sets conditions that CPs must comply with and can issue directions under these conditions. Some conditions, known as General Conditions, apply to all CPs. Others apply to certain individual companies that Ofcom has decided are universal service providers or have SMP in a particular market. Anyone can appeal against Ofcom's decisions through a number of routes, including to the Competition Appeal Tribunal (CAT) or to the High Court.

The General Conditions that apply to all CPs are mainly about protecting consumers' general access and interconnection, planning for emergencies, providing information to Ofcom, and allocating and transferring phone numbers.

We are the designated universal service provider for the UK (except for the Hull area where it is KCOM Group) and so we have certain universal service obligations. This is an important responsibility and we take it seriously. Our main obligation is to make sure that basic fixed-line services are available at an affordable price to all consumers in the UK. We are also obliged to provide public payphones.

The European directives require Ofcom to review relevant communications markets regularly, usually every three years, and to decide whether any CP has SMP in those markets. If Ofcom decides that a CP has SMP, it could put controls in place, typically on the prices which the CP can charge. Ofcom will generally try to set charges that are reasonably based on costs and an appropriate return on the capital invested.

### **Impact of regulation**

There are a number of regulatory decisions and outcomes of appeals that affected us during the year and will impact us in the future.

Ofcom finished its review of the business connectivity markets, which cover products such as Ethernet and private circuits. It renewed price controls for another three years. The main changes were an increase in the size of the deregulated London area and deregulation of long distance wholesale private circuits and some retail leased lines. We also now have SMP in high bandwidth Ethernet services outside the deregulated London area which will be

subject to a charge control. We expect the charge controls to have a net negative year-on-year impact of around £50m-£100m on group revenue and EBITDA in 2013/14 with a further similar impact in 2014/15

In December 2012 Ofcom issued its final determinations on disputes over historic Ethernet pricing. Ofcom concluded that between April 2006 and March 2011 the prices we set for certain Ethernet services were too high resulting in an overcharge of £151m over this period. We disagree with the determinations and have submitted an appeal to the CAT

In July 2012 the Court of Appeal overturned the CAT's favourable August 2011 decision in relation to wholesale ladder pricing. Ladder pricing links the amounts that BT charges mobile operators for mobile calls to 0800, 0845 and 0870 numbers terminating on our network to the retail price charged by mobile operators to their customers. We have been granted permission to appeal this decision to the Supreme Court and the hearing is expected in early 2014. In 2011/12 we recognised revenue of £56m and EBITDA of £29m from ladder pricing. We did not recognise any revenue or profit from ladder pricing this year. One-off charges of £85m against revenue and £58m against EBITDA have been recognised in the year relating to ladder pricing in the 2010/11 and 2011/12 years.

In March 2011 we lost an appeal to the CAT relating to Ofcom's decision in a dispute over our charges to other CPs for trunk components of wholesale partial private circuits. In July 2012 the Court of Appeal issued its judgment on our appeal against the CAT's decision. The appeal failed to set aside Ofcom's determination or the CAT judgment, but provided helpful clarification of Ofcom's powers.

Sky appealed in June 2010 against Ofcom's decision to regulate Sky Sports 1 and 2. In August 2012 the CAT decided in Sky's favour, and in April 2013 we received permission to appeal the CAT's decision to the Court of Appeal.

The charge controls for WLR, LLU and ISDN30 products which became effective in April 2012 had a negative impact of around £120m on group revenue and EBITDA in the year. We expect a further impact of around £120m in 2013/14.

During 2013/14, Ofcom is expected to complete its reviews of:

- the Fixed Access market (including WLR, LLU, GEA, ISDN 2 and ISDN 30 products)

- the Wholesale Broadband Access market (including IPstream, Datastream and WBC)

- the Wholesale narrowband market (comprising calls and interconnection services).

Where we are found to have SMP, Ofcom will carry out consultations on setting controls. These could change the prices we charge for these products.

Ofcom has recently opened a compliance investigation following a complaint which alleges that BT has acted anti-competitively, contrary to UK and EU law. The complaint alleges that BT has abused its dominant position, claiming that the margin between the prices BT Retail charges for some of its superfast broadband products, and the price paid to Openreach for the relevant network inputs, is insufficient to allow other CPs to compete profitably with BT Retail. Ofcom has stated that the initial information gathering phase of the investigation will take place during spring/summer 2013 which will inform consideration during autumn/winter 2013, of whether, and if so how, to proceed further with the investigation.

