PROFILE OF TELECOM ITALIA S.p.A.
(TELECOM ITALIA)

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INTRODUCTION

Telecom Italia is one of the world's largest fixed telecommunications operators, with approximately 27 million subscriber fixed lines installed (including ISDN equivalent lines). Through its subsidiary TIM, Telecom Italia is also the largest mobile telecommunications operator in Italy and one of the largest in the world, with around 45 million mobile customers (which includes 28.3 million equity customers). In Italy TIM is the sole provider of analogue mobile telecommunications services, one of four operators with the right to provide GSM digital mobile telecommunications services and, as at June 15, 2001, one of four operators with the right to provide DCS 1800 digital mobile telecommunications services. TIM is one of five companies which have acquired a UMTS licence to provide third generation mobile services in Italy.[1]

While Telecom Italia is undoubtedly one of the key global telecom operators, however, it stands out from the world's other former monopoly telecom companies due to its arcane ownership structure. Despite being a publicly quoted company it has been controlled since 1998 by an intricate network of holding companies. In 2001 there was a significant realignment amongst these companies, which resulted in a new management and a new ownership structure for Telecom Italia. In the midst of this corporate upheaval the bulk of the company's shareholders, including around 1.5 million Italian retail investors, have found themselves powerless to alter the strategic direction of the company in which they chose to invest. This discrepancy between ownership and control at Telecom Italia raises a number of interesting issues in the area of corporate governance.

ORIGINS AND DEVELOPMENT

Privatisation

Telecom Italia was created in August 1994 as the single public telecommunications service provider in Italy through the merger of five telecommunications companies (satellite, maritime, long distance, domestic and intercontinental operators). On July 18, 1997, the old Telecom Italia was merged with and into STET — Società Finanziaria Telefonica — per Azioni ('STET'), its parent holding company, with STET as the surviving corporation. At the date of the merger, STET changed its name to Telecom Italia. The new company entered the world stage combining the resources and functions of a holding company with those of the group's main operating company.[2]

In November 1997, the Italian Treasury completed the privatisation of Telecom Italia, selling substantially all of its stake in the company through a global offering (comprising of an Italian public offering and an international and US public offering) and a private sale to a stable group of shareholders. In Italy the privatisation in 1997 of Telecom Italia was popularly known as the 'mother of privatisations' and attracted 1.5 million private investors.

[1] Telecom Italia, SEC Form 20F, 2000
[2] Telecom Italia, SEC Form 20F, 2000

The Post-Privatisation Period

The newly privatised company was quickly beset by intense corporate infighting. As *The European* commented a year into the privatisation in 1998, "Company strategy has repeatedly taken second place to the battle of egos".[3] A similar picture was painted by *The Economist* which stated that, "As Italy gets through governments, so Telecom Italia gets through managers".[4]

The main architect of the privatisation was the Chairman, Guido Rossi. He did not, however, stay on board for long, resigning in 1998 after a dispute with his CEO, Tomaso Tommasi, over their respective responsibilities. According to the *Financial Times* the boardroom dispute centred around Rossi's attempt to introduce Anglo-Saxon corporate governance rules into the company, an attempt resisted by many of his fellow management including Tommasi.[5] Rossi was also said to have been frustrated at the company's inability to shake off the influence of the country's politicians who for decades had regarded Telecom Italia as an integral part of Italy's intricate web of political favours and influence. Alluding to the continuing importance of the politicians in Telecom Italia, *The European* stated that finding Rossi's successor would be as much "a political issue" as "a business decision".[6]

The new Chairman was Gian Mario Rossignolo who had formerly been Chairman of Zanussi. He dealt with the corporate governance difficulties that had beset his predecessor by scrapping the CEO position and turning himself into "a powerful executive chairman".[7] His brash style led to his popular nickname of 'John Wayne'. Rossignolo's tenure with the company proved just as short, however, and he quickly resigned when the leaking of the company's less than impressive financial results to the press undermined the stock price. In October 1998 that price was 19% below the offer price paid by retail investors in Italy. Commenting after the departure of Rossignolo, *The European* stated that, "Telecom Italia's first year of life as a privatised company has been a public relations disaster…".[8]

Next in line was Franco Bernabe, a former economics professor who had transformed the Italian oil company, ENI, from a struggling ex-state-run conglomerate into the world's seventh-biggest oil operator. In contrast to his brash predecessor, Bernabe was described as "a reserved, even socially awkward manager…".[9] Only six months after taking up the top post, however, he was forced into the limelight as he attempted to defend the company against the advances of unwelcome suitor, Olivetti.

In addition to the frequent personnel changes at the top of the company Telecom Italia's early years as a private company were also marred by a variety of strategic and operational difficulties. An extensive project to wire up Italy with fibre optic lines, known as Project Socrates, was abandoned. Ambitious deals with the likes of AT&T and Cable and Wireless, which would have allowed Telecom Italia to break

[3] *The European*, June 22, 1998
[4] *The Economist*, 17 October 1998
[5] *Financial Times*, 28 November, 1997
[6] *The European*, 4 December, 1997
[7] *The European*, 22 June, 1998
[8] *The European*, 23 November, 1998
[9] *Business Week*, 3 May, 1999

out of its limited domestic market, came to nothing. At the company's first Annual Meeting Telecom Italia suffered the humiliation of an abstention by institutional investors during the formal vote to accept its 1997 accounts.

