CASE STUDY

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RINGING THE CHANGES

With slow growth in its core European market, mobile phone giant Vodafone must focus its attention on emerging countries and new data services.

Arun Sarin reclined in his seat in a first-class compartment en route to London. The CEO of Vodafone, the world's largest mobile telephone operator, reflected on the events of the past few days, in particular Vodafone's decision to sell its struggling Japanese business to Tokyo-based Softbank in a deal valued at £8.9bn, and its promise to distribute £6bn to shareholders. Vodafone had trailed behind NTT DoCoMo and KDDI since its entry into Japan in 2001 and the underperforming unit had been weighing on the group's share price. The time had come to make a hard decision, and Sarin had made it.

It was not the first time he had been faced with such a decision. Vodafone had made headlines two years earlier with its failed attempt to take over US mobile operator, AT&T Wireless. Vodafone lost the bid to American rival Cingular Wireless, which offered £22bn in cash for AT&T Wireless – some £2bn more than Vodafone reportedly offered. At the time, Sarin had not been sure whether to regret the failed takeover. He could easily have financed a larger sum for the bid, but shareholders had been explicit that anything beyond an offer of £20bn would be detrimental. Sarin knew he could not afford to alienate Vodafone's shareholders by pursuing growth at all costs.

Being CEO was definitely not an easy job, especially with the shadow of his larger-than-life predecessor Sir Christopher Gent looming over him. But this was exactly why Sarin was being paid £1.2m a year as base salary.

Overview of the Vodafone Group

Vodafone is the leading mobile phone operator in the world. It has more than 160 million customers in 26 countries. It employs approximately 67,000 people globally and is headquartered in Newbury, England. It boasts a market capitalisation of £89bn, making it the 11th most valuable company in the world. Originally founded in 1984 as Racal Telecom Limited, by 1987 it managed the largest mobile phone network in the world. It became an independent company in 1991 under the name Vodafone. The accession of Christopher Gent as CEO in 1997 saw the shifting of Vodafone's strategy from organic growth to aggressive external growth, orchestrating its move towards globalisation. The contested 1999 takeover of Mannesmann doubled Vodafone's customer base and made it one of the ten largest companies in the world in terms of market capitalisation.

Vodafone experienced a phase of consolidation and restructuring in 2002, with a reported 82.9 million customers for the financial year ending March 31, 2001. The company grew at a somewhat slower pace than in previous years, partly through internal growth, partly by acquisitions (acquiring Ireland's Eircell, for example, and increasing its stake in Spanish AirTel Movil). However, "slower growth" still meant that Vodafone had added approximately 20 million customers by the end of 2002. Arun Sarin took over as Vodafone's CEO on July 20, 2003.

Growth at Vodafone

Vodafone had a track record of successful takeovers, Mannesmann being the most prominent example. At times, Vodafone had acquired other businesses along with the mobile phone business, as in the case of Japan Telecom and Mannesmann, where it took over the ownership of fixed-line operations. However, Vodafone had always been very explicit in its concentration on its core business of mobile telecommunications and it would usually start looking for potential buyers for the non-core businesses soon after the takeover. Vodafone balanced its investment options by taking its time to ensure a good investment and disinvestment option. For example, it sold Japan Telecom's fixed-line operations in 2003 for £1.4bn.

Since mid-2001, Vodafone had entered into arrangements with other network operators in countries where it did not hold any equity stake. Under the terms of so-called "Partner Network Agreements", Vodafone co-operated with its counterparts in the development and marketing of global services under dual brand logos. By 2003, Vodafone had extended its reach into 11 other countries, thus establishing a first foothold in these markets. These agreements were win-win situations: Vodafone gained new market insight with little risk and, at the same time, was able to assess the quality of the partner in order to identify possible takeover targets, while the partner benefited from Vodafone's unique marketing and technological capabilities.

Branding, identity and pricing

Once a successful bid for a takeover target had been concluded, Vodafone followed a flexible strategy in terms of branding, corporate identity and pricing models. "Which model we adopt depends on a number of factors and considerations, such as the strength of the local brand, the prevalent company culture and the general fit between Vodafone's processes and the acquired business processes," explained Alan Harper, Vodafone's group strategy and integration director. "But frankly, at the end of the day, it comes down to a question of management judgement." That judgement hinged on the customer response of the market, and the organisational response of the acquired company. The national brand was usually kept alive for some time until the dust of the takeover battle had settled. Vodafone then carefully launched its phased re-branding campaign to bring the new subsidiary under the Vodafone umbrella, usually adding "Vodafone" to the original corporate brand. Later, the original national name was eliminated completely and only the global brand and logo remained. This process could take more than two years and usually passed almost unnoticed by the customers.

Vodafone launched its first truly global communications campaign at the beginning of August 2001 to reinforce brand awareness. A homogeneous corporate brand and identity was communicated across all media, including the slogan, "How are you?" and the inverted comma as its logo. The group also selected two globally recognised brands: it sponsored the Manchester United Football Club and the Ferrari Formula One team to improve awareness and perception of the brand.

