

Thomas Hazlett: For whom the Ma Bell...

By Thomas Hazlett

Published: December 6 2005 23:03 | Last updated: December 9 2005 17:57

The controversial 1960s comic Lenny Bruce reputedly once puffed “communism is a drag, man - it’s like one big telephone company.” Decades later, the collapse of the Iron Curtain suggested that the phone company had outlived its totalitarian counterpart. But with the close of trading last month, the remnants of American Telephone & Telegraph were laid to rest in that shared dustbin of history, and virtually no one shed a tear for her passing.

Ma Bell’s new owners at SBC paid \$16bn to scavenge her corporate parts, salvaging the famous AT&T name, its ticker symbol, “T”, and its logo, which it has slightly touched up. But the financial record cannot be airbrushed: \$100 invested in Ma Bell in January 1970 was worth \$626 at check-out. After-inflation the return was \$113, just 13 per cent of the \$846 real gain on \$100 invested in the S&P 500.

Any one company constitutes a risky bet, even if it is 120 years old, the most widely held issue in the US (owned by 3.2m investors in 1984) and a venerable member of the Dow Jones Industrial Index.

But the curiosity is that AT&T held the crown jewels of the US telecommunications sector. Through the era of microchips, personal computers, cable TV, wireless phones, satellite communications, e-commerce and the Internet, that sector has experienced explosive growth. Occupying the eye of this storm of innovative enterprise was Ma Bell, a prima donna that – protected by regulators and dominant over the ‘central nervous system of the U.S. economy’ - dictated terms and conditions, and made every phone a rented black one for a half century.

In the mid-1990s, conventional wisdom held that AT&T had deftly side-stepped the gales of creative destruction. Shedding its local phone operations to the Baby Bells, the 1984 antitrust divestiture let Ma Bell keep its long distance lines and gave it freedom to maneuver.

Released from regulations applied to ‘natural monopoly’ local loops, it could offer a wide range of information services and fashion a plethora of new networks. Shrewd investors pitied the local phone companies mandated to provide plain old telephone service and barred from entering a host of exciting new markets.

AT&T breathed its freedom in spasms of expansion and contraction. In 1991, it dived into computers with the \$7.4bn purchase of NCR. The merger flopped and NCR was spun off in 1996 – just as Bell Laboratories was divested (as Lucent) in an IPO. In 1994,

however, AT&T acquired a nationwide cellular network, paying \$11.5bn for Craig McCaw's Cellular One. In 1998 and 1999, AT&T bought the first and third largest US cable systems (TCI and MediaOne) shelling out about \$92bn. Share price soared to over \$300 in early 2000, fifteen times its final closing price.

Having acquired every network in sight, AT&T proceeded to sell about everything it owned. It spun-off wireless with a 2001 IPO. The following year it unloaded its cable systems to Comcast for \$53.5bn, a painful write-down. The sales bolstered AT&T's balance sheet, slimming debt. Yet they also left the former behemoth heavily dependent on long distance revenues.

Just as 'long distance' was becoming a quaint term. Wireless carriers were offering 'digital one rate' plans, delivering calls cross-country for free, while business customers played rival wide area networks (including the fraudulent, then bankrupt and then 'reorganised' WorldCom) against each other to obtain steep discounts.

The Baby Bells' entry into long distance, following state-by-state edicts in 1999-2003, intensified the price implosion, and the arrival of mass market voice-over-internet sealed the verdict: once a user has network access, global distance is gratis. The market AT&T dominated – and that generated \$108bn in 1999 – had vanished.

Behemoths scramble like drunks at last-call. A key rationale for AT&T's acquisition spree was to branch out into local telephony, piggybacking voice service on cable TV conduits. But, having flipped its cable holdings, it then sought to resell Baby Bells' 'last mile' connections where wholesale rates were set by regulators. As state commissions lowered these rates in 2002 and 2003, AT&T quickly grabbed five million residential lines. But when federal courts threw out these rules in March 2004, the regime collapsed. AT&T hastily abandoned consumer markets (for local and long distance) altogether.

The \$16bn paid for AT&T's scrap assets constitutes just one-seventh the enterprise value of the former SBC, one of four surviving Baby Bells. Being at the centre of the burgeoning 'information economy' did not, alas, make for easy windfalls and the dizzying strategic spin moves will be grist for business school case studies for semesters to come.

Today, entrepreneurs, investors, and network operators around the globe yearn to learn from the AT&T experience. They will find four simple bewares: (a) of high-priced acquisitions; (b) of cheap credit; (c) of market boundaries defined by history; (d) of business models scripted by regulators.

And this essential warning: being in the right place at the right time may yet prove insufficient to fend off the centripetal forces of modern capitalism, which can thrust dominant economic players into competitive oblivion in less than one generation's time.