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**TELECOM ITALIA:  
ITALY'S HIGH TECH OLD-STYLE TELECOMS INCUMBENT**

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**TELECOM ITALIA:  
ITALY'S HIGH-TECH OLD-STYLE TELECOMS INCUMBENT<sup>1</sup>**

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**Abstract.**

The Telecoms Boom and Bust 1996 to 2002 has had a significant impact on the structure of the Telecommunications Industry. During the boom it seemed as if new entrant telecoms operators, entering on the back of new technologies, might even replace the incumbent operators such as Telecom Italia, Deutsche Telekom and France Telecom. But the bust has decisively reversed this tendency. The aim of this paper is to examine in detail some of the major recent changes that have taken place in Telecom Italia and the forces that have driven these changes.

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<sup>1</sup> The author would like to acknowledge interviews with a number of senior Telecom Italia executives and also very able research assistance from Ian Duff and Andrea Gallice. Helpful discussions with Professor Cristiano Antonelli from the University of Turin and a fellowship from the International Center for Economic Research (ICER), Turin, are also gratefully acknowledged.

## INTRODUCTION

The study of Telecom Italia, Italy's incumbent telecoms operator, provides important insights into the dynamics of the Telecoms Industry in this one of Europe's largest four countries. However, in studying Telecom Italia we learn far more than only about telecoms. The study also provides an important insight into the process of capital accumulation in Italy and into the way in which financial institutions work in this country, a *modus operandi* that is very different from the other large European countries, namely Britain, France and Germany. To be more specific, in July 2001 two Italian businessmen, from two large established Italian companies, succeeded in spending Euro 7 billion in cash in order to acquire Telecom Italia, a company with a market capitalisation at the time of Euro 55 billion. How was this possible? What does it tell us about the Italian telecoms industry and financial institutions? From the perspective of Telecom Italia itself, what are the company's main activities including its advanced services, in Italy itself as well as elsewhere; how is the company organised; what is its strategy; and what does the future hold for it? These are the kinds of questions with which this paper is concerned.

### TELECOM ITALIA'S COMPLICATED CORPORATE OWNERSHIP STRUCTURE

Telecom Italia was created in August 1994. It became the monopoly public telecoms service provider in Italy through the merger of five telecoms companies that were operators in the areas of long-distance services, domestic services, international services, maritime services, and satellite services. On July 18, 1997 the five companies were merged into their holding company, STET (Società Finanziaria Telefonica), which then changed its name to Telecom Italia. In November 1997, the Italian Treasury privatised Telecom Italia, selling almost all of its stake in the company through an Italian public offering and separate international and US public offerings. In addition, the Treasury sold shares in Telecom Italia to a small group of wealthy private shareholders and approximately 1.5 million Italians also bought shares in the company.

#### *Privatisation to May 1999*

The principal architect of the privatisation of Telecom Italia was its Chairman-to-be, Guido Rossi. However, Rossi resigned in 1998 after a dispute with the company's CEO, Tomaso Tommasi, over new corporate governance rules that Rossi was attempting to introduce.<sup>2</sup> The new Chairman was Gian Mario Rossignolo, formerly Chairman of the Italian white goods company, Zanussi. He scrapped the post of CEO, turning himself into a powerful executive chairman. However, he too soon resigned when news was leaked regarding Telecom Italia's poor performance. In October 1998, Telecom Italia's share price was 19 percent below the offer price paid by Italian retail investors. The next Chairman was Franco Bernabè, a former economics professor who had transformed ENI, the Italian oil company, from a struggling state company into the world's seventh-largest oil operator. However, Bernabè had his share of troubles too in

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<sup>2</sup> *Financial Times*, November 28, 1997.

attempting to turn Telecom Italia round. As a result of the problems the company's institutional investors abstained during the formal vote on its 1997 accounts. *The Economist* commented that, "Since its privatisation in 1997 Telecom Italia has floundered. It has no convincing strategy and it has discarded senior executives and potential merger partners...like so much used confetti."<sup>3</sup>

### ***The Olivetti Take-Over***

Clearly, Telecom Italia was ripe for take-over. But who would want to take over a large, sprawling, bureaucratic company that was already in serious difficulty? Had this question been asked at the time of Telecom Italia's privatisation in 1997, few would have come up with Olivetti as an answer. Only eighteen months earlier, Olivetti had been on the brink of collapse and required government funding to survive. Yet in February 1999 Olivetti launched a hostile take-over bid, the biggest in European corporate history, in competition with the German incumbent, Deutsche Telekom, that also had its eye on the weakened Telecom Italia and had already begun preliminary merger talks with the Italian company. In June 1999, Olivetti's bid succeeded, resulting in a deal worth \$34 billion.

### *Olivetti*

Olivetti, now Italy's largest telecoms company, was one of the country's industrial success stories. Founded in 1908 by Camillo Olivetti in Ivrea, to the north-west of Turin, Olivetti was Italy's first typewriter factory. In 1933, Adriano Olivetti, Camillo's son, became head of the company and succeeded in rapidly expanding its activities. Olivetti soon diversified its products into electrical typewriters, calculators, and numerical controls. Under Adriano's leadership Olivetti became in the 1950s one of the European leaders in the field of electro-mechanical office products. Evidence both of Olivetti's strength and its increasing globalisation was the company's acquisition of Underwood in 1959, one of the leading US typewriter manufacturers.

The late 1950s was also the time of one of Olivetti's greatest challenges as the electro-mechanical paradigm gave way to the microelectronics paradigm. Olivetti attempted to adapt to this radical change in its operating environment and in 1959 produced the Elea 9003, Italy's first electronic computer. However, after Adriano Olivetti's death in 1960, the difficulties that the company faced in its attempt to make the technological paradigmatic leap began to surface in the form of a series of financial crises. These crises forced Olivetti to sell its Electronics Division. However, work in the company on electronics continued and in 1965 Olivetti produced its P101, a programmable desktop computer that was a precursor to the Personal Computer. In the 1970s Olivetti poured more of its resources into electronics, efforts that led to a series of serious financial crises by the end of the decade.

In 1978 the Italian financier, Carlo De Benedetti, made a significant investment in the company and took over its management. In 1978 Olivetti produced its first electronic typewriter and in 1982 introduced its first PC, a year after IBM. This period marked an

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<sup>3</sup> *The Economist*, April 24, 1999.

era of accelerated growth for Olivetti as it entered more broadly into the IT products field and also began providing IT services. In 1983 Olivetti made one of its first forays into telecoms with an alliance with AT&T, through its Western Electric subsidiary one of the largest telecoms equipment companies in the US. In order to attempt to enter the European telecoms equipment market, a market still dominated by national champions such as Siemens in Germany and GEC and Plessey in the UK, AT&T established alliances with Philips in the Netherlands and Olivetti in Italy. This experience gave the Italian firm a taste of the telecoms industry that was to witness rapid growth with its adoption of digital switching technologies and with the increasing liberalisation of telecoms services from the latter half of the 1980s.<sup>4</sup>

At the beginning of the 1990s, after a period of increasingly damaging global competition in its main IT products markets, Olivetti made the crucial path-breaking strategic decision to enter the telecoms services market. Together with some global telecoms operators, Olivetti established Omnitel, a mobile operator, that began commercial services at the end of 1995. Also in 1995, following similar strategic thinking, Olivetti established Infostrada, a fixed-line operator. With its new activities in telecoms services leading the way, Olivetti, strongly pressurised by increased competitive pressures in both the Italian and the global IT markets, began a process of costly restructuring.

This restructuring process was led by Roberto Colaninno, who became CEO of Olivetti in September 1996. Colaninno, trained as an accountant, began his career in the car parts industry, rising to become CEO at a company called Fiamm. In 1981, held by a British holding company, Fiamm was bought out through Sogefi, a finance firm in which Carlo De Benedetti was involved. De Benedetti later became Chairman of Olivetti and after he did he recruited Colaninno, who had developed a good reputation in the areas of financial engineering and restructuring, to become the firm's CEO.

In 1997 Colaninno established an alliance with Mannesmann, the German engineering company that, like Olivetti, had made the strategic decision to move out of its existing markets and enter the telecoms market. In the same year, as part of the same restructuring process, Olivetti sold its personal computer division to the Taiwanese firm, Acer and the following year sold its systems and services operation. However, Olivetti retained a presence in office products, specialised systems, and IT services in the Italian market.

### *Olivetti's Bid for Telecom Italia*

Encouraged by his move into telecoms and successful restructuring, Colaninno in February 1999 launched an audacious hostile bid for Telecom Italia. Not only was this the first time that an incumbent telecoms operator from one of the large industrialised countries had been confronted by a hostile predator. This was also the biggest hostile take-over bid in European corporate history. Not surprisingly, Bernabè with the support

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<sup>4</sup> See M. Fransman, *Japan's Computer and Communications Industry*, Oxford University Press, 1995, for a detailed discussion of telecoms switching and liberalisation.

of the board of Telecom Italia decided to resist. For some time already, it later emerged, secret talks had been underway between Telecom Italia and Deutsche Telekom regarding a possible merger. Had the merger been completed, it would have created Europe's largest telecoms company with around 300,000 employees and a market capitalisation at the time of about \$175 billion, although some critics remained skeptical regarding the future prospects for two merged lumbering, bureaucratic giants.

Deutsche Telekom, however, was not to succeed in its role of White Knight. In April 1999 Olivetti made an offer for 5.1 billion Telecom Italia shares at a price of \$12.20 per share. Although this offer was lower than Deutsche Telekom's offer, it was mainly in cash. In May the Olivetti offer was accepted with the deal, valued at \$34 billion, being finalised in June when Olivetti took ownership of 54.96 percent of Telecom Italia's shares.

The deal had important consequences, both within Italy and beyond. In the short term, in order to comply with anti-trust regulations, Olivetti was forced to sell both Omnitel and Infostrada, its mobile and fixed operators respectively, to its ally Mannesmann. (Omnitel, currently Italy's second largest mobile operator, was later acquired by Vodafone after it took over Mannesmann. In 2001, Infostrada merged with Wind, currently Italy's third mobile operator that had been established by Enel, the Italian electricity company, France Telecom and Deutsche Telekom<sup>5</sup>.) Unintentionally, the deal also resulted in the breakup of the Deutsche Telekom-France Telecom alliance and its Global One joint venture, jointly owned with Sprint of the US. The fallout between Deutsche Telekom and France Telecom became inevitable once it emerged that Ron Sommer, CEO of the former company, had entered into secret negotiations with Telecom Italia without informing his supposed ally, Michel Bon of France Telecom. Such opportunistic behaviour, once it became public, prevented a continuation of the alliance.<sup>6</sup>

In the longer term the takeover of Telecom Italia by Olivetti was to have important implications for the structure of the Italian telecoms industry, although this was not apparent at the time. In order to understand the longer term consequences it is necessary to appreciate the way in which the takeover was financially structured.