Clearly, then, the newly privatised company got off to a rather shaky start. The business press forced the point home with *The Economist* commenting 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".[10]

Business Week was equally unimpressed describing Telecom Italia as "a lumbering mastodon" of a company, ripe for take-over.[11]

THE OLIVETTI TAKE-OVER

If, at the time of Telecom Italia's privatisation in 1997, a likely take-over candidate had been selected, Olivetti would not have featured at the top of the list. Olivetti was less than a seventh of the size of its target. Only 18 months previously it had itself been on the brink of collapse and had needed government support to stay afloat. A company in transition, it had moved out of the typewriter business into personal computers before embracing telecoms. In the process it had lost around three-quarters of its staff.[12]

Roberto Colaninno

Much of the credit for the turn-around at Olivetti was given to the CEO, Roberto Colaninno. Trained as an accountant, Colaninno began his career in the car parts industry, rising to become CEO at Fiamm, which formed part of a British holding group. In 1981 he was involved in the buy-out of Fiamm through Sogefi, a finance firm in which Carlos de Benedetti was involved. Benedetti later went on to become Chairman of Olivetti and in September 1996 recruited Colaninno as the company's new CEO.

Colaninno arrived at Olivetti with a reputation for being able to release value in companies through financial engineering and restructuring. Soon after arriving at his new post he moved Olivetti away from personal computers and continued the shift in the company towards telephony, in particular mobile telephony. Colaninno was also seen as politically astute and succeeded in slicing apart Olivetti (putting an end to Italy's domestic computer industry in the process) despite strong opposition from trade unionists and politicians. His political skills and connections were to prove useful in winning over the then Italian Prime Minister, Massimo D'Alema, during the take-over struggle for Telecom Italia.[13]

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[10] *The Economist*, 24 April, 1999
[11] *Business Week*, 7 June, 1999
[12] *The Economist*, 27 February, 1999
[13] *The Economist*, 29 May, 1999

The Take-over Battle

Olivetti launched a hostile bid for Telecom Italia in February 1999. At the time it represented the biggest hostile take-over bid in European corporate history and was the first such take-over in Italy. Telecom Italia resisted the offer, although its defence strategy got off to a bad start with an EGM called by Bernabe failing to attract the required quorum of shareholders. Clearly Telecom Italia was in no shape to fend off the attacker single-handed and needed the services of a 'white knight'. This took the form of Deutsche Telekom (DT) who, it emerged, had been in preliminary merger talks with the Italians even before Olivetti's intervention. BT was also tipped as a likely partner for Telecom Italia around this time with the British company seen as under-represented in the Italian market.[14] In April the Telecom Italia Board backed a share-swapping merger with DT which valued the group at a higher level than the Olivetti offer (although in shares rather than cash).

Few commentators saw the coming together of two ex-monopolies as good for either the companies' shareholders or the future of the European telecoms industry. It was widely seen as a defensive alliance and as a step backwards for European telecom companies. Had the deal gone ahead it would have created an immense company with a market capitalisation of around $175 billion and 300,000 employees. As for the corporate governance angle, *The Economist* stated that, "This deal has every likelihood of destroying shareholder value".[15] *Business Week* also saw the deal in terms of shareholders' interests, commenting that, "…behind the highly charged emotions, this corporate battle is about creating value for shareholders".[16] From this perspective the ambitious and entrepreneurial Olivetti quickly took on the image of the shareholders' champion.

Not all commentators were convinced, however. *The Banker* cast doubt upon this perception pointing to the position of Telecom Italia's savings shareholders who were not included in the Olivetti offer.[17] The people holding these shares, it suggested, could end up as minority shareholders with no say in a company ultimately run by a tiny holding operation in Luxembourg.

In April Olivetti made a tender offer for 5.1 billion Telecom Italia shares at a price of $12.20 a share. While this was lower than DT's offer it was mainly in cash. This bid was ultimately successful, going through in May, with the deal being valued at $34 billion. With all the votes counted it transpired that approximately 52% of Telecom Italia's shareholders had voted for the deal giving Olivetti control at virtually the minimum cost possible. A greater level of acceptance on the part of Telecom Italia shareholders would have forced Olivetti further into debt. As at June 16, 2001 Olivetti owned 54.96% of Telecom Italia shares.[18]

[14] *The Economist*, 17 October, 1998
[15] *The Economist*, 24 April, 1999
[16] *Business Week*, 26 April, 1999
[17] *The Banker*, May 1999
[18] Telecom Italia, SEC Form 20F, 2000

The take-over deal was structured through a pyramid of holding companies, known as 'Chinese boxes'. This highly leveraged ownership structure allows a small group of investors to exercise control over much larger outfits. Colaninno and his allies invested in two investment companies, Hopa and Fingruppo, which owned a third holding company, Bell. In turn Bell controlled Olivetti (with a minority stake). The actual take-over vehicle in the Telecom Italia deal was a company called Tecnost. Hence the ownership structure was complex and multi-layered – what the FT described as a "ramshackle alliance of entrepreneurial investors".[19]

Predictably the bid for Telecom Italia was surrounded by controversy. Despite claiming that Olivetti had no 'significant' stake in the target company, Colaninno then sold a holding of 0.5% (around $200 million) of Telecom Italia's shares, depressing the price and making the Olivetti offer look more attractive. Commenting after the take-over battle was won, *The Banker* stated that, "One deal more than others has demonstrated the deficiencies of Europe's fledging takeover laws – and that is the Olivetti/Telecom Italia affair."[20]. The same publication later went on to emphasise that far from being good for shareholders the Olivetti deal had left those investors with minority holdings in a precarious position. In conclusion it stated that, "This was a giant leap for a man (Olivetti boss Roberto Colaninno) but one small step backwards for investor relations".[21]

Telecom Italia Under Colaninno

While Olivetti's take-over of Telecom Italia was generally seen as an impressive display of corporate skill, there was a widespread consensus that running the company would prove more difficult than buying it. Peter Cohen (one of the Olivetti team most identified with its original move into mobile telephony), stated soon after the take-over that, "This thing, Telecom Italia, is an overwhelmingly monstrous undertaking".[22] And so it proved.