See Ofcom's website at [www.ofcom.org.uk](http://www.ofcom.org.uk)

**for more details on regulation**

BT's Undertakings

In response to Ofcom's 2005 strategic review of telecommunications, we put forward some legally binding undertakings under the Enterprise Act 2002. These Undertakings (which include the creation of Openreach) began in September 2005.

They aim to give clarity and certainty to the UK telecoms industry about the way we provide upstream regulated products. This in turn supports effective and fair competition in related downstream markets.

Most of the commitments in the Undertakings have been delivered, but we were unable to move a small percentage of certain customer records to separated computer systems by the target date of 31 December 2012. Ofcom has issued a Direction, which we have accepted, that gives us until 30 November 2013 to meet this commitment.

#### [Our relationship with HM Government](#)

We can be required by law to do certain things and provide certain services to government. For example, under the Communications Act, we (and others) can be required to provide or restore services during disasters. The Civil Contingencies Act 2004 also says that the Government can impose obligations on us (and others) at times of emergency or in connection with civil contingency planning. The Secretary of State can also require us to take certain actions in the interests of national security and international relations.

#### [Overseas regulation](#)

The degree of regulation in international markets varies widely. This can hinder our ability to compete. We are pressing incumbent operators and their national regulatory authorities around the world for fairer, cost-related wholesale access to their networks.

In particular, we are working with the industry and the regulator in the US to encourage early completion of the regulator's review of the Business Access market and to put remedies in place to address any dominance found.

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**Performance**

In this section we discuss the financial performance of the group as well as the operating and financial performance of our customer-facing lines of business.

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We assess and explain the performance of the group using a variety of alternative performance measures. These include underlying revenue and operating costs excluding transit, adjusted and reported EBITDA, adjusted earnings per share, normalised and reported free cash flow and net debt. These are not defined under IFRS and are therefore termed non-GAAP measures. Each of these measures is defined and discussed in more detail on pages 170 to 172.



We assess the performance of our customer-facing lines of business on an adjusted basis, being before specific items which are not allocated to the customer-facing lines of business. A definition of specific items is set out on page 170 and specific items for this year and the two prior years are disclosed in note 9 to the consolidated financial statements.

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### 42 **Performance**

#### **Group Finance Director's introduction**

We have delivered a strong financial performance by focusing on efficiency. This has enabled us to make some key investments for the future.

#### **Our performance this year**

Underlying revenue excluding transit was down 3%, reflecting regulatory headwinds and the challenging conditions in Europe and the financial services sector. However, it showed an improved trend in the second half of the year, which benefited from stronger performances in BT Global Services, BT Retail's Business and Consumer divisions and in BT Wholesale.

We reduced our underlying operating costs excluding transit by 6% in the year. Some of this reflects the decline in revenue, but the majority is the result of our cost transformation activities. Over the last four years we have reduced our operating costs and capital expenditure before purchases of telecommunications licences by £4.7bn in aggregate.

But there is still much more to do, and plenty of opportunity. Through forensic analysis of our end-to-end processes across our lines of business, we can continue to improve our efficiency and reduce the cost of failure.

Adjusted EBITDA was £6.2bn, an increase of 2% and adjusted profit before tax was up 11% at £2.5bn. Adjusted EPS, at 26.6p, was up 12%.

We invested £2.4bn in capital expenditure which included the accelerated investment in our fibre rollout. This has now reached more than half the UK. Efficiencies within our capital investment programmes mean we are doing more for less. In addition we secured a 4G spectrum licence for £0.2bn, which will enable us to provide enhanced services and build on our existing strength in wi-fi.

We generated normalised free cash flow of £2.3bn in the year, in line with our expectations.

#### **Outlook**

We expect an improved trend in underlying revenue excluding transit next year.

We expect adjusted EBITDA to be £6.0bn-£6.1bn in 2013/14. The small decline compared with this year is despite underlying improvements in our business performance and is more than accounted for by our investment in BT Sport and the higher pension operating charge. The EBITDA performance in the first half of the year will be impacted by our upfront investment in BT Sport. We expect adjusted EBITDA to increase to £6.2bn-£6.3bn in 2014/15 and to

grow further in 2015/16.

We expect higher levels of normalised free cash flow than previously, at around £2.3bn in 2013/14, around £2.6bn in 2014/15 and with further growth in 2015/16.