### *The Financial Structuring of Olivetti's Control*

In order to gain control of Telecom Italia, a company far larger than Olivetti, Colaninno and his advisers established a pyramid of holding companies. This financial structure served the main purpose of allowing Olivetti, and a small group of investors who had been persuaded by Colaninno regarding the merits of the investment, to control Telecom Italia by purchasing only a minority of its shares.

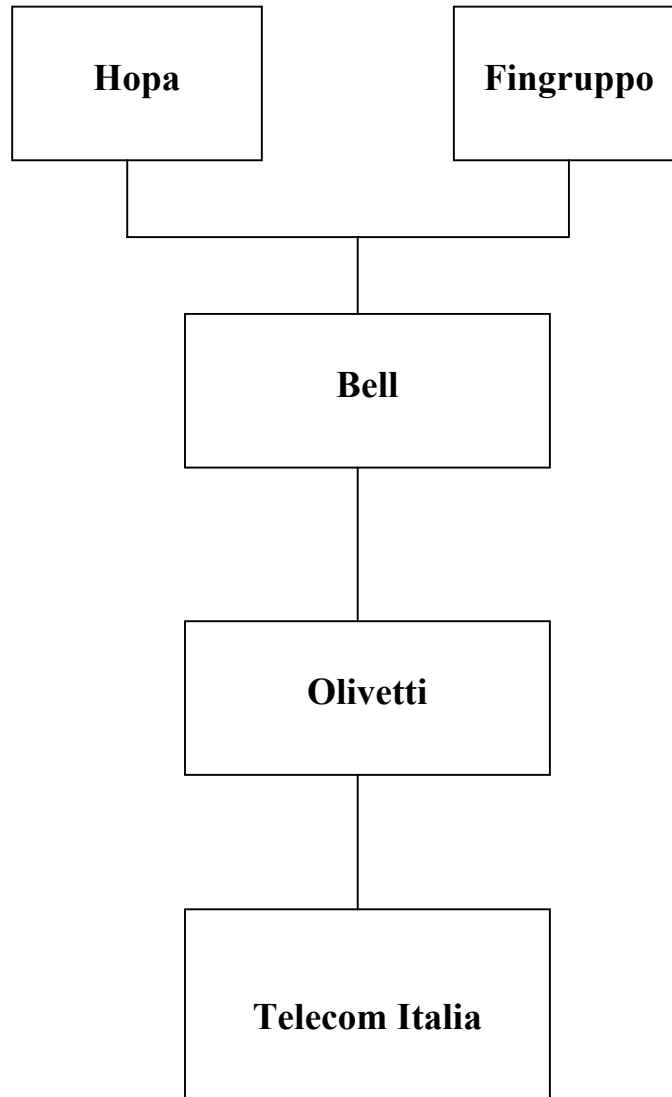
The financial structure of the deal is shown in Exhibit 1.

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<sup>5</sup> See below for further details on the Italian mobile industry.

<sup>6</sup> See the author's papers on Deutsche Telekom and France Telecom for more information on the ramifications of the breakup of the alliance.

**Exhibit 1. The Financial Structuring  
of the Olivetti Takeover of Telecom Italia**



As shown in Exhibit 1, Colaninno and his allies created two investment companies, Hopa and Fingruppo. These two companies owned 55 percent of a third holding company, Bell. In turn, Bell owned 23 percent of Olivetti. Although Bell was a minority shareholder in Olivetti, it was the largest single shareholder that gave it effective control of Olivetti. (Under Italy's Draghi Law that deals with takeovers, a bidder is allowed to acquire less than 30 percent of the equity of a company without having to make a full offer for the remaining shares. This requirement is similar to the takeover law in the UK. The effect was that Colaninno and his associates were able to exercise effective control over Olivetti while holding only a controlling minority share of only 23 percent.) In the final link in what have been referred to as Chinese Boxes,

Olivetti held a 55 percent majority holding in Telecom Italia giving the company full control.

In this way, Colaninno and Olivetti were able to successfully implement their takeover that was to change the face of the Italian telecoms industry with ramifications in other key parts of the European industry. However, to anticipate the rest of our story, the success of this financial structuring left it vulnerable to similar ambitions by outside predators.

### *Telecom Italia Under Colaninno*

How did Telecom Italia, struggling to find a viable role for itself before the Olivetti takeover, fare under Colaninno? The short answer is not very well. In part, the reason is that the financial structure that Colaninno and his advisers carefully constructed created many further problems.

One major problem resulted from attempts to handle the debt that resulted from the Olivetti takeover of Telecom Italia. In total Olivetti took on an additional debt burden of approximately \$16 billion, much of which accumulated in Tecnost, the Olivetti subsidiary that was used as one of the main takeover vehicles. The problem, however, was that most of the free cash flow of the new company existed further down the 'Chinese Boxes', in Telecom Italia and even more so in its mobile subsidiary Telecom Italia Mobile. This raised the difficulty of creating an acceptable mechanism for mobilising the free cash flow in Telecom Italia and Telecom Italia Mobile in order to pay the debts that had accumulated in Tecnost.

The attempt to mobilise this cash, however, ran into a further difficulty that was a direct consequence of Colaninno's attempt at financial engineering. This difficulty emerged because Colaninno's takeover process, and its benefits, incorporated only a minority of Olivetti's and Telecom Italia's shareholders. As already noted in Exhibit 1, Colaninno and his colleagues exercised control over Bell which in turn controlled Olivetti with only 23 percent of its shares. Furthermore, Olivetti controlled Telecom Italia with only 55 percent of the latter's shares. This created the problem of minority shareholders, particularly the non-voting holders of so-called savings shares who did not need to be consulted and partly as a result frequently failed to benefit.

These difficulties soon became apparent. Shortly after he assumed his new post in Telecom Italia, Colaninno came up with a plan aimed at reducing some of Tecnost's debt burden. In essence this involved transferring control of Telecom Italia Mobile (TIM) to Tecnost, thereby allowing it to benefit from TIM's cash flow. (With the rapid uptake of mobile services at the time the mobile sector became the most important generator of both revenue and profit, not only for Telecom Italia but also for all the other incumbent telecoms operators<sup>7</sup>). In return, Telecom Italia's minority shareholders would be offered Tecnost shares, with the price they were to pay being used to reduce the debt.

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<sup>7</sup> For further details see the author's other papers on AT&T, BT, Deutsche Telecom, and France Telecom.

This proposal, however, ran into strong opposition from the minority shareholders who felt that it ran counter to their interests. In this they were supported by some of the quality financial press. For example, *The Economist* called the proposal, judged from a shareholders' perspective, "downright insulting".<sup>8</sup> The *Financial Times* went even further: "If Mr Colaninno does not have the resources to run TI without abusing minorities, he should sell it to someone who does".<sup>9</sup>

Some minority shareholders voted with their feet. For example, IFIL, an Italian investment company closely linked to Fiat<sup>10</sup>, sold its entire stake in Telecom Italia, widely interpreted as a protest at the way minority shareholders were being treated. Moreover, with the recent globalisation of Italian financial markets foreign investment companies were establishing a foothold in Italian equities. For instance, global investors such as Fidelity International and Merrill Lynch were also shareholders in Telecom Italia Mobile. As a result of the pressure, Colaninno was forced to withdraw his financial restructuring proposal. However, at this time Telecom Italia's share price was holding up, benefiting from the favourable light in which telecoms shares were regarded by investors and this helped to dampen criticism of Colaninno.<sup>11</sup>

But Colaninno's luck was not to last. In early 2001, Colaninno came up with another proposal. Telecom Italia's shareholders with non-voting shares were to be offered the opportunity to purchase more expensive voting shares. The premium would allow Olivetti to cut its debt by about a third. Had the \$10 billion deal gone through, this would have reduced Olivetti's share in Telecom Italia to about 40 percent, down from its current 55 percent. However, this proposal was also opposed by activist shareholders who felt that it benefited Olivetti significantly more than Telecom Italia. A more objective measure of the relative benefits was provided by the market price of the non-voting shares relative to that of the ordinary voting shares. Between the privatisation of Telecom Italia in November 1997 and Olivetti's bid for the company in February 1999 the non-voting shares traded on average at a 31 percent discount to the voting shares. However, from the time of Olivetti's bid to February 2001 the discount had widened to 49 percent, implying that the non-voting shares had become relatively less attractive. This led the *Financial Times* to comment that, "Telecom Italia [non-voting] savings shares have traded at distress levels on fears of abuse."<sup>12</sup> Responding to the offer, a group of fifty fund managers, led by the British hedge fund, Liverpool Limited, protested that the proposed terms for the conversion of savings shares were "unacceptable".<sup>13</sup>

Colaninno's misfortunes were compounded by three further events. The first hit Telecom Italia in April 2001 when the Italian antitrust authorities fined the company \$60 million for abuse of its dominant market position. The second occurred in April and May 2001 when two board members of Telecom Italia resigned after alleging that

<sup>8</sup> *The Economist*, October 9<sup>th</sup>, 1999.

<sup>9</sup> *Financial Times*, May 24<sup>th</sup> 2000.

<sup>10</sup> As is shown later, Fiat, controlled by the Agnelli family, was part of a political-financial grouping that opposed Colaninno and his allies.

<sup>11</sup> If there was a silver lining to the storm-cloud Colaninno had created over Olivetti and Telecom Italia it was that, apprehensive of its high level of debt, Telecom Italia was more reticent than its leading European incumbent counterparts in forking out money for expensive third-generation mobile licenses, a reticence that would later reward the company at least in comparative terms.

<sup>12</sup> *Financial Times*, February 6<sup>th</sup>, 2001.

<sup>13</sup> *Financial Times*, February 7<sup>th</sup>, 2001.

Colaninno had misled the board by failing to declare his interests as the company's corporate governance procedures required him to do. The gravity of this claim was enhanced when it was announced at the beginning of July that a Turin magistrate would investigate Colaninno and several board members in connection with possible conflict of interest.

The subject of the allegations was the purchase in 2000 by Telecom Italia's Tin.it, its internet service provider, of Seat Pagine Gialle, an on-line directories company, for Euro 9.5 billion. The problem was that both Colaninno and Emilio Gnutti, a director of Telecom Italia, were shareholders in the investment company, Hopa (the company that was used as a takeover vehicle in Olivetti's takeover of Telecom Italia – see Exhibit 1.) Hopa was involved in the Seat acquisition. Although Colaninno and Gnutti did not directly benefit, Hopa made a capital gain of Euro 129 million from the deal. However, Colaninno and Gnutti failed to inform the Telecom Italia board of their interest in the deal for two board meetings after the deal was announced. It was only at the third meeting, after questions had begun to be asked, that they informed the board of their interest and agreed to abstain from voting.