First of all Colaninno had to deal with a chain of ownership which had been effective in gaining control but which dictated against effective management. As the FT explained it:

> "The complex structure Olivetti put in place to acquire TI has left it with an almighty headache. The cash flow is in TI and its subsidiaries, while the debt is in Olivetti and Tecnost…" [23]

In total Olivetti had taken on around $16 billion of extra debt most of which was shouldered by the Tecnost subsidiary.

In addition to the problems surrounding Telecom Italia's new capital structure there were doubts raised about Colaninno's abilities as a telecoms manager. *The Economist* questioned his understanding of the telecoms industry pointing out that it had been Colaninno's predecessor at Olivetti who had been responsible for setting up the highly

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[19] *Financial Times*, 31 July, 2001
[20] *The Banker*, May 1999
[21] *The Banker*, December 1999
[22] Quoted in *Business Week*, 7 June, 1999
[23] *Financial Times*, 20 January, 2000

successful Omnitel Pronto.[24] In order to raise finance for the Telecom Italia deal (and to appease the regulators) Colaninno had sold Omnitel and Olivetti's fixed-line business, Infostrada, to Mannesmann for $8.3 billion – a "bargain basement price" in the eyes of *Business Week*.[25] *The Economist* went on to argue that Colaninno was more inclined to see the telecoms part of the Olivetti business as a mere bargaining chip in his attempt to raise finance for the Telecom Italia take-over. It never seemed to occur to him that he was selling two successful telecoms operations to take on a former monopoly full of legacy equipment and ideas. *The Economist* concluded by stating that:

> "The question that hovers over Mr Colaninno is whether he can come up with an effective strategy for Telecom Italia as well as cut and cauterise, as he has done in the past" [26]

Soon after taking on his new post in charge of Telecom Italia, Colaninno announced a radical restructuring scheme to clear some of Tecnost's debt. In essence this involved transferring control of TIM to Tecnost thereby allowing it to benefit from its huge cash flow. In exchange Telecom Italia's minority shareholders would be offered Tecnost shares. Commenting upon the scheme from a shareholder's perceptive, *The Economist* described it as "downright insulting".[27]

After pressure from minority shareholders the scheme was shelved. By now the idea that the Olivetti take-over had been good for shareholders was losing credibility. One important Italian investment firm, IFIL, linked to FIAT, sold its entire stake in the company, a sale that was seen as a protest at the way Olivetti was treating minority shareholders. On this issue the FT stated that, "If Mr Colaninno does not have the resources to run TI without abusing minorities, he should sell it to someone who does".[28]

The episode was widely viewed as an example of the changing climate in Italy whereby minority shareholders could no longer be ignored. The *New York Times* attributed this change largely to the growing presence of American-style institutional money management in Europe.[29] Amongst TIM's shareholders, for example, were global investors such as Fidelity International and Merrill Lynch, companies highly adept at protecting their financial interests.

Following the "mess over Tecnost", *The Economist* indicated that, "Telecom Italia's boss is now on probation".[30] At the time global telecom stocks were riding high and Telecom Italia's increasing valuation helped to detract from Colaninno's weakening position.

In early 2001 Colaninno was back with another proposition to shareholders. This time the plan involved an offer to Telecom Italia's shareholders with non-voting stock to

[24] *The Economist*, 29 May, 1999
[25] *Business Week*, 7 June, 1999
[26] *The Economist*, 29 May, 1999
[27] *The Economist*, 9 October, 1999
[28] *Financial Times*, 24 May, 2000
[29] *New York Times*, 12 December, 1999
[30] *The Economist*, 25 December, 1999

upgrade to voting stock. The premium payable would allow Olivetti to cut its debt by around a third.[31] If the $10 billion deal had gone through then Olivetti would have seen its share of Telecom Italia reduced to around 40%. This was seen as no bad thing, though, since it would give the company more leeway when it came to finding a corporate partner. By now its precarious position in the international league of telecoms companies and its falling share price made a future deal look increasingly inevitable. As Colaninno commented, "To unlock Telecom Italia we needed to reduce Olivetti's debt".[32]

The most likely candidates for a deal at this stage included the old favourite, Deutsche Telekom, with the mobile units of both companies already co-operating. Dutch operator KPN and French mobile operator Bouygues were also seen as possible alliance partners.[33] Colaninno's constant concern for the level of Olivetti's debt led Telecom Italia to avoid most of the expensive third generation auctions during 2000. In the aftermath of these auctions many of the competitor companies were faced with debt problems similar to Colaninno's. *Business Week* indicated that this twist of fate might give Colaninno the breathing space to at least be fairly selective when choosing future suitors.[34]

The share deal was once again threatened, however, by the company's falling share price (a share price threshold had been built into the deal) and by activist shareholders who saw the scheme as more to the benefit of Olivetti than Telecom Italia. The plight of non-voting shareholders during Olivetti's tenure was shown by the fact that between privatisation and the Olivetti bid these shares traded at an average 31% discount to the voting stock. Between the Olivetti involvement and February 2001 this discount widened to 49%, an indication that these shares became less sought after. As the FT commented, "TI savings shares have traded at distress levels on fears of abuse".[35]

With the share conversion offer on the table a group of 50 fund managers led by hedge fund, Liverpool Limited, held a meeting and described the proposals for the conversion of savings shares as "unacceptable".[36] Gordon Singer, a fund manager with Liverpool, stated that many funds were "mad" with Telecom Italia and would vote against the scheme.[37] Liverpool Limited had already shown its activism in January 2001 by initiating legal action against Telecom Italia over its failure to progressively buy back a large proportion of non-voting shares as it had agreed to do in the aftermath of the Olivetti take-over.