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Vodafone never used low prices to attract new customers. Instead, it focused on creating and marketing new value-added services that enticed customers to sign up with Vodafone, even if it implied paying slightly higher rates. However, Vodafone was not immune to the pricing policies of its competitors, which meant that it lowered its tariffs whenever the price differential became too great and the new subscriber market share dropped below a critical level.

Integrating to one Vodafone

Vodafone realised that real business integration extends far beyond having a single brand. Critics had pointed out that establishing a global brand and logo is among the easier tasks of managing a multinational corporation. After the heady days of Gent and acquisitions by the dozen, Sarin had to find innovative ways to integrate what strategy director Alan Harper called "a disparate group of national operations" into one company. Sarin recognised that winning over the hearts of the employees and achieving cultural alignment was perhaps the biggest challenge of all.

To co-ordinate, restructure and integrate its varied systems across 26 countries, Vodafone launched its "One Vodafone" initiative that aimed to boost annual pre-tax operating profit by £2.5bn by 2008.

Despite integration efforts, corporate headquarters had to ensure a certain level of independence for individual country subsidiaries to take into account differing business models and customer expectations. For example, 48 per cent of Vodafone's customers in Germany had a contract, while this kind of long-term commitment to an operator was almost unheard of in Italy, where 92 per cent were prepaid customers.

A further issue concerned how customers could derive benefit from Vodafone's increasingly global reach, ultimately driving top-line growth. Vodafone started creating service offerings and product packages with this in mind: it created a tariff option, for example, that enabled customers to move seamlessly around the globe on a special per-minute rate, on the same network, without having to worry about high interconnection fees or differing technical standards. Such a global service offering could clearly serve as a differentiating factor to competitors that could not match Vodafone's global footprint.

Challenges ahead

Despite these developments, Sarin knew that many challenges lay ahead. Vodafone was the largest player in the industry, but vast untapped markets lay ahead, with today's mobile phone market of about 1.7 billion customers projected to grow to 2.5 billion in just five years. Vodafone had no presence in Latin America or the Middle East but it was making inroads in other growth markets. It made a series of acquisitions during 2005, in Romania, the Czech Republic, India and South Africa, culminating in the £2.6bn purchase of Telsim, a Turkish mobile operator.

However, significant business risks lurked in all markets and Sarin was well aware of them. The introduction of 3G, which had a promising start in Germany with good sales of mobile connect cards, might shift the focus of the whole industry away from networks to content. Sarin knew that most of the growth would have to come from new data services.

At the beginning of 2006, Sarin took some tough decisions. He faced up to slowing growth in his core market by unveiling an impairment charge of £23–8bn. He exited the Japanese market, and announced his decision to split Vodafone into three new units, covering Europe, emerging markets and new business opportunities – an attempt to exploit changes in market and customer trends. He also managed to tighten his grip on the company, putting down a boardroom revolt that had questioned his leadership. He not only won a public expression of support from Lord Ian MacLaurin, the company's chairman, but he also forced out Sir Christopher Gent, the honorary life president and former chief executive.

Sarin knew that Vodafone would need to concentrate on sales in emerging countries, reduce costs in more mature European markets and seek to be more innovative to improve growth. It was now up to him to shape Vodafone's future.

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IN MY OPINION

Surprises are characteristic of the mobile phone market. Consider the astonishing popularity of SMS messaging, for example, or the frustrating technical glitches with 3G. The latest surprise has been the surge of new subscribers in emerging markets such as India, China, Russia, Brazil and Africa. Global shipments of mobile phones are expected to reach the watershed number of one billion this year if the rate of sales in emerging markets continues. This should be good news for mobile phone operators such as Vodafone – but it also presents a variety of challenges.

As many of the key European markets approach saturation, ARPU (average revenue per user) has replaced subscriber numbers as the most important way of judging the success of a mobile phone firm. Vodafone must pay attention to slow or sinking APRU figures in its traditional core markets (Britain, Germany, Italy). A key area of focus for Vodafone's Europe region will therefore be cost reduction and revenue stimulation, reflecting a more mature mobile marketplace.

Rival telecoms operators are responding to this particular challenge by integrating their fixed and mobile networks, offering special deals to customers who buy both services together. Vodafone's "mobile-only" approach may leave it dangerously isolated. Voice revenues could also be undermined as cheap voice-over-internet technologies, such as Skype, spread from fixed to mobile networks. This might force Vodafone to move from its "pure mobile" strategy to a "converged services" model that includes fixed-line services such as broadband internet access and television.

Vodafone has reacted to growth markets in three ways: by exiting from low-profitability acquisitions such as Japan; by making acquisitions in selected growth markets such as India, the Czech Republic and Romania; and by partnering – a clever move to build brand presence without acquisitions. But growth markets include economies such as Indonesia, Russia, Latin America and Africa – areas that Vodafone has, so far, been reluctant to penetrate.

The growth drivers in emerging markets are cheap handsets and basic mobile services. Vodafone, however, has focused its efforts on developing packaged services to sophisticated markets. A two-tiered approach with careful timing is needed.

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