The third misfortune, not entirely of Colaninno's or Telecom Italia's making, was the company's steadily falling share price. In June 2001 Credit Suisse First Boston predicted that Telecom Italia's net profits would fall by 14 percent to \$1.5 billion during 2001 and the company share price continued to slide.

It is tempting to suggest that Telecom Italia's falling share price was more a reflection of the sentiment in global financial markets that had turned markedly against the telecoms sector, than an indication of the company's own performance. And it certainly is true that by July 2001 the share prices of the leading European incumbent telecoms operators had declined markedly. However, it is also the case that judged over a five-year period, Telecom Italia's share price had fallen by significantly more than its European counterparts. This is evident from Exhibit 2.

**Exhibit 2. The Share-Price of Telecom Italia  
and its European Counterparts,  
five-year change to September 2001**

COMPANY	CHANGE IN SHARE PRICE (%)
<b>BT</b>	-5.85%
<b>Deutsche Telekom</b>	-28.37%
<b>France Telecom</b>	-12.58%
<b>Telecom Italia</b>	-42.53%
Source: Bloomberg.com	

Once again, therefore, as in the period immediately preceding the bids made by Olivetti and Deutsche Telekom, Telecom Italia and its leader found themselves in a vulnerable position. This vulnerability was increased by two further considerations.

The first consideration was that the constellation of political and financial forces in Italy had changed significantly, to the detriment of Colaninno. In 1997 Colaninno had succeeded in winning the support of the centre-left Prime Minister of Italy, Massimo D'Alema, in his takeover battle for Telecom Italia. However, in 2001, a new right-wing Prime Minister had just taken over, Silvio Berlusconi. Furthermore, Enrico Cuccia, the powerful head of the Italian bank Mediobanca, who had supported Colaninno, had just died. Mediobanca had been involved in a conflict with the Agnelli family that controls Fiat. The Agnellis had just managed to outflank Mediobanca and obtain control of the important Italian company, Montedison<sup>14</sup>. The defeat of Colaninno would be a further blow to Mediobanca.<sup>15</sup>

The second consideration that also increased the vulnerability of Colaninno and Olivetti was equally important. Ironically, the very financial structure that Colaninno and his allies had created in order to assert their control over Telecom Italia was susceptible to use by a predator focused on Colaninno and Olivetti as its prey.

### *The Pirelli-Benetton Take-Over*

Just as Olivetti under Colaninno had seen the acquisition of Telecom Italia as an opportunity to diversify into what was perceived as the more profitable market of telecoms services<sup>16</sup> – and out of markets such as IT products – so two other Italian companies perceived the same opportunity. The first was Pirelli.

Like Olivetti, Pirelli had a long history in the Italian industrial sector. The company was founded by a twenty-four year old engineer, Giovanni Battista Pirelli, in 1872. Pirelli & C. was established in Milan as a general rubber goods factory. It was its competencies in rubber processing that shaped the company's evolution. By the end of the Nineteenth Century, Pirelli was manufacturing insulated telegraph wires, submarine telegraph cables, and bicycle tyres. The company's first passenger car tyre was made in 1901. Pirelli also used its competencies to facilitate the process of globalisation of its business. By 1917 it had opened cable factories in Spain, Britain, and Argentina and this international expansion continued through the Second World War and afterwards. Tyres and cables continued to be Pirelli's main business areas. In 1971 Pirelli entered

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<sup>14</sup> The Montedison group gets around 70 percent of its sales from its share in companies that produce sugars and starches, animal feed, oilseed, and olive oil. The group's Edison unit generates and sells electric power and explores for and produces oil and gas.

<sup>15</sup> For further information on this political-financial infighting, see *The Economist*, May 29<sup>th</sup>, 1999 and *Financial Times*, July 31<sup>st</sup> 2001.

<sup>16</sup> As noted earlier, Olivetti had already diversified decisively into telecoms services through its establishment of Omnitel, a mobile operator, and Infostrada, a wireline operator. However, Colaninno saw Telecom Italia as a far bigger and more lucrative fish that still enjoyed monopoly power in parts of the Italian telecoms market. He was therefore willing to sell Omnitel and Infostrada to Mannesmann, the German company also diversifying into telecoms services, in order to raise funds for the acquisition of Telecom Italia and in order to satisfy the regulatory authorities.

into a union with the well-established tyre manufacturer, Dunlop, although this relationship was terminated in 1980.

In 1982 Pirelli began producing optical fibre and optical fibre cables in Italy.<sup>17</sup> With the transition to digital transmissions systems this was to become a lucrative business. Just prior to its decision to try and acquire Telecom Italia in 2001 Pirelli had sold parts of its fibre optics business to Cisco and Corning for a total of \$6 billion that allowed Pirelli to accumulate a cash pile of around Euro 2.5 billion just as the global telecoms industry was in the process of collapsing. It is true to say, therefore, that the competencies that Pirelli had accumulated over the years in cables (including optical fibre) and tyres provided the springboard to its diversification into the competence-unrelated area of telecoms services.

The second company was the Benetton Group, seventy percent owned by the Benetton family. Unlike Olivetti and Pirelli, Benetton was a relatively new Italian company having been established only in 1965 in Ponzano Veneto in Italy. From the beginning the company's main business was the retail selling of clothing, although it later diversified into related areas such as shoes and sporting goods. Prior to June 1986 the company was wholly owned by the Benetton family. From this date, however, the Benetton family, like many other business interests in Italy, decided that access to international capital markets was more important than complete financial control. Accordingly, shares representing about 11 percent of the company were sold in an initial public offering. In June 1989 the group made a public offering on the New York Stock Exchange and in 1994 a global offering was made.

From the late 1980s, however, the Benetton group began to run into difficulties. Franchisers of the group's brand began to suffer as a result of Benetton's relentless expansion, both in Italy and abroad, which brought strong competition. By 2001 the Benetton group operated in 120 countries through 5,000 franchised Benetton stores, department stores, and company-owned and franchised megastores. Furthermore, Benetton found itself challenged by a number of successful new brand-based competitors, such as Gap. The company may also not have been helped by its creative but controversial advertising campaign that, for example, showed in advertisements a nun kissing a priest, a man dying of Aids, and the president of the group naked and asking for his clothes back.

By the end of July 2001, when Pirelli and Benetton made their bid for Telecom Italia, Benetton's shares had dropped to around \$27 from a year high of \$43, implying that the Benetton family had witnessed the value of their 70 percent holding in the group drop by some 40 percent. These conditions, clearly, motivated the search for a more profitable area of business for the family's accumulated fortunes.

### *The Ripeness of the Takeover Fruit*

The Pirelli-Benetton move came at an opportune moment. In effect, the takeover process was surprisingly simple. Colaninno and his colleagues had done the necessary spadework. The Achilles heel of their financial structure was the Bell holding company

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<sup>17</sup> For a detailed history of the invention of optical fiber for telecommunications, see M. Fransman, *Japan's Computer and Communications Industry*, Oxford University Press, 1995.

that (as shown in Exhibit 1) held a controlling 23 percent share in Olivetti, which in turn held 55 percent of Telecom Italia. The main investors in Bell were a small group of Colaninno's allies who had also seen their investment ultimately in Telecom Italia as an attractive opportunity. Unfortunately, however, both for themselves and for Colaninno this turned out not to be the case.

With global sentiment turning markedly against the telecoms sector (as strongly as sentiment had been in favour of this sector until March 2000) Telecom Italia's shares had been performing extremely badly. Olivetti's shares too, the company that formally owned Telecom Italia, had taken a battering. From the time of Olivetti's takeover of Telecom Italia in 1999 to July 2001 Olivetti's shares had fallen by about 20 percent, leaving a group of disgruntled investors in Bell. Colaninno tried to appease them through a major re-organisation of the company (discussed in detail below).

However, this re-organisation, if it were ever to bear fruit, would take time to be effective. But Colaninno's former allies lacked patience. Some of them had financed their investment in Bell through debt that had to be repaid. Others were simply not willing to wait for Colaninno's promised land, particularly since the global environment for telecoms had significantly worsened. Under these conditions, an attractive offer from Marco Tronchetti Provera, the head of Pirelli, and Gilberto Benetton would be too hard to refuse. And attractive the offer certainly was. For their holdings in Bell the investors were offered a premium of 80 percent over the current market price. Faced with such an incentive, the investors deserted their erstwhile ally, Colaninno.

The delight of the investors in Bell, however, was matched by the dismay of the other minority shareholders in both Olivetti and Telecom Italia. The reason was that none of them was entitled to the offer of an 80 percent premium for their shares and they were not consulted. Under Italy's Draghi takeover law (very similar to the corresponding law in the UK) an investor acquiring less than 30 percent of the equity of a company is not legally obliged to make a full offer for all the company's shares. As noted earlier, Colaninno had fully exploited this legal provision in his takeover of Olivetti.

The result, astoundingly, was that Tronchetti Provera and Gilberto Benetton were able to spend a mere Euro 7 billion (\$6.1 billion) in order to acquire control of Telecom Italia, with a market capitalisation at the time of Euro 55 billion. The total market capitalisation of the three companies that they now controlled – the Bell holding investment company, Olivetti, and Telecom Italia – was Euro 113 billion. The *Financial Times* calculated that Pirelli and Benetton acquired control of Telecom Italia with less than 0.5 percent of its equity.<sup>18</sup>

Not surprisingly, the quality financial media had a field-day. According to the *New York Times*, the acquisition of Telecom Italia “was just one more peculiar Italian exercise in capitalism without capital”.<sup>19</sup> *Business Week* saw it as “...a throwback to the opaque governance that dominated corporate Italy for decades...”<sup>20</sup> According to the *Financial Times*, “Roberto Colaninno's reign at Telecom Italia has ended as it began: with abuse of minority shareholders.”<sup>21</sup> Another of the paper's journalists

<sup>18</sup> *Financial Times*, August 2<sup>nd</sup>, 2001.

<sup>19</sup> *New York Times*, August 3<sup>rd</sup>, 2001.

<sup>20</sup> *Business Week*, August 2<sup>nd</sup>, 2001.

<sup>21</sup> *Financial Times*, July 30<sup>th</sup>, 2001.

summed up his view on the matter: “Clearly, old-style European capitalism still works with a vengeance in Italy; the future of companies is decided by a few rich men, not by institutions or by private investors.”<sup>22</sup>

What was more surprising was that although there were protests by some, mainly foreign, institutional investors, no shareholders meeting was called at which the large numbers of disenfranchised shareholders could voice their opposition (as had also been the case with the Colaninno takeover). The reason, some analysts have suggested, is the absence in Italy of large pension funds and insurance companies that in countries such as the US or UK are likely to have exerted coordinated pressure at an early stage to have influenced the outcome (pressure such as was exerted to influence the re-structuring of both AT&T and BT). Tronchetti Provera himself publicly admitted that his financial maneuver would probably not have worked in the UK with its influential pension funds. In Italy, in strong contrast, shareholders are widely dispersed and correspondingly difficult to organise.