As 2001 progressed Colaninno faced a succession of additional problems and challenges at Telecom Italia. In April 2001 Italian anti-trust authorities fined the company $60 million for abusing its dominant market position.[38]

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[31] *Business Week*, 19 February, 2001
[32] Quoted in *Financial Times*, 6 February, 2001
[33] *Business Week*, 19 February, 2001
[34] *Business Week* , 16 February, 2001
[35] *Financial Times*, 6 February, 2001
[36] *Financial Times*, 7 February, 2001
[37] *Financial Times*, 20 February, 2001
[38] *Business Week*, 2 July 2001

In April and May 2001 two Telecom Italia board members resigned over the failure of Colaninno to reveal an investment he had in Seat prior to the merger with Telecom Italia (see below) and his lack of adherence to corporate governance procedures.[39] Interestingly, one of the replacements later named was Guido Ferrarini, a law professor and corporate governance expert. It is tempting to see this appointment as an attempt by Telecom Italia's dominant investors to counterbalance Colaninno, who had demonstrated a tendency to pay scant regard to such procedures.

In May 2001 Colaninno clashed with shareholders at the AGM with exchanges being at times highly personalised. Commenting on the meeting, he stated that, "The interventions were either banal, provocative, even aggressive…None of them worry me, none of them scare me."[40] But from his point of view his plight was looking increasingly worrisome.

In June a report by Credit Suisse First Boston forecast that the company's net profits would fall by 14% to $1.5 billion during 2001.[41] The company's share price continued to slip.

In July 2001 it was reported that Colaninno and other Telecom Italia executives were under investigation for possible conflict of interest and false accounting in connection with the Seat take-over. The report that Colaninno was under investigation sent Olivetti's share price down by 8.6% with Telecom Italia shedding 4.5%.[42] The investigation centred around Colaninno's involvement with Hopa, a company which owned a stake in Seat and which made a capital gain of around £121 million through the deal.[43] Colaninno had reportedly referred to this interest in Seat as only "small" and "theoretical".[44] Given that Hopa was the main investment group in Bell, which in turn was the means by which Colaninno and his allies controlled Olivetti, then the deal also had wider implications regarding the chain of control within Telecom Italia. Even Colaninno's allies may have taken offence at this piece of manoeuvring, as it would have weakened their own position within Bell at the top of Telecom Italia's complex chain of command. In early July the FT drew attention to Colaninno's precarious position at Bell, noting that control of this small investment company would give direct access to Telecom Italia. As for Colaninno himself, it mused that "…those who live by the sword often die by the sword".[45] And so it turned out.

By the summer of 2001 Colaninno was looking extremely vulnerable. By now the Telecom Italia share price was well down and stood below the threshold level for his share conversion plans. To add to his woes there had been a change of government in Italy with the left wing coalition, which favoured Colaninno, being replaced by the right wing party, Forza Italia, headed by Berlusconi. In the corporate arena Mediobanca, which had consistently backed Colaninno, had lost its figurehead, Enrico Cuccia. This company also saw its strategic position weakened after losing control of the Montedison conglomerate to Fiat. A fundamental shift of power was

[39] *Financial Times*, 12 June, 2001
[40] *Financial Times*, 4 May, 2001
[41] *Business Week*, 2 July, 2001
[42] *Financial Times*, 31 May, 2001)
[43] *Financial Times*, 30 May, 2001
[44] *Financial Times*, 31 May, 2001
[45] *Financial Times*, 4 July, 2001

taking place in Italian political and corporate circles and Colaninno was being increasingly sidelined. It seemed only a matter of time before he lost his job at the helm of Italy's flagship company.

THE PIRELLI TAKE-OVER

When privatising Telecom Italia in 1997 the Italian Treasury had sought strategic investors who would be charged a premium for the right to hold a substantial stake in the company. A number of companies were approached but rejected the terms offered by the Italian government. One of these was Pirelli, the Italian tyre and cable operation.[46] Four years later Pirelli, led by their Chairman, Marco Tronchetti Provera, was to wrestle control of Telecom Italia away from Colaninno's faction.

In July 2001 Pirelli and Edizione Holding, the investment arm of the Benetton clothing family, agreed to pay around \$6.1 billion for the 23% stake in Olivetti held by Bell, a Luxembourg-based holding company. The corporate vehicle created for this purpose was to be owned 60% by Pirelli and 40% by Edizione. In total it would own 27% of Olivetti when the companies' existing stakes in the company were factored in.[47]

This coup was facilitated by Olivetti's poorly performing shares, which had lost around 20% of their value since the company had acquired its stake in Telecom Italia in 1999. The backers who had supported Colaninno in that take-over through their involvement with Bell ran out of patience after two years of falling share prices for both Telecom Italia and Olivetti. The offer from Pirelli of \$3.65 per Olivetti share was double the market price and proved more tempting than Colaninno's promises of future gains.