**Tony Chanmugam**

**Group Finance Director**

9 May 2013

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**Table of Contents**44 **Performance****Overview**

We operate in an environment characterised by changing customer expectations and developments in technology. The UK telecommunications sector is one of the most competitive markets in the world and there has been continued regulatory pressure to reduce the prices of some of our products. There has been an ongoing shift by customers towards interactive broadband, data and IP services as well as mobile. Fixed-line voice services, which have historically been high margin products, have been in decline. Large multinational customers want complex managed network services across their footprint and SMEs often want a single supplier for their communications needs.

We have responded to these external developments. Growing demand for broadband and data services has meant that we have been enhancing our product offering to meet future customer requirements. We make our networks and expertise available to other CPs, many of whom we compete with, to benefit from our economies of scale. We are also strengthening our position in the high-growth regions of the world. But the economic conditions and regulatory challenges have hampered our growth ambitions over recent years.

Our focus on improving customer service and efficiency has generated substantial cost savings, enabling us to grow our profits and cash flow despite the revenue pressures. We also started a group-wide restructuring programme in the second half of this year which will further improve our cost base and enhance customer service.

Our cost savings have allowed us to make strategically important investments for the future of BT, whether that be in rolling out our fibre broadband network, TV or in 4G spectrum. These are long-term investments which will help in achieving our aim to generate profitable revenue growth in the future.

**Outlook**

Our outlook is set out below.

	2013/14	2014/15	2015/16
Underlying revenue excluding transit <sup>a</sup>	Improved trend		
Adjusted EBITDA <sup>a</sup>	£6.0-£6.1bn	£6.2-£6.3bn	Growth
	Broadly level	Broadly level	
Capital expenditure <sup>b</sup>			
Normalised free cash flow <sup>a</sup>	with 2012/13 c.£2.3bn	with 2012/13 c.£2.6bn	Growth
Dividend per share	Up 10%-15%	Up 10%-15%	
Share buyback programme	c.£300m	c.£300m	

<sup>a</sup> Underlying revenue excluding transit is defined on page 170. Adjusted EBITDA and normalised free cash flow are defined on page 171.

<sup>b</sup> Before purchases of telecommunications licences.

Our normalised free cash flow outlook is above our previous expectations, reflecting the benefits of our restructuring programme and capital expenditure efficiencies. We expect our restructuring programme to reduce our cost base by around £200m per year with this run-rate largely achieved in 2014/15, contributing to an improvement in EBITDA and capital expenditure efficiency. We expect around £400m of further specific restructuring costs, most of which will be incurred in 2013/14.

## Income statement

### Summarised income statement

Year ended 31 March	2013	2012	2011
	£m	£m	£m
<b>Revenue</b>	<b>18,253</b>	<b>19,307</b>	<b>20,076</b>
Other operating income			
Operating costs <sup>a</sup>	392	387	373
<b>EBITDA</b>	<b>(12,464)</b>	<b>(13,630)</b>	<b>(14,563)</b>
Depreciation and amortisation	6,181	6,064	5,886
<b>Operating profit</b>	<b>(2,843)</b>	<b>(2,972)</b>	<b>(2,979)</b>
Net finance expense	3,338	3,092	2,907
Associates and joint ventures	(653)	(681)	(845)
<b>Profit before taxation</b>	<b>9</b>	<b>10</b>	<b>21</b>
Taxation	2,694	2,421	2,083
<b>Profit for the year</b>	<b>(606)</b>	<b>(584)</b>	<b>(452)</b>
	<b>2,088</b>	<b>1,837</b>	<b>1,631</b>

<sup>a</sup> Excluding depreciation and amortisation.

### Revenue

Underlying revenue excluding transit was down 3%, and showed an improved trend for the second half of the year compared with the first half.

The decline in underlying revenue excluding transit in the year reflects lower revenue from calls and lines, the tough conditions in Europe and the financial services sector and regulatory price reductions.

Calls and lines revenue was down 8% (2011/12: 9%). The continuing decline is due to customers switching from fixed-line calls to mobile, broadband, data and IP services.

These declines were partly offset by a 7% increase (2011/12: 7%) in broadband and convergence revenue. This was due to growth in our broadband base, particularly BT Infinity, and our Ethernet portfolio.

Adjusted revenue was down 5%, with transit revenue down by £293m (including mobile termination rate reductions of £187m), a £168m negative impact from foreign exchange movements and a £36m negative net impact from acquisitions and disposals. This compares with a 4% decline in 2011/12, principally due to a 9% reduction in calls and lines revenue and a 26% reduction in transit revenue.