Deprived of an effective political voice, however, shareholders expressed their dissatisfaction in other ways. Immediately after the announcement, shares in Pirelli fell by 16 percent and shares in Olivetti by 10 percent. However, shares in Telecom Italia, Telecom Italia Mobile, and Seat-Pagine Gialle (the directories company merged with Tin.it, Telecom Italia’s internet company) rose around 3 to 4 percent in the hope that the changes in ownership might improve the fortunes of the company.

Tronchetti Provera became chairman of Telecom Italia and Gilberto Benetton vice-chairman. Enrico Bondi became CEO of Telecom Italia and chairman of Telecom Italia. (Born into a wealthy Milanese industrial family, Tronchetti Provera, graduate of Milan’s Bocconi University, began work in Camfin, his family’s heating oil transportation business. In 1978 he married Cecilia Pirelli, daughter of Leopoldo Pirelli, the chairman of Pirelli. In 1991 (by which time he had already divorced Cecilia Pirelli) he became managing director in Pirelli in charge of finance and administration and the following year became CEO of the company. This followed a period of crisis in Pirelli after the company had failed in its bid for the more successful German car tire company, Continental. The financial deal was handled by Mediobanca, the Milanese investment bank. In restructuring Pirelli, Tronchetti Provera made the strategic decision to make optical fibre an area of priority. As noted earlier, the sale of some of its investments in this area to Cisco and Corning gave Pirelli some of the finance it needed for the Telecom Italia acquisition.)

### *The Financial Structuring of the Pirelli-Benetton Takeover*

The financial structuring of the Pirelli-Benetton was designed to control the structure that Colaninno had already put in place.

Tronchetti Provera and the Benettons exercise their control through GPI, a holding company in which Pirelli holds 60 percent (through an investment of Euro 100 million) and Edizione Holding, the holding company 70 percent owned by the Benetton family, 40 percent. GPI owns 55 percent of Camfin. (Camfin was originally part of Tronchetti

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<sup>22</sup> *Financial Times*, July 30<sup>th</sup> 2001.

Provera's family's oil business. 3.5 percent of Camfin is owned by Massimo Moratti, whose family also has oil interests and whose sister-in-law, Letizia, is a minister in Berlusconi's centre-right government.) In turn, Camfin owns 29.99 percent of Pirelli & C. which owns 33.4 percent of Pirelli S.p.A, the main Pirelli company that operates its cables and tires businesses. Pirelli S.p.A owns 80 percent of a new company set up by Tronchetti Provera and the Benetton, Olimpia. Olimpia owns 100 percent of Bell. Bell, it will be recalled was established by Colaninno and his allies and it was the latter's defection that allowed the Pirelli-Benetton takeover. Bell, in turn, owns a controlling 23 percent of Olivetti, which owns 55 percent of Telecom Italia.

This financial structure, however, while serving the desired purpose of facilitating control of Olivetti and Telecom Italia with a relatively small investment and only a tiny proportion of the shares of these two companies, is not without serious problems. Of these one of the most serious is the conflict of interest between the indebted investors near the top of the chain and investors in the cash-rich operating companies (such as Telecom Italia and Telecom Italia Mobile) at the bottom. These problems bedeviled Colaninno and are sure to continue troubling Tronchetti Provera and Gilberto Benetton. Adding strain to these conflicts is the continuing slide in the companies' share prices. Between July 28<sup>th</sup>, when the Pirelli-Benetton deal was announced, to September 27<sup>th</sup>, Olivetti's share price fell by 60 percent. This prompted Tronchetti Provera to attempt to negotiate a slightly better (i.e. lower) price with the investors in Bell on the grounds that the value of the acquired assets had fallen so significantly.

The surprise of the terrorist attack in New York on September 11<sup>th</sup> added significantly to the uncertainty facing not only these companies, but all their counterparts in the world economy. How long it will take for these investments to yield adequate returns, if ever they do, is anyone's guess.

## **CORPORATE ORGANISATION**

The last section has focused on the complicated changes in Telecom Italia's ownership structure since the Olivetti takeover in 1999. But while ownership determines the *distribution* of gains made by a company, it is crucial to understand how these gains are generated in the first place. To put the matter more crudely, apart from their financial manipulations, what did the rulers of Telecom Italia do for the company itself? This key question will occupy the remainder of this paper. The first step in answering it will be an examination of the corporate organisational changes that were brought about in Telecom Italia.

### ***Early Indications of the Pirelli-Benetton Approach in Managing Telecom Italia***

In analysing the Pirelli-Benetton takeover of Telecom Italia it seems relatively clear that the prime motive was the acquisition of ownership and control over a set of income-generating assets. There was little indication that Tronchetti Provera and the Benettons made the acquisition in order to implement their own vision of where Telecom Italia should be going if it were to improve its performance. This emerged implicitly when Tronchetti Provera was questioned immediately after the acquisition of Telecom Italia

was announced. Asked about the absence of firm proposals for Telecom Italia in the announcements that he and his colleagues had made, Tronchetti Provera had the following to say:

“I know we would be better off giving details, but I don’t want to make pronouncements we can’t respect, especially when we don’t know the company well.”<sup>23</sup>

This was confirmed almost two months later when, during a presentation to analysts and reporters, Tronchetti Provera outlined strategic goals for Telecom Italia that, according to the *Financial Times*, “did not appear to be strikingly different from previous management”.<sup>24</sup>

Tronchetti Provera said that his “primary goal” for Telecom Italia would be to make the group net cash flow positive as soon as possible. With an existing debt of Euro 17.4 billion, Telecom Italia would sell up to Euro 5 billion worth of assets in the next two years, although he did not make clear what these assets would be. With regard to more specific strategic goals he mentioned only two points. The first was that Telecom Italia would concentrate on developing broadband and ADSL services within Italy that would give faster Internet access. Secondly, Telecom Italia Mobile (TIM) would focus on so-called 2.5 generation mobile technology – namely general packet radio switching (GPRS) – rather than third-generation UMTS technology. Regarding the first strategic goal, Tronchetti Provera was merely following decisions that other European incumbents – such as Deutsche Telekom and France Telecom – had already announced. In spelling out the second goal, however, he was indicating a conservative approach to future mobile services, one that emphasised cost and profitability to a greater extent than being a market leader in offering exciting new services.

It seems clear, therefore, that in the short run at least there will not be any sharp change in organisational or strategic direction for Telecom Italia under its new Pirelli-Benetton ownership. It is therefore necessary to clarify the organisational and strategic changes that were brought about in Telecom Italia in the last year of Colaninno’s leadership. The following section analyses these corporate organisational changes.

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<sup>23</sup> *Financial Times*, August 1<sup>st</sup>, 2001.

<sup>24</sup> *Financial Times*, September 27, 2001.

***Telecom Italia's Organisation in 2000***

Exhibit 4 shows Telecom Italia's corporate organisation as it existed at December 31<sup>st</sup>, 2000.

**Exhibit 4. Telecom Italia's Corporate Organisation,  
December 31<sup>st</sup>, 2000**

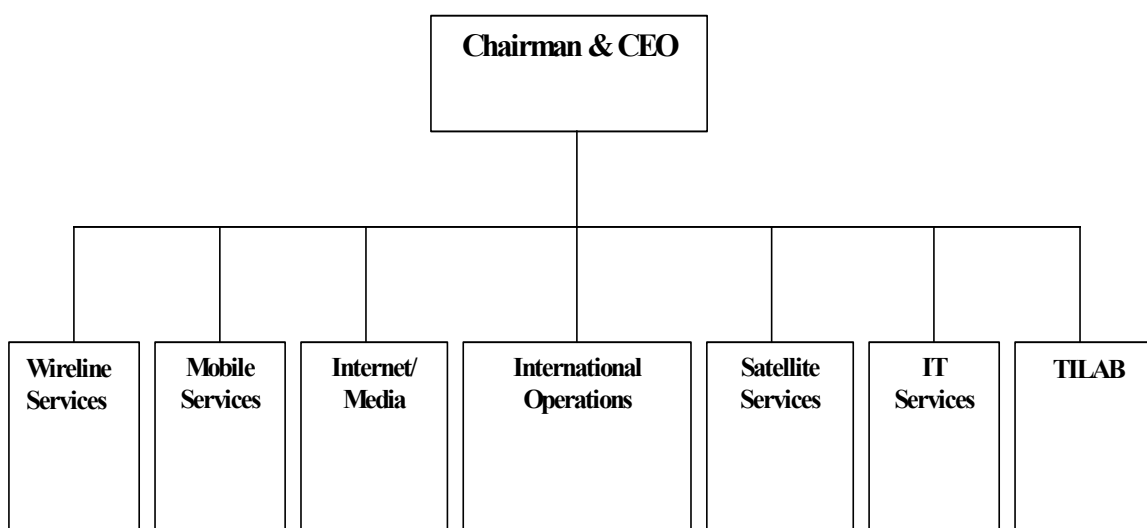
<b>TELECOMS</b>	<b>INFORMATION TECHNOLOGY</b>	<b>INTERNET</b>	<b>OTHER</b>
<ul style="list-style-type: none"> <li>▪ Telecom Italia</li> <li>▪ Telecom Italia Mobile</li> <li>▪ Telespazio (Satellite)</li> <li>▪ STET International, Netherlands</li> <li>▪ STET Mobile Holding</li> <li>▪ TMI – Telemedia International Italia</li> </ul>	<ul style="list-style-type: none"> <li>▪ Finsiel</li> <li>▪ Telesoft</li> <li>▪ Sodalìa</li> <li>▪ Netsiel</li> </ul>	<ul style="list-style-type: none"> <li>▪ Seat Pagine Gialle</li> </ul>	<ul style="list-style-type: none"> <li>▪ Other businesses</li> </ul>
Source: Telecom Italia, Annual Report, 2000, p5			

There were a number of glaring problems with this form of corporate organisation. First, each of the entities did not have sufficient autonomy to provide efficient, incentivised decision-making. Secondly, the fixed-network business was not sufficiently separated from the mobile business. Thirdly, international operations were not clearly distinguished so as to allow for a focus on foreign markets. Finally, there was a confusion between function and market. Specifically, Telecom Italia Mobile was responsible for mobile communications in Italy, but not internationally. Clearly, something had to be done to correct these organisational defects. Moreover, other European incumbents were in the process of streamlining their corporate organisations.<sup>25</sup>

In the latter half of 2000, under Colaninno's leadership, Telecom Italia began the process of corporate re-organisation. The changes in organisational structure that resulted are shown in Exhibit 5.