Pirelli was well placed to make its move on Olivetti since it was sitting on around Euros 2.5 billion in cash after selling parts of its fibre optics business to Cisco and Corning. By focusing on the 23% of Olivetti controlled by Bell, Pirelli was able to avoid any offer to other Olivetti shareholders. This approach to the take-over, which simply followed in Colaninno's footsteps, was made possible through Italy's so-called Draghi law which specifies that a bidder acquiring less than 30% of a company's equity need not make a full offer for that company. Likewise Telecom Italia's other shareholders were not consulted or compensated when the offer was agreed. As the take-over was an indirect one Telecom Italia's minority shareholders were once again left out in the cold – a fitting end to a period during which their rights had been continually overlooked. As the FT saw it, "Roberto Colaninno's reign at Telecom Italia has ended as it began: with abuse of minority shareholders".[48]

In seizing control of Telecom Italia with a market capitalisation of approximately \$65 billion Pirelli had spent only around \$7 billion. The FT calculated that Tronchetti controlled Telecom Italia with less than 0.5% of its equity and around 0.1% of its enterprise value.[49] By wresting control of the part of Olivetti previously controlled by

[46] *The European*, 2 October, 1997
[47] Dow Jones Newswires, 30 July, 2001
[48] *Financial Times*, 30 July, 2001
[49] The FT, 2 August, 2001

Colaninno it was able to emulate him in using this as a power base to take charge of Telecom Italia. As the *New York Times* put it, the new twist in Telecom Italian's ownership, "was just one more peculiar Italian exercise in capitalism without capital".[50] *Business Week*, for its part, saw it as "… a throwback to the opaque governance that dominated corporate Italy for decades…".[51] British and American investment funds protested loudly after the deal although to deaf ears within a new Italian government whose priority (like its predecessors) seemed to be in keeping Telecom Italia in Italian hands whatever that might mean for shareholders' rights.

At the end of July 2001 it was announced that Tronchetti was to become Chairman of Telecom Italia with Gilberto Benetton (of the Benetton Group) becoming Vice Chairman. It was also announced that Enrico Bondi (formerly CEO at Montedison) and Carlo Buora of Pirelli would become co-CEOs. Later it was reported that Bondi would also take over as Chairman at TIM. Looking at the new control structure few commentators regarded the change as an improvement from the perspective of Telecom Italia shareholders. As the FT saw it, "Far from being a victory for shareholder capitalism, this looks like one group of barons being replaced by another…"[52]

After losing his job at Telecom Italia, Colaninno was appointed to the board of Mediobanca, heightening the impression that the whole episode was a playing-out of the rivalry between two political/economic groupings in Italy. This impression was heightened when new boss Tronchetti hinted that Telecom Italia would be prepared to shed Seat, thereby ending the company's experiment with broadcast television and reducing the threat posed to the media interests of new Prime Minister, Silvio Berlusconi.

In reviewing the fall of Colaninno, the *New York Times* also alluded to the political sphere, indicating that the new government of Berlusconi was less well disposed to Colaninno than his predecessor Massimo D'Alema.[53] Inherent in this interpretation is the possibility that Telecom Italia could face upheaval every time there is a political change in the country. And of course Italy is well known for the frequency of such changes.

Marco Tronchetti Provera (Tronchetti)

Marco Tronchetti married into the Pirelli family in 1976 but did not join the company until ten years later. In the interim he worked for Camfin, his own family's heating oil transportation business. Tronchetti was appointed CEO at Pirelli in 1992 following a corporate shake-up after the Italian company had failed in its bid for Continental, the German tyre company, in 1991. In his first year in charge he jettisoned some 40 subsidiary companies in order to focus on core activities. At the same time he moved the company increasingly towards telecommunications investing heavily in the cables division.

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[50] *New York Times*, 3 August, 2001
[51] *Business Week*, 2 July, 2001
[52] *Financial Times*, 30 July, 2001
[53] *Financial Times*, 30 July, 2001

Now divorced, Tronchetti is a well-known socialite and features regularly in Italy's gossip columns thanks to a high profile relationship with a former model. He is also taken seriously as a businessman, however, and is perhaps only second to Fiat's Giovanni Agnelli in terms of prestige.[54]

Pirelli's Prospects

For Pirelli the Telecom Italia deal means taking on substantial new debt. Their share price fell 18% in the aftermath of the deal, an indication that many investors thought that they would have the same problems with Telecom Italia as those experienced by Olivetti. [55]

As the FT has pointed out, buying Telecom Italia does not seem too problematic.[56] The difficult part is making the deal work. Tronchetti will inherit a capital structure with inherent conflicts of interest throughout the chain of control. At the top of the chain there are heavily indebted corporate investors while the shareholders at the bottom of the chain, in cash-rich Telecom Italia and TIM, are reluctant to lose the dividends extracted from their companies' regular cash-flow.

Moreover Pirelli has its own web of 'Chinese boxes', stretching across no less than eight separate layers of control.[57] Tronchetti has a 60% stake in a private investment company, GPI. This in turn controls Camfin, which controls Pirelli and company, which controls Pirelli SPA, the operating business. This then holds 60% of the investment vehicle (known as 'New Co') used for the Olivetti bid. So the new capital structure is even more convoluted than that which caused so many problems for Colaninno. The FT suggested that in a few years' time history could easily repeat itself with a new group of investors buying out those currently at the centre of control.[58] Such a vicious cycle is unlikely to be to the benefit of Telecom Italia or its shareholders. One way out, it argued, would be for Olivetti to merge with Telecom Italia and break the unproductive chain of capital control. Later the FT went further and suggested that a full Pirelli-Olivetti-Telecom Italia merger could be the best way forward.[59] All three companies are after all, now controlled by one man, Marco Tronchetti.