A full breakdown of our revenue by major product and service category is provided in note 4 to the consolidated financial statements.

### Operating costs

We reduced operating costs before depreciation and amortisation by £1,166m in the year by focusing on efficiency. In aggregate operating costs and capital expenditure (excluding purchases of telecommunications licences) have reduced by £4.7bn over the last four years despite greater investment in new areas of the business.

Underlying operating costs before depreciation and amortisation and excluding transit were down 6% (2011/12: 4%) reflecting the benefit of transforming our cost base and reduced cost of sales due to the decline in revenue. Our total operating costs before depreciation and amortisation and specific items were £12,464m, down 9% (2011/12: 6%). There are more details on our group-wide cost transformation programmes on page 13.

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Labour costs, both direct and indirect, make up the largest category within our cost base. Net labour costs decreased by 4% (2011/12: broadly flat) to £4,626m, as improved productivity and better systems and processes offset our investment programmes, the recruitment of around 1,600 engineers and the insourcing of around 4,000 jobs. Leaver costs were £58m (2011/12: £97m).

Payments to telecommunications operators (POLOs) were down 15% (2011/12: 16%) reflecting lower mobile termination rates and reduced transit and wholesale call volumes. We spent 4% less on property and energy (2011/12: 7% less) as we drove better space utilisation but lower energy usage was more than offset by higher energy prices. Network operating and IT costs were down 7% (2011/12: 11%) as we rationalise our networks and systems. Other operating costs, which include cost of sales, marketing and transport costs, decreased by 11% (2011/12: 3%) due to the decline in revenue and the benefit of our cost transformation programmes.

A detailed breakdown of our operating costs is set out in note 6 to the consolidated financial statements.

**EBITDA**

Adjusted EBITDA increased by 2% (2011/12: 3%) to £6,181m, reflecting further progress in transforming our cost base.

Underlying EBITDA, which excludes a £10m negative impact from foreign exchange movements and an £11m negative net impact from acquisitions and disposals, also increased by 2% (2011/12: 3%).

An analysis of EBITDA by line of business is set out in note 4 to the consolidated financial statements. Commentary on line of business results is provided in the line of business performance section on page 53.

**Depreciation and amortisation**

Depreciation and amortisation of £2,843m decreased by 4% (2011/12: flat). This is due to more efficient delivery of our capital investment programmes over the last four years.

**Net finance expense**

Net finance expense before specific items of £653m decreased by £28m (2011/12: £164m) due to the lower average cost of net debt.



	2013	2012	2011
Year ended 31 March	£m	£m	£m
Interest on borrowings	660	672	852
Capitalised interest	(5)	(9)	(6)
Fair value movements on derivatives	11	29	34
Total finance expense	666	692	880
Total finance income	(13)	(11)	(35)
<b>Net finance expense</b>	<b>653</b>	<b>681</b>	<b>845</b>

The table below provides an overview of average gross debt, investments and cash balances, net debt and the related weighted average interest rates over the past three years.

	2013	2012	2011
Year ended 31 March	£m	£m	£m
Average gross debt	10,599	9,295	10,808
Weighted average interest rate on gross debt	6.1%	7.3%	7.8%
Average investments and cash balances	1,611	1,148	2,192
Weighted average interest rate on investments	0.5%	0.6%	0.6%
Average net debt	8,988	8,147	8,616
Weighted average interest rate on net debt	7.3%	8.3%	9.8%

Interest on our borrowings decreased by £12m (2011/12: £180m). Although the weighted average interest rate has reduced, its effect was largely offset by an increase in our average gross debt due to the £2bn pension deficit payment in March 2012. Fair value movements on derivatives include £5m (2011/12: £16m, 2010/11: £28m) of swap restructuring costs on certain derivatives. They also include £6m (2011/12: £13m, 2010/11: £6m) of fair value movements on derivatives not in a designated hedge relationship.

Finance income increased by £2m (2011/12: £24m decrease) mainly due to higher average cash and investment balances.



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Net interest cash outflow of £692m (2011/12: £685m, 2010/11: £944m) is £39m higher (2011/12: £4m, 2010/11: £99m) than the net finance expense in the income statement. This is mostly due to certain interest cash outflows and inflows being spread over a number of years in the income statement.

	<b>2013</b>	2012	2011
Year ended 31 March &nbs	£m	£m	£m