<sup>25</sup> See my other papers on AT&T, BT, Deutsche Telekom, and France Telecom for the details.

### Exhibit 5. Telecom Italia's Corporate Organisation, 2001



As shown in Exhibit 5, from 2001 under the corporate re-organisation, Telecom Italia has been organised as seven business units under a corporate organisation controlled by the Chairman, Marco Tronchetti Provera, the CEO, Enrico Bondi, and the company's board. According to Telecom Italia's official description, the re-organisation has "led to the creation of [seven] autonomous Business Units, coordinated by a Corporate function with the responsibility for strategy and control."

In the following section the distribution of revenue, operating profit and income, and employment by business unit is analysed.

#### *Distribution of Revenue, Operating Profit and Income, and Employment by Business Unit*

The distribution of Telecom Italia's sales and service revenue, operating profit and income, and employment by business unit is shown in Exhibit 6.

**Exhibit 6. Telecom Italia:  
Distribution of Revenue, Operating Profit and Income, and Employment  
By Business Unit, 4<sup>th</sup> quarter, 2000 (billions of lire)**

<b>BUSINESS UNIT</b>	<b>Sales &amp; Service Revenues (%)</b>	<b>Gross Operating Profit (Loss) (%)</b>	<b>Operating Income (Loss) (%)</b>	<b>Employees (%)</b>
<b>Wireline Services</b>	7,847 (48.1%)	3,399 (53.1%)	1,733 (54.0%)	60,548 (55.4%)
<b>Mobile Services</b>	4,837 (29.6%)	2,287 (35.7%)	1,453 (45.3%)	15,257 (14.0%)
<b>Satellite Services</b>	249 (1.5%)	38 (0.6%)	(51)	1,206 (1.1%)
<b>International Operations</b>	1,827 (11.2%)	517 (8.1%)	68 (2.1%)	11,592 (10.6%)
<b>Internet/Media</b>	137 (0.8%)	(30)	(56)	7,515 (6.9%)
<b>IT Services</b>	1,354 (8.3%)	189 (3.0%)	85 (2.7%)	12,005 (11.0%)
<b>Venture Capital &amp; Innovation</b>	72 (0.4%)	4 (0.06%)	(22)	1,254 (1.2%)
<b>TOTAL</b>	<b>16,323</b>	<b>6,404</b>	<b>3,210</b>	<b>109,377</b>
Source: Telecom Italia Group, First Quarter Report, 2001, p5.				

Several important points about Telecom Italia emerge from Exhibit 6. The first relates to the declining significance of wireline services and, correspondingly, the rising importance of mobile services (a feature common to all the major telecoms operator incumbents – see my other papers on BT, Deutsche Telekom, and France Telecom). Wireline services contributed 48 percent of sales and service revenues, 53 percent of gross operating profit, and 54 percent of operating income. However, while mobile services provided 30 percent of sales and service revenues and 36 percent of gross operating profit, these services provided 45 percent of operating income – almost half. Furthermore, while wireline services employed 56 percent of the total workforce of Telecom Italia, mobile services employed only 14 percent (providing part of the explanation for the relatively high contribution of mobile services to operating income). In short, mobile makes a crucial contribution to Telecom Italia's performance and growth, even though wireline services continue to be a 'cash cow' contributing to the cash flow that is necessary to pay Telecom Italia's large debt.

The second point is the trivial contribution made by the Internet and media. After all, Internet is, together with mobile, one of the growth areas in telecoms. As will be shown in more detail later, in the section on Telecom Italia's Internet activities in its business unit, the takeup of Internet access has been relatively low in Italy compared to other European countries (and, of course, even lower compared to the US). In the last quarter of 2000, Internet/media contributed only 0.8 percent to sales and service revenues and made a gross operating loss and operating income loss. However, this business unit employed a not-insignificant proportion of the company's workforce – 7 percent. Whether this performance may improve in the future is considered in the section dealing with this business unit.

Thirdly, international operations also make a relatively small contribution to operating income. This business unit contributed 11 percent to total sales and service revenues, 8 percent to gross operating profit, but only 2 percent to operating income. However, international operations employed 11 percent of the company's workforce. Clearly, if international operations are to become an important source of growth – as it certainly has become for France Telecom (see my chapter on France Telecom) – then Telecom Italia will have to perform much better in the future in this area.

Fourthly, the story with IT services is similar to that for international operations. IT services accounted for 8 percent of sales and service revenue, but only 3 percent of gross operating profit and 3 percent of operating income. However, this business unit employed 11 percent of the company's total workforce. Like Deutsche Telekom (see my chapter on this company), Telecom Italia is trying to turn IT services into an important business area. However, in the light of these figures one must wonder whether this telecoms company has a competitive advantage compared to the computer and software specialists.

The fifth point deals with satellite services. Mirroring the poor performance of the global satellite companies – such as Iridium, ICO, and Globalstar – that have failed to deliver in competition with land-based mobile operators, this business unit of Telecom Italia's is also failing to deliver. The figures speak for themselves. Satellite services contributed 2 percent to total sales and service revenues, 1 percent to gross operating profit, but made an operating loss. However, this business unit employs 1.1 percent of the company's workforce.

Finally, it is also clear that the Venture Capital and Innovation business unit – formerly the R&D division of Telecom Italia – is not making a good contribution to the company's performance. This business unit's activities are analysed in more detail in a section below. From the exhibit here it is apparent that this business unit contributed only 0.4 percent to total sales and services revenue and 0.06 to gross operating profit. However it too made an operating loss. It employed 1.2 percent of Telecom Italia's total workforce, about the same number as satellite services. However, it must be added that, unlike any of the other business units, the innovation part of this business unit has not conventionally been conceived of as a business making a contribution to profit, but has been seen – as in the other incumbent telecoms operators – as a conventional corporate R&D function contributing indirectly to profit through providing technology inputs to the other business units. The complications surrounding this business unit are taken up later in the section dealing with it.

In the following sections some of Telecom Italia's seven business units are examined in more detail, starting with wireline, mobile and internet services.

## THE BUSINESS UNITS

### *Wireline Services*

This business unit is divided into three areas:

- Phone services (including residential, public and business)
- Data.com (data and web services for business including ADSL)
- Wholesale (responsible for the supply of infrastructures and network services to the commercial units of Telecom Italia and other telecom carriers)

From April 2001 the Wireline Services business also assumed responsibility for international phone and data services and for the development of international networks for wholesale customers.

Interestingly, unlike BT, that has separated wholesale activities in a distinct business and has contemplated spinning it off completely or floating it partially, Telecom Italia has made the organisational decision to keep wholesale as a part of a larger business unit, although as a separately identifiable area.

It is clear that Telecom Italia is facing strong competition in Wireline Services. This is evident from the fact that in the first quarter of 2001 there was a 13 percent decrease in revenue from traffic over a year previously as a result of price reductions and discount policies. A reduction in costs, however, allowed for an improvement in both gross operating profit and operating income.

In July 1999 Infostrada lodged a formal complaint with the Italian Antitrust Authority against Telecom Italia for alleged abuse of its dominant position in the supply of access services using ADSL technology. The case was concluded on April 27<sup>th</sup>, 2001 (indicating how long it takes, and therefore how difficult and costly it is, for new entrants to challenge the dominant incumbent). The result was that the authority ordered Telecom Italia to pay a penalty of Lire 115 billion (about \$60 million). This case also illustrates that while Telecom Italia does face increased competition from some parts of its Wireline Business Unit, it is still able to exercise quasi-monopoly power in other areas. The Italian regulator has since obliged Telecom Italia to offer a wholesale plan to other carriers wanting to access the company's ADSL local networks.

### *Mobile Services – Telecom Italia Mobile (TIM)*

In contrast to the Wireline business unit, in the first quarter of 2001 the Mobile business unit increased revenue by 6.5 percent, gross operating profit by 13.5 percent, and operating income by 19.4 percent over the same quarter one year earlier. In part this is

a reflection of the lower intensity of competitive pressure in mobile compared to many parts of the wireline market in Italy (see below).

*The European Mobile Market*

The European mobile market is shown in Exhibit 7.

**Exhibit 7. European Mobile Market, April 2000**

<b>COUNTRY</b>	<b>POPULATION (millions)</b>	<b>USERS (millions)</b>	<b>PENETRATION (%)</b>	<b>MARKET SHARE IN EUROPE</b>
<b>Italy</b>	57.8	30.7	53.1%	18.9%
<b>UK</b>	57.8	25.15	43.5%	15.4%
<b>Germany</b>	81.3	24.5	30.1%	15.0%
<b>France</b>	57.3	21.8	38.0%	13.4%
Source: DanCell Consult ApS, Denmark				

Exhibit 7 shows several things about the European mobile market for the four largest European countries. The first is that Italy had by far the highest mobile penetration rate amongst the four countries. (Scandinavia, which had the highest penetration rates in the world, is left out of this exhibit.) In Italy the rate was 53 percent. The next country, the UK, had a penetration rate of 44 percent. Secondly, Italy's share of the European market was 19 percent, compared to about 15 percent for the UK and Germany and 13 percent for France. Thirdly, Germany, with a population of 81 million compared to about 58 million for the other three countries (that have a remarkably similar population) had a lower absolute number of users than Italy and the UK. One reason for the relatively high penetration of mobile users in Italy may be the relatively poor quality of the wireline network and services that prevailed when mobile services were introduced.

*The Italian Mobile Market*

The Italian mobile market and the four competitors are shown in Exhibit 8.

**Exhibit 8. The Italian Mobile Market, April 2001 (April 2000)**

<b>COMPANY</b>	<b>CUSTOMERS (millions)</b>	<b>MARKET SHARE</b>
<b>TIM</b>	20.7 (18.4)	48% (60%)
<b>Omnitel</b>	14.9 (10.9)	34.6% (36%)
<b>Wind</b>	6.5 (1.5)	15% (4%)
<b>Blu</b>	1 (-)	2.4% (-)
<b>TOTAL</b>	43.1 (30.7)	(100%)
Source: DanCell Consult ApS, Denmark		

Two points emerge from Exhibit 8. First, TIM is the overwhelmingly dominant player in the Italian mobile market. Even though its market share decreased from 60 percent to 48 percent, it still has a far higher share than the second company, Omnitel with 35 percent. Secondly, the reason for the decline in the market share of TIM and Omnitel is the late entry of the third and fourth competitors, Wind and Blu, as is discussed in more detail below. By April 2001 market penetration in Italy as a whole had increased to 74 percent from 53 percent one year earlier.

*Telecom Italia Mobile (TIM)*

Background

Telecom Italia Mobile was established in 1994 by Sip, the Italian monopolist incumbent. The following year it became TIM. In 1997 TIM had its initial public offering with Telecom Italia left owning 52 percent of the company. In the latter half of 2000, under the corporate reorganisation discussed earlier, TIM became one of the seven business units of Telecom Italia.