While the recent experience of Telecom Italia has been used as an ongoing example of the idiosyncrasies inherent within Italian capitalism, not all commentators see this as altogether negative. Professor Julian Franks of the London Business School, for example, stated that, "If you looked at America, England and Italy and were asked which is the most prosperous it's not obvious that the Italians have suffered from their lousy capital markets".[60]

[54] *New York Times*, 4 August, 2001
[55] *New York Times*, 30 July, 2001
[56] *Financial Times*, 31 July, 2001
[57] *Financial Times*, 1 August, 2001
[58] *Financial Times*, 31 July, 2001
[59] *Financial Times*, 4 August, 2001
[60] Quoted in the *Financial Times*, 3 August, 2001

INVESTORS

Following privatisation the shareholder structure of Telecom Italia was extremely fragmented, a fact which the FT saw as making it more prone to a take-over.[61] When that take-over materialised through the actions of Olivetti, the company was left with the ownership structure shown in Table 1.

Table 1: Shareholder Structure of Telecom Italia

Shareholder	Percentage Holding (report date 28/2/2001)
Olivetti S.p.A.	54.99
Italian Treasury	3.46
International Institutional Shareholders	29.56
Italian Institutional Shareholders	11.06
Group Employees	0.21
Others	0.72

Source: Company Annual Report, SEC 20F, 2000

With the majority stake held by Olivetti it is necessary to look at the share structure of this company in order to see who ultimately controls Telecom Italia. Olivetti has for a number of years been controlled by a minority stake held by Bell. Until mid-2001 Bell held 23% of Olivetti and was controlled by Colaninno and his allies. When these allies lost patience with Colaninno and sold their holdings, Bell was left under the control of a corporate vehicle owned by Pirelli (60%) and Benetton (40%). It now accounted for 27% of Olivetti.

As seen in Table 1 over 40% of Telecom Italia is in the hands of institutional shareholders. As Table 2 shows the individual stakes are fairly small. When working in concert, however, these shareholders are able to exercise their power, something that Colaninno learned to his cost.

Table 2: Telecom Italia: Institutional Holdings

Institutional Shareholder	Percentage Holding (report date 31/3/2001)
Brandes Investment Partners	0.37
Invesco Global Asset Management	0.14
Citigroup Inc	0.05
World Asset Management	0.05
Gabelli Funds LLC	0.04
Mellon Bank N.A.	0.03

Source: Business.com

[61] *Financial Times*, 22 February, 1998

CORPORATE ACTIVITY

Mergers and Acquisitions

February 17, 2000

Telecom Italia S.p.A.'s Board reviewed and approved the preliminary agreements reached with the controlling shareholders and the management of Seat Pagine Gialle (Seat Yellow Pages) and the industrial project relating to the integration of the activities of Tin.it with those of Seat. The agreements entailed Telecom Italia increasing to 29.9% its holding in the ordinary share capital of Seat, at a price of Euro 4.5 per share, which was to be followed by the actual combination of Tin.it and Seat. Telecom Italia had previously held 11% of Seat. By the end of the deal it was anticipated that Telecom Italia would increase its stake to more than 50%.

Seat, a yellow pages company, had a popular Internet portal. By taking control of Seat Telecom Italia would be able to create Italy's leading Internet business. The merger was essentially a reverse take-over of Seat whose assets were to be combined with those of Tin.it, Telecom Italia's Internet access subsidiary. The deal was valued at £36.6 billion.[62] Previously plans had been announced to list Tin.it on the Milan stock exchange, following in the footsteps of Telefonica with Terra Networks. By building on its existing stake in Seat, Telecom Italia was able to follow an alternative strategy, one that would enable it to retain greater control of its Internet unit.

Lex in the FT saw the deal as "another clever wheeze from Telecom Italia", the implication being that after its previous financial manoeuvres the company could be regarded as somewhat slippery. Seat's shareholders, it suggested, "should watch Telecom Italia like hawks".[63]

November 23, 2000

Telecom Italia announced the purchase of Mageos, a French ISP for Euro 110 million. The deal, through its French subsidiary 9 Telecom, came soon after the purchase of Jet Multimedia, a French web services company acquired for Euro 900 million. Both deals were seen as part of Telecom Italia's attempt to develop its position in Internet and multimedia services in France.

December 19, 2000

Telecom Italia announced that it had agreed to acquire control of Chilean telecommunications company, Entel, in a $820 million buyout of its local investment partner, Chilquinta. Under the terms of the agreement, Chilquinta agreed to sell to Stet International, the international arm of Telecom Italia, a total of 60,621,539 shares in Entel for a total of $820 million. Entel is the second largest telecommunications group in Chile. Speaking on the deal, Colaninno stated that the purchase "completes the consolidation phase of our most significant stakes in the Latin American fixed line and mobile telephone market".[64] In June of 2000 the company had paid $810 million

[62] *Financial Times*, 30 March, 2000
[63] *Financial Times*,12 February, 2000
[64] *Financial Times*, 20 December, 2000

for a 30% stake in Globo.com, a Brazilian Internet portal, indicating that Telecom Italia was also pursuing the South American Internet market.

Sales and Disposals [65]

June 2000

In June 2000 Meie Group (consisting of 51.2% of Meie Assicurazioni and 51% of Meie Vita) was sold to Unipol Assicurazioni S.p.A. for L670 billion. This part of Telecom Italia had been involved in insurance services.