As of February 28, 2001 the Italian Treasury owned 3.46 percent of Telecom Italia, which implies a small holding in TIM. The declared intention, however, was to eliminate the Italian government's holding in Telecom Italia completely. Formally, TIM is an autonomous business unit within Telecom Italia with the latter retaining authority for overall strategy (within which TIM is supposed to formulate its own, consistent, strategy) and financial control. In practice, however, as a senior TIM

executive made clear to me, the Chairman and CEO of Telecom Italia – that is, Tronchetti Provera and Gilberto Benetton – have de facto control over TIM.<sup>26</sup>

TIM was the first GSM operator in the world to begin operations. It is the second-largest Italian company in terms of market capitalisation, Fiat being the largest. TIM is the only one of the four mobile operators to have been partly floated. A large number of Italians bought shares in TIM.

### Strategy

In an interview with the author, Mauro Sentinelli, the managing director of TIM (who has retained this position after the Pirelli-Benetton takeover, and who is de facto in charge of the company's day-to-day activities), expressed his own personal views on the future of the European mobile industry and TIM's role in it. The following is a summary of some of the main issues that emerged from the discussion.<sup>27</sup>

In Sentinelli's view, the global mobile communications industry operates under essential bandwidth constraints. These constraints follow from the given fact that spectrum is limited. This limitation is a physical fact even though technological advance (e.g. bandwidth compression techniques) can to some extent increase the capacity of existing spectrum. The constraints are fundamentally different in the case of optical fibre networks. These networks can be replicated in a way that spectrum cannot (and, of course, technological advance can also increase the carrying capacity of existing optical fibres e.g. through DWDM techniques that send multiple signals operating at different coloured wavelengths through the same fibre). From this it is possible to conclude that mobile communications will always remain 'narrowband' while optical fibre is inherently 'broadband' in the sense that the total amount of bandwidth is constrained in the former case but essentially unconstrained in the latter case.

For Sentinelli a number of important consequences follow from this given starting point. Perhaps the most important implication is that the mobile industry will never be able to completely substitute for, and replace, the fixed optical-fibre based industry. Rather the two are fundamentally complementary, even though to some extent they are also at the same time substitutable. (For example, in some cases a person will have a choice regarding whether to use a mobile phone or a fixed phone to make a voice call or send data, thus making mobile and fixed networks substitutable.)

From this it follows that the mobile industry will continue to occupy a niche in the general field of communications. That niche will largely be determined by the unique characteristics of mobile communications that cannot be substituted by fixed communications. Specifically, the mobile industry offers two unique characteristics: the

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<sup>26</sup> Interestingly, he expressed the view that even with a the largest minority holding, Telecom Italia would still retain the same degree of control. Of course, as made clear earlier, Olivetti and then Pirelli and Benetton have exerted their control over Telecom Italia on the basis of a controlling minority shareholding.

<sup>27</sup> This summary includes the author's interpretation of Mr Sentinelli's views as well as an independent elaboration on some of the implications. For this reason it would be wrong to interpret these ideas as strictly reflecting Mr Sentinelli's thinking.

ability to be mobile, and the ability to be located.<sup>28</sup> It is these two unique characteristics that determine the limits or boundaries of the ‘mobile niche’ in the ‘communications space’.

Since bandwidth will always necessarily be more plentiful and therefore cheaper in optical fibre networks relative to mobile networks, it follows that there will be a tendency for ‘bandwidth-hungry’ content and applications to be distributed via the former networks. The main exception is when the unique characteristics of mobile communications – mobility and ‘locatability’ – are a necessary part of the bundle of characteristics that the consumer is buying. For example, the consumer who needs to see a video clip while on the move may need to use a mobile network rather than a fixed network, even though the latter is intrinsically more suitable for handling bandwidth-hungry applications.

This implies that both mobile and fixed networks will continue to occupy their own niches in the communications space. The same is true of their services and also the equipment that they use. Regarding their associated consumer appliances, mobile phones, PDAs (personal digital assistants), laptops, and desktops will all similarly occupy their specialist evolutionary niches, with bandwidth requirements generally increasing as we go up this list.

There are a number of further implications that follow from this. Given the complementarity of mobile and fixed networks (even though, as we have already noted, they are also to some extent substitutable), the question is raised regarding whether it is preferable to organise these two kinds of networks, and their complementarity and substitutability, within the same company, or whether they should be organised in separate companies with some combination of mechanisms for the separate companies to coordinate the networks and their services.

To make this general issue more specific, some companies are ‘specialist mobile plays’ while others integrate internally mobile and fixed networks (and perhaps even other kinds of networks too). Vodafone, the largest mobile operator in the world, is the best example of a specialist mobile play (although it also needs some fixed network capacity in its overall network). Other telecoms companies are in the process of moving in the same direction. Examples are mmO2 (formerly BT Wireless) that has been spun off from BT and therefore has become a specialist mobile play. The story is similar with AT&T Wireless. However, in other cases, all of which are of former monopoly incumbents, mobile networks and services are being integrated with fixed networks and services internally, i.e. within the same company. Examples are Telecom Italia, NTT (with DoCoMo), Deutsche Telekom (with T-Mobile), and France Telecom (with Orange). Which form of organisation is more efficient – specialisation in mobile versus mobile-fixed integration within the same company – remains to be seen, although it is possible to deduce theoretical arguments supporting each alternative.

Sentinelli’s views on the relative importance of distribution and content are perhaps more controversial. In his view, it is distribution rather than content that will generate revenue and profitability growth for mobile operators. Content, he feels, will not be profitable, even though content may be necessary to attract the users and therefore

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<sup>28</sup> There is also a further characteristic that is also an important constraint, namely the necessarily small size of the mobile appliance’s display, the trade-off for small size, light weight, and mobility.

generate the demand for distribution. The Internet has demonstrated clearly that it is very difficult and with very few exceptions (e.g. football games) to make content pay. DoCoMo's i-mode illustrates the same point. Only a tiny fraction of profit comes from content itself, the bulk coming from distribution. This implies that portals are likely to be important from a financial point of view only to the extent that they generate a demand for network distribution. It also implies that stand-alone portals that are seen as profit centres and have to buy their network services are unlikely to be profitable.<sup>29</sup>

If Sentinelli is correct, a number of businesses will be in trouble. These include Vizzavi, the multi-access portal owned by Vodafone and Vivendi, and T-Motion, the portal based in London owned by Deutsche Telekom's T-Mobile and T-Online. Sentinelli's thinking is in line with the recent announcement by BT Online, BT's Internet business, that it will concentrate on broadband access provision, leaving content to specialist providers.

How will TIM be able to compete with Vodafone? Not only is Vodafone the largest mobile operator both in Europe and the world, it also owns Omnitel, the second largest mobile operator in Italy. If, as Vodafone claims, its scale and the global extent of its operations translate into increased competitiveness, then surely TIM will face serious difficulties.

Sentinelli, not surprisingly, disagrees. Two of the competitive advantages that Vodafone claims it possesses according to Sentinelli are non-existent. Vodafone argues that since it owns mobile networks in many countries in Europe and in the world it has the advantage of end-to-end control. This will allow it to provide services more cheaply and of higher quality since it will not have to pay expensive roaming charges to other operators and quality will be better since its own engineers and operators will have end-to-end control.

Sentinelli, however, claims to have evidence that this argument is incorrect. In Europe Vodafone began offering a one-price tariff that allowed customers to call anywhere in Europe for the same price. However, "when we found out about this I phoned some of my European friends and we agreed that we would offer a similar service through cooperation. So one week after Vodafone's service was launched we began the same thing, except our price was slightly lower. Some large firms in Italy were furious with Vodafone who had incorrectly given the impression that only they could offer this kind of service."

The second advantage that has sometimes been claimed by Vodafone is the Europe-wide content that its joint-venture portal, Vizzavi, offers. (Vizzavi aims to have both Europe-wide content as well as country-specific content where necessary. The ability to offer Europe-wide content, it is argued, is extremely attractive for service, content and application developers since it would give them access to a far larger market. Companies such as TIM, France Telecom's Orange, and Deutsche Telekom's T-Mobile,

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<sup>29</sup> It is interesting to compare the views on content of Dr Keiji Tachikawa, president of DoCoMo. According to an article in the *Financial Times*, Dr Tachikawa "said European operators did not yet understand the right business model for data services. 'It is important to figure out how to develop attractive content and convince content providers to do so. Western [operators] still don't understand that very well,' he said." (September 27<sup>th</sup>, 2001.)

it is suggested, are not able to offer Europe-wide content because they operate in few countries compared to Vodafone.)

In Sentinelli's view, however, all content will be country-specific, eliminating this as a potential source of competitiveness for Vodafone. He gives as evidence the very different appearance of the different portals in different countries, not only in terms of language, but also culture-bound design.

As is implicitly clear from this discussion, TIM's strategy is to find its mobile niche in the communications space and, through cooperation with the other Telecom Italia business units, realise the synergies that follow from complementarity. The overall aim of the game is to generate as much revenue and profit as possible from distribution. A further goal is to replicate this business model in other parts of Europe and in Latin America. TIM's interests in these areas are discussed in the following sub-section.

#### TIM's Main European and Latin American Interests

By the end of 2000, TIM's foreign lines were greater in absolute number than its Italian lines. The ratio of foreign to Italian lines was 108:100.<sup>30</sup> TIM's European and Latin American interests, containing all its foreign interests, are shown in Exhibits 9 and 10 respectively. Of TIM's total foreign interests by line at the end of 2000, 79 percent were in Europe while 21 percent were in Latin America.

#### **Exhibit 9. TIM's European Interests<sup>31</sup>, December 2000**

<b>COMPANY</b>	<b>COUNTRY</b>	<b>% OWNED BY TIM</b>
<b>Mobikom</b>	Austria	25.0%
<b>Radiomobil</b>	Czech Republic	5.9%
<b>Bouygues Telecom</b>	France	10.8%
<b>Stet Hellas</b>	Greece	58.1%
<b>Auna</b>	Spain	7.2%
<b>IS-TIM</b>	Turkey	49.0%
Source: Telecom Italia, Annual Report 2000, p.47		

<sup>30</sup> Telecom Italia, Annual Report 2000, p.49. It is not clear from this source, however, whether the data on which this ratio is based adjusts for TIM's proportional ownership of the foreign mobile companies. One assumes it does.

<sup>31</sup> Note that some of Telecom Italia's mobile interests are held directly by Telecom Italia and not through TIM. Exhibits 9 and 10 refer only to TIM's direct foreign mobile assets. Where foreign mobile assets are owned directly by Telecom Italia, they are recorded under the International Operations business unit. However, the latter are not very significant. For further details, see Telecom Italia, Annual Report, 2000 and 2001.