In the same month the company's leasing operation, Teleleasing, was sold to the Mediobanca Group for approximately L57 billion.

August 4, 2000

It was announced that Sirti, the engineering and cable-laying subsidiary of Telecom Italia was being sold to a group of Italian and international investors. Telecom Italia received a total consideration of L314 billion for its stake.

The move was seen as in keeping with the group's policy of shedding non-core operations. Interestingly, at one stage a likely buyer for the Sirti group appeared to be Pirelli, before the cable and tyre company withdrew from negotiations. Less than a year later Pirelli was to take control of Telecom Italia as a whole.

October 16, 2000

Telecom Italia announced that an investor group led by Clayton, Dubilier & Rice Inc. (CD&R) and Cisco Systems Inc. would purchase approximately 80% of the company's Italtel telecommunications switching equipment subsidiary. Italtel would then be an independent supplier of converged voice/data and network technology to provide integrated multi-service solutions to customers. The transaction had a value of approximately Euro 1 billion. CD&R's Fund VI were to provide approximately Euro 285 million of equity in exchange for 50.1% of Italtel, with Cisco and Telecom Italia each owning approximately 19%.

As part of the deal Telecom Italia agreed to enter into a strategic alliance with Cisco to develop Internet and broadband telecommunications technology. In particular the two companies sought to develop a range of services in voice, data and video to business and consumer clients. The move was seen as part of Colaninno's strategy of seeking alliances with international partners while shedding Telecom Italia's non-core activities.[66]

November 2000

In November 2000 Telecom Italia announced it would be selling part of its property portfolio to a joint venture between Lehman Brothers and Beni Stabili S.p.A. in a transaction expected to raise around Euro 2.5 billion. The real estate portfolio held by

[65] This section draws heavily on Telecom Italia SEC Form 20F, 2000
[66] *Financial Times*, 1 July, 2000

the joint venture consisted of 581 properties, totalling 3.7 million square metres. Telecom Italia aimed to vacate approximately 1,000 additional properties over the next five years.

Joint Ventures [67]

January 30, 2000

Telecom Italia announced that it had signed a Memorandum of Understanding with Israeli and Cypriot partners in Med-1, marking the operational start of the Nautilus project. As a result of the deal, Telecom Italia took over operational control of Med-1, a private operator in the undersea transmission capacity market in the eastern Mediterranean, increasing its share from 23.17% to 51% after purchasing 27.83% owned by Israeli partners Aurec, Clalcom, Globescom, Kama and Zoi, who were to sell pro rata while maintaining around a 40% stake in Med-1.

January 31, 2000

Telecom Italia and Banca Popolare di Milano signed an agreement for the supply of new technological solutions to enable access to We@bank, Banca Popolare's service for Internet banking, online trading and high value added services. The agreement focused on the We@exclusive, We@finance and We@easy services, designed respectively for top traders, expert Web navigators and relative newcomers to the Web.

February 1, 2000

CSELT, the Telecom Italia research centre, and Lucent Technologies, the telecommunications equipment manufacturer, signed an agreement to work together researching services

February 8, 2000

Telecom Italia and the Il Sole 24 Ore newspaper announced an agreement to develop Internet banking and online trading services. Telecom Italia's Finance Net electronic banking solutions would be integrated with the Il Sole 24 Ore-Radiocor X-Plane platform.

February 23, 2000

Telecom Italia and the Banca Popolare di Vicenza struck a deal for the provision of new ICT (Information and Communication Technology) platforms for e-business in the Vicenza area, as well as through the realisation of horizontal and vertical portals. The portals were to contain a local search engine, news, links to services of public interest plus access to specific information channels and the option of searching by subject.

[67] This section draws a lot of material from Business.com

February 23, 2000

Telecom Italia announced that it was expanding its partnership with Sigma S.p.A., an Italian provider of information technology services for reservations, ticketing and consultation to travel agencies, tour operators and hotel chains. The Telecom Italia solution would enable all networked travel agencies to access Intranet and Internet services.

February 25, 2000

Tin.it, Telecom Italia's Internet service provider, and GTP Holding announced that they had signed a Protocol of Agreement for drawing up a partnership for the development and distribution of products and services for the Internet market. The agreement was to develop a commercial and strategic collaboration with the objective of augmenting distribution of their respective products and services.

February 28, 2000

Telecom Italia announced that it has entered into an agreement to supply customers of the Banca Popolare di Novara with new online financial services. The agreement called for the implementation of jointly developed services using network technologies and applications systems. By using Trading Online, customers would be able to buy and sell stocks and shares as well as accessing information on world-wide bourses and stock markets.

March 3, 2000

Telecom Italia and the Banca di Roma Group agreed upon the outline of a joint venture to create a new bank. Initial capital subscription was to be apportioned 85% to the Banca di Roma Group and 15% to the Telecom Italia Group, through a holding company to be set up by Telecom Italia and TIM. Capital for the new bank would also be made available to partners capable of contributing added value to the venture.

March 6, 2000

Servizi Interbancari, an Italian credit card market provider, and Telecom Italia through Tin.it, launched a venture to promote and support the development of Internet and e-commerce use in Italy. The venture was to undergo a trial phase before being extended to all (CartaSì) credit card holders.

March 13, 2000

Telecom Italia and Winterthur Italia (Credit Suisse Group) announced OPERA, a new technological platform for creation of a networked company. OPERA, a network hardware and software application, running over Telecom Italia's broadband communications services, allows customised relations between management, branches and customers. The companies also reached an agreement for the cabling of Telecom Italia's telecommunications network, alongside provision of secure Internet access and e-mail for all branches.