**Exhibit 10. TIM's Latin American Interests**

<b>COMPANY</b>	<b>COUNTRY</b>	<b>%OWNED BY TIM</b>
<b>Maxitel</b>	Brazil	90.0%
<b>Tele Celular Sul</b>	Brazil	51.8%
<b>Tele Nordeste Celular</b>	Brazil	51.8%
<b>Tim Peru</b>	Peru	100%
<b>Digitel</b>	Venezuela	56.6%
Source: Telecom Italia, Annual Report 2000, p.47		

As shown in Exhibit 9, TIM has a majority holding in only one company, in Greece, although it also has a 49 percent holding in Turkey. TIM is not well represented in the three largest and wealthiest European countries. In France it has an 11 percent holding in Bouygues Telecom but no holdings at all in Germany and the UK. In Spain TIM has a 7 percent holding while of the smaller, wealthier European countries TIM is represented only in Austria with a 25 holding.

In Latin America, as Exhibit 10 shows, TIM has made its major commitment in Brazil with majority holdings in three regional companies. TIM also has majority stakes in Peru and Venezuela.

As was seen in Exhibit 6, the International Operations business unit contributed 11 percent to TIM's revenue and 2 percent to its operating income. But since the company now has more lines overseas than it does in Italy, this contribution is likely to rise in the future becoming an important source of growth for TIM.

### TIM's Competitors

In Exhibit 8, the market share of the four Italian mobile companies is shown. In this subsection more details are given of the startup and ownership of TIM's three competitors. A summary of these details is provided in Exhibit 11.

**Exhibit 11. TIM's Competitors**

<b>COMPANY</b>	<b>ESTABLISHMENT DATE</b>	<b>ORIGINAL INVESTORS</b>
<b>Omnitel</b>	<b>June 1990</b>	<b>Olivetti, Bell Atlantic International, Cellular Communication International, Telia International, Lehman Brothers</b>
<b>Wind</b>	<b>December 1997</b>	<b>Enel, France Telecom, Deutsche Telekom</b>
<b>Blu</b>	<b>May 2000</b>	<b>Autostrada, BT, Benetton</b>

As can be seen from Exhibit 8, Omnitel is the second-largest mobile operator in terms of market share after TIM. As noted earlier, Olivetti, the main shareholder in Omnitel, had to sell the company when it acquired Telecom Italia. Omnitel was sold to Mannesmann which, in turn, was acquired by Vodafone. Omnitel, therefore, is currently owned by Vodafone.

Wind began operations in December 1997 as a joint venture of Enel, the Italian electricity company, France Telecom and Deutsche Telekom. In July 2000, after Deutsche Telekom was beaten by Olivetti in its bid for Telecom Italia (its secret dealings causing a fundamental split with its former ally, France Telecom), Deutsche Telekom pulled out of the Wind joint venture with France Telecom taking over its share. In May 2001, Wind acquired Infostrada, a fixed-network company originally set up in 1995 by Olivetti, but also sold to Mannesmann in June 1999 after Olivetti's acquisition of Telecom Italia. In April 2000, Infostrada was acquired by Vodafone.

The acquisition of Infostrada makes Wind an integrated mobile-fixed-internet company. In October 1998 Infostrada acquired Italia On Line (IOL), not linked with AOL, which was one of Italy's most successful portals. In 1999 Infostrada launched Libero, a highly successful free internet access service (similar to Freeserve in the UK, eventually acquired by France Telecom's Wanadoo internet subsidiary).

Blu is the most recent of the four Italian mobile operators, beginning commercial operations only in May 2000. Autostrade, the Italian motorways company, is the main shareholder with a 32 percent stake, while BT was the main technology provider (until BT sold its stake as part of its restructuring and debt reduction programme). The Benetton family owned 7 percent of Blu which it had to sell following the Pirelli-Benetton acquisition of Telecom Italia. Blu is by far the weakest of the four operators, largely as a result of the uncertainty caused by the withdrawal of BT and Benetton.

### Italy's 3G Mobile Licenses<sup>32</sup>

A major event that took place in Italian mobile telecoms was the allocation of third-generation licenses in 2000. This event, that will shape the future of the Italian mobile telecoms industry, was fraught with conflict and political intrigue. In this subsection the 3G license issue will be briefly summarised.

The first problem that faced the Italian government was whether to opt for an auction or a 'beauty contest' as the mechanism for allocating the 3G licenses. While many thought, like the British and Germans, that an auction was a preferable mechanism<sup>33</sup>, there was a serious downside problem. This was the Italian fear that foreign companies would, in general, be able to pay more than Italian companies for the licenses and would therefore take over the Italian mobile industry.

After long and heated conflict and debate it was eventually decided that a hybrid process would be adopted involving two stages. In the first stage applicants would be selected on the basis of their reliability and quality of their business plan. In effect, this would give the Italian authorities a significant degree of political control over the outcome. In the second stage an auction would be held similar in structure to that organised in the UK. The Italian authorities were also motivated by the significant sums that 3G auctions had raised in both Britain and Germany.

There were six companies that entered the auction process in October 2000. They and their major investors are shown in Exhibit 12.

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<sup>32</sup> This subsection makes use of excellent research assistance from Andrea Gallice.

<sup>33</sup> For more details on the pros and cons of auctions, see M. Fransman and other related articles in <http://www.TelecomVisions.com>

**Exhibit 12. The Six Companies Entering the  
Italian 3G Mobile Auction, October 2000**

<b>COMPANY</b>	<b>MAJOR SHAREHOLDERS (%)</b>
<b>TIM</b>	<b>Telecom Italia (60.1%)</b>
<b>Omnitel</b>	<b>Vodafone (100%)</b>
<b>Wind</b>	<b>Enel (73.4%), France Telecom (26.6%)</b>
<b>Blu</b>	<b>Autostrade (32%), BT (20%), Distacom (9%), Edizione (9%), Mediaset (9%)</b>
<b>Iipse 2000</b>	<b>Telefonica (45.6%), Sonera (12.6%), Atlanet (12%), Banca di Roma (10%)</b>
<b>Andala (now H3G)</b>	<b>Hutchison Whampoa (51%), Tiscali (25.5%), Cir (15%)</b>

The Italian auction began on Thursday, October 19<sup>th</sup> 2000 at 2 p.m. However, it began in an atmosphere of uncertainty and disquiet. The reason was that it became known that there were tensions within the Blu camp. The reason was that BT, the main technological provider to the consortium, some time previously had agreed informally with its partners to increase its share of the jointly owned company to 51 percent. The other shareholders, including Autostrade with the largest minority holding of 32 percent, wanted to decrease their holding in the company. However, BT had since run into severe financial problems, partly as a result of falling profitability in its core long-distance and international businesses and partly the result of its indebtedness following the price it paid for its 3G auctioned licenses in Britain and Germany. As a result BT wanted, not only to limit its commitments, but in many cases outside Britain, to actually reduce them.<sup>34</sup>

Just two hours before the beginning of the auction, however, Blu confirmed, to the delight of the Italian authorities, its participation in the auction. Since there were six bidders for a total of five licenses it was essential that all six companies participate. Blu stayed in the auction until the tenth round on the second day. It then, on Saturday afternoon, officially requested a suspension of the competition (which, according to the rules, it was entitled to do). The suspension was accepted until 9:30 a.m. on the following Monday, giving Blu a weekend to try and resolve its internal difficulties.

However, at 9:30 a.m. Blu announced that it was withdrawing from the auction. The Italian authorities had no option but to stop the auction and award the five licenses to the five remaining bidders. However, this did not stop the controversy. Clearly, the remaining five bidders were the great winners, getting their licenses for far less than everyone had anticipated in the light of the previous British and German auctions. The

<sup>34</sup> See my paper on BT for a more detailed account of the Blu affair.

Italian government and taxpayers generally were dismayed, since the return to the government from license fees was far less than expected. Some argued that Blu had been involved in collusion with some or all of the other bidders. There was talk of a court case against Blu for its alleged collusion. In the event, however, an administrative court decided that Blu could not be punished because it had respected the rules of the auction. BT subsequently pulled out of Blu as part of its global restructuring in order to reduce its high level of indebtedness. To add to the ironies, by the end of 2001 there was a clear consensus, in the light of the bursting of the global telecoms financial bubble, that European companies had overpaid for their 3G licenses. Indeed, in Finland the incumbent Sonera returned its 3G license to its government without any charge!

### TIM's Cooperation with DoCoMo

TIM announced on January 18<sup>th</sup> 2001 that it had entered into a joint venture with KPN Mobil N.V. and NTT DoCoMo to provide mobile Internet services across Europe. The intention, initially, was to offer games, exchange of messages and images, and a number of Internet-based transactions in Italy, Germany, the Netherlands, and Belgium. The handsets used would be combined i-mode/WAP handsets. On January 29 2001, TIM signed a protocol agreement with DoCoMo and Sony Computer Entertainment Inc. to jointly develop a mobile Internet service.

### *Internet-Media*

As shown in Exhibit 5, Internet/Media is one of Telecom Italia's seven business units. In Exhibit 6, however, it can be seen that this business unit in the last quarter of 2000 contributed only 0.8 percent to revenue. Furthermore, it made both a gross operating loss and an operating income loss.

It is worth noting that the Internet has been relatively weak in Italy as a whole. In 2000 only 9.2 percent of the Italian population had access to the Internet, compared to an average of 17 percent for Europe as a whole.

Not surprisingly, Telecom Italia has made it a priority to strengthen its position in the Internet area which is one of the fastest-growing telecoms market segments. In February 2000, Telecom Italia announced that it had reached agreement for an eventual incorporation of Seat Pagine Gialle (Seat Yellow Pages), a popular Internet portal and directory (in which Telecom Italia already had an 11 percent holding). Accordingly, on November 15<sup>th</sup> 2000, Tin.it, Telecom Italia's Internet business, was incorporated into Seat Pagine Gialle, creating Italy's leading Internet service provider. In addition, according to Telecom Italia's First Quarter Report, 2001, "the Seat group oversees the whole chain of value in the sector of the media, extending its activities to publishing, information and television."<sup>35</sup>

It may be, however, that politics will influence the outcome of Seat's involvement in television. During the takeover of Telecom Italia by Pirelli and Benetton, Tronchetti

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<sup>35</sup> P. 20.

Provera indicated that, in order to avoid conflict with Prime Minister Berlusconi's television interests, he may be willing for Seat to drop its entry into television, an entry that Berlusconi's media interests had vigorously opposed. (Seat had bought an Italian television company – Telemontecarlo - with a view to challenging Rai and Mediaset, two key parts of the Berlusconi media empire. However, partly because of the opposition, the Seat television company was not performing very well on the stockmarket.)

### *Telecom Italia's Portals*

TIM has its own portal ([www.i-tim.it](http://www.i-tim.it)). Interestingly, however, it is not integrated with Seat's portal, VirgilioTin ([www.vtin.virgilio.it](http://www.vtin.virgilio.it)). For example, there are no cross-links between these two portals. (Seat acquired Virgilio, a successful Italian portal that was also the most used Italian search engine.) The lack of integration of the two portals seems to be an indication of the autonomy of Telecom Italia's mobile and internet business units, but it may also be an indication of the absence of cooperation and coordination between these businesses even when this may be in their collective best interest.

### **TILAB**

TILAB is one of Telecom Italia's seven business units. Telecom Italia defines TILAB's activities as 'venture capital and innovation'. According to Telecom Italia's annual report, TILAB "is responsible for both identifying, managing and making the best possible use of new initiatives in the sector of Information & Communications Technology (ICT) and for coordinating the research, development and innovation projects of the Telecom Italia Group."<sup>36</sup>

It is clear that TILAB is but one example of a far wider trend that is affecting all the R&D-performing telecoms incumbent operators in Western countries.<sup>37</sup> In view of the importance of this trend, personal interviews were held with some of TILAB's leaders. The rest of this section contains a summary of these discussions.

The trend referred to stems from the great pressure that is being put on the R&D function in the R&D-performing incumbents to contribute to the profit generated by the company as a whole. As I have analysed elsewhere<sup>38</sup>, the incumbents' profits have been eroded by strong competition, most particularly in the area of fixed long-distance and international voice and data. The downturn in profitability, often aggravated by increasing indebtedness, has created enormous pressure within these companies to restore profitability. The R&D function has not escaped this pressure. Although not traditionally regarded as a business or a profit centre, but rather regarded as a key support function whose contribution to the company's businesses has been in the form of inputs to innovation, in the past R&D laboratories have tended to be largely funded from corporate as opposed to business sources. In companies such as Telecom Italia, BT and AT&T this model for R&D has now been abandoned.

<sup>36</sup> Telecom Italia, First Quarter Report, 2001, p.24.

<sup>37</sup> See my studies of AT&T, BT, Deutsche Telekom, and France Telecom.

<sup>38</sup> See M. Fransman (forthcoming).

Telecom Italia's response to this pressure has involved the following. First, TILAB has been established as a separate business unit and profit centre that, as noted, combines the functions of technology support, technology commercialisation, and venture capital. It is the addition of venture capital to the conventional functions of R&D and the addition of an enhanced role in actively commercialising the outputs from R&D that Telecom Italia claims constitutes its distinctiveness. This claim to distinctiveness is highlighted in one of TILAB's overheads shown in Exhibit 13.

### **Exhibit 13. How We Differentiate Ourselves**

<ul style="list-style-type: none"><li>▪ Capital</li><li>▪ Strategic consultancy</li><li>▪ Technology support</li><li>▪ Marketing support</li><li>▪ Roll-out support</li><li>▪ Go-to market support</li></ul>
Source: TILAB 2001

It is significant that of the six areas identified in Exhibit 13 as constituting the total field of TILAB's responsibility, only one is a traditional R&D function, namely technology support. The first two areas – capital and strategic consultancy – TILAB sees as being the 'traditional VC's [ie venture capitalist's] focus'. The last three areas clearly go beyond the traditional R&D function into what might be called the 'commercialisation of R&D'. Hitherto, these three functions were the sole responsibility of the relevant businesses of the incumbent and were areas that the R&D people did not venture into.

Exhibit 14 shows the national and global extent of TLAB's R&D activities.

#### Exhibit 14. TILAB's National and Global Activities

##### TELECOM ITALIA: TILAB

TITLE	LOCATION	FUNCTION
<b>Turin</b>	Turin	▪ R&D Laboratories
<b>Technology Innovation Centres</b>	Turin, Rome, Naples, Sicily	▪ Technology labs supporting research and entrepreneurship
<b>Market Innovation Centres</b>	Turin, Rome, Venice San Francisco	▪ Economic analyses of technology and market innovation, scenario building and socialisation
<b>Consumer Lab</b>	Rome	▪ Marketing support with product testing services and consumer innovative services
<b>San Francisco</b>	San Francisco	▪ Scout for innovation & hi-tech companies (Silicon Valley)
<b>New York</b>	New York	▪ Scout for innovation & hi-tech companies (Boston/Route 128) ▪ USA Fund Office

In searching for a new role, TILAB's discussions included the desirability of going outside Telecom in the search for innovations and innovative companies. These discussions then raised the issue of whether Telecom Italia could benefit by also taking a venture capital stake in the companies located. Telecom Italia already had a venture capital unit, but its activities were not integrated with those of the R&D laboratories. It was eventually decided that the activities of R&D and innovation and venture capital were complementary and could be integrated into a separate business unit – hence TLAB that officially began in March 2001. Although BT's Brightstar also has responsibility for spinning-off companies emerging from its R&D, this is confined to non-core areas. TLAB, in contrast, will also spin-off companies in core areas. Furthermore, TLAB will also be proactive in locating potential innovative companies outside Telecom Italia.

As part of these activities, on April 26, 2001 TILAB and Ramius Capital Group, an American management company, set up Saturn Venture Partners. This joint venture is a US registered venture capital fund that will manage \$280 million. Other investors in the venture include TIM, Olivetti, Hopa and Mediobanca. The fund, based in New York, will invest mainly in the US in the technological and telecoms sector.

The current CEO of TILAB is Andrea Granelli born in 1960. Granelli's background is atypical of the classical R&D background which in the incumbent R&D laboratories has traditionally involved university research in science or engineering followed by research in the incumbent's central R&D laboratories followed by a career in the management of R&D. Although Granelli did research at the CNR, the Italian national research council, in the areas of IT and Biotech, he then joined McKinsey, the consultancy company, in 1989. In 1995 he joined Video On Line, the first Italian ISP, as general manager. In July 1996 he joined Telecom Italia as sales and marketing manager for Tin (Telecom Italia's ISP). In 1998 he became CEO of Tin.it. In February 2001 he became CEO of TILAB.

### *Comments*

The profitability pressures that have motivated TILAB to move in the direction it has – attempting to combine venture capital and the commercialisation of R&D with the traditional function of providing R&D support for the company's businesses – are understandable. However, this is not to say that the move in this direction is necessarily desirable or profitable.

Several questions may be raised. The first is whether it is possible for TILAB to simultaneously achieve these three objectives: traditional R&D support for the other business units (e.g. TIM which does not have its own R&D labs); commercialisation of the company's R&D; and venture capital business. At the very least it must be asked whether there is not a trade-off between these three objectives. For example, in order to achieve the second and third objectives will TILAB not be sacrificing some of its traditional activity of providing R&D support to the other business units? And if there is a tradeoff, does the gain from objectives two and three outweigh the loss of achievement under objective one?

Secondly, what reason is there to believe that Telecom Italia in general and TILAB in particular have much to offer in the area of venture capital? This is itself a specialised business area requiring specialist competencies. Telecom Italia's competencies, and TILAB's traditional telecoms incumbent R&D competencies, may not be particularly relevant in the area of venture capital.

However, while these two sets of questions do seem relevant, it remains to be seen how successful TILABs will be.

## **REGULATION AND TELECOM ITALIA'S WHOLESALE AND RETAIL BUSINESSES**

Regulation of Telecom Italia and the Italian telecoms industry is governed by Italian Law No. 249/1997, that instituted the Regulatory Body of the Communications Authority, and by Presidential Decree No. 318/1997, that implemented directives at the level of the European Union. As with the other member countries of the European Union, there are continuing tensions between the role of the National Regulatory Authority and the regulatory role of the various parts of the Brussels bureaucracy.

Of particular interest is the question of the relationship between Telecom Italia's wholesale and retail businesses. This relationship is of interest precisely because Telecom Italia retains de facto monopoly control over many parts of its wholesale telecoms network. As with many of the other European incumbents, Telecom Italia has frequently been accused of abusing its de facto monopoly power. These accusations have involved, for example, issues of interconnection charges and access to the Telecom Italia controlled local loop.

As was shown in the discussion on the Wireline Services business unit, 'wholesale' is one of three areas under the control of this unit. Although Telecom Italia may have considered the question internally, there has been little discussion in the public domain regarding the wisdom of separating the wholesale network as a distinct business unit. The European incumbent where this option has been most vocally and most publicly debated is BT. For some time, as part of its restructuring in 2001, BT discussed the possibility of separating its wholesale network, which had already been restructured as a distinct business unit. The suggestion was that this business unit, called Netco, could be either wholly or partially floated. Indeed, this discussion stimulated two groups to make offers for BT's wholesale network. The first was Earth Lease, a consortium led by the US finance group, Babcock and Brown. Its bid was for BT's local network. The second group, WestLB, a German bank, was interested in buying all of BT's network assets. In September 2001, however, BT announced that it had abandoned plans to sell-off its wholesale network. The apparent reason was that the financial pressure on BT had been reduced by its recent record-breaking special rights issue. This implies that, financial pressure aside, BT saw little intrinsic merit in the separation.

Interestingly, also in September 2001, although a little earlier than the BT announcement, it was stated in the media that Italy's telecoms ministry was considering plans to separate Telecom Italia's wholesale network from the rest of the company. The separated 'netco' company would be open to outside investors.<sup>39</sup> Whether these plans will be taken further, especially in the light of BT's reconsideration of the wholesale issue, is not clear at the time of writing.

## **THE FUTURE OF TELECOM ITALIA**

Telecom Italia is of particular interest since so far it is the only one of the large European incumbents to be acquired by private sector companies. It is true that the

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<sup>39</sup> *Financial Times*, September 18<sup>th</sup>, 2001.

acquisition processes – involving first Olivetti and then Pirelli-Benetton – have been very much influenced by Italian institutions. This was a major theme of the present paper. However, the tendency to regard the incumbent telecoms operators, or even parts of them, merely as financial assets about which decisions should be made in precisely the same way as any financial asset, represents a significant change from the times when telcos were regarded as government owned or sponsored utility providers. The bids for parts of BT's wholesale network from financial consortia, discussed in the previous section, are indications of the same trend. How far this trend will eventually go and what the outcome will be in terms of the reshaping of the European telecoms operator incumbents remains to be seen.

As for Telecom Italia, it is clear from this paper that its recent past has been shaped by takeover battles. This has left the company with a potentially unstable financial structure. This structure has not satisfied many minority shareholders and, as Tronchetti Provera and Gilberto Benetton clearly showed, leaves Telecom Italia vulnerable to a similar takeover in the future. The extent to which Telecom Italia's managers have had their attention and resources diverted from the 'business of telecoms' towards the 'battles of financial markets', and the cost thereof, can only be wondered at.