March 14, 2000

Tin.it, the Telecom Italia Internet service provider, and Compaq Italia signed an agreement to bundle their hardware, software and Internet access products. Under the agreement, all Compaq Presario PCs would be pre-installed with a free Tin.it ClubNet subscription offering immediate Internet access.

March 22, 2000

Telecom Italia, through Internet service provider Tin.it, and Class Editori, through e-Class, struck a deal to set up a portal dedicated to 'family finance' in Italy. The portal brought together a range of personal finance tools for managing family portfolios.

January 2001

At the end of January 2001 TIM announced it was studying an alliance with Deutsche Telekom's T-Mobil and other operators in order to offer standard rates to customers travelling outside their home country. Analysts saw the announcement as an intensification of the battle for the business traveller amongst the mobile operators. Additionally the deal was seen as a possible precursor of closer ties between Telecom Italia and Deutsche Telekom which had been seen as a possible 'white knight' during the Olivetti take-over.

January 18, 2001

On January 18, 2001, TIM announced that it had entered into a joint venture with KPN Mobil N.V. and NTT DoCoMo Inc. to provide mobile Internet services across Europe.

January 29, 2001

On January 29, 2001, TIM signed a Protocol Agreement with NTT DoCoMo and Sony Computer Entertainment Inc. to jointly develop a mobile Internet service. One of the potential applications made possible by this agreement is access to PlayStation videogames.

ADDRESSABLE MARKET [68]

According to Dataquest, the Italian telecommunications market grew by 13.4% in 2000, with revenues of more than L61,000 billion attributed as follows: 47% to fixed line telephone services; 40.6% to wireless telephone services; and 12.4% to the data transmission/Internet segment.

The greatest contributor to the increase was wireless services, with an increase in the number of subscribers of 38.4% and a rise in revenues of 25.4%. With over 42 million subscribers at the end of 2000, Italy is the second largest market in Europe (behind

[68] This section draws heavily on Telecom Italia, SEC Form 20F, 2000

Germany with over 47 million subscribers), although the level of penetration (calculated as the number of customers of mobile telephone services to population) reached 73.3% and is the highest together with Finland. During 2000, the number of mobile telephones continued to grow faster then the number of fixed line telephones, with wireless connections representing 60.3% of total connections.

The Internet market increased from 8.2 million subscribers at the end of 1999 to 14.1 million at the end of 2000 (an increase of 72%). Despite the considerable increase generated by free access and specific commercial offers (such as 'E vai!' promoted by Tin.it), the level of penetration (25%) remained below the European average, with potential for growth. Average annual growth rates in Italy were forecast to be 27% compared to 22% for the rest of Western Europe.

STOCK MARKET

Share Performance

As well as its Italian listing Telecom Italia is also quoted on the New York Stock Exchange as an ADS. As at August 3, 2001 it had a market capitalisation of $68.2 billion. At this date the company's ordinary voting shares had a five-year high of $210 and a five-year low of $27.38.

Standing at around $35 in the second half of 1996 the share price rose steadily over the next few years, standing at over $200 at the beginning of 2000. Since then the share price has followed the whole sector downwards and stood at $91.90 on August 3, 2001. For the year to this date the stock showed a total return of minus 23.7%. The three-year figure stood at 36.3% with the five-year figure at 210.2%.[69]

The company also has non-voting shares that have proved a source of controversy over the last few years. As stated earlier these under-performed the voting shares after Olivetti's take-over, an indication that investors were cautious as to whether the rights of non-voting stock would be respected.

Bonds

In April 2001 the company successfully completed its first straight debt issue, raising around Euro 6 billion which was designed to refinance shorter term bank debt . The bonds were three times over-subscribed, a fact which was seen as a vote of confidence in the Italian operator's financial prospects.[70] Having kept away from the corporate buying spree in the telecoms industry, and the more expensive of the third generation mobile auctions, Telecom Italia was one of the few telecoms companies with a positive credit rating outlook at the time.

In June 2001 Telecom Italia raised a further Euro 700 million in bonds which used the company's highly predictable fixed line revenues as security, an asset-backed fund-raising strategy never attempted before.[71] Following the success of this issue it was

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[69] WSRN.com
[70] *Financial Times*, 11 April, 2001
[71] *Financial Times*, 27 June, 2001

thought probable that other operators would emulate this form of securitisation using telephone bill revenues.

NETWORK [72]

Cellular Network

TIM's TACS network consists of 2,706 radio base stations and 85,998 radio channels. TIM has reduced the level of investment in its TACS network as the number of TACS customers has levelled off. TIM's GSM network consists of 8,935 radio base stations and 546,512 radio channels (an increase of 22% over 1999). Telecom Italia's management claim that as a result of TIM's enhancement of the GSM service and increased coverage, TIM's network is in line with the best European GSM networks.

Fixed Network

Domestic network

Telecom Italia's domestic fixed network includes 66 transit switches and 653 main local switches. The long distance fixed network includes 3.7 million circuits, while the distribution fixed network includes 104 million kilometres of pairs over copper cable.

Digitalisation and ISDN

At December 31, 2000, 99.7% of Telecom Italia's domestic telecommunications lines were connected to digital telecommunications exchanges. The digitalisation of the long distance fixed network was completed in 1994 and in most major cities the level of digitalisation of the local fixed network is close to 100%. Since the end of 1999, ISDN services have been accessible to substantially all of Italy. Telecom Italia has one of the largest ISDN networks in Europe. ISDN allows subscribers to use their existing access lines for a number of purposes, including high speed data transmission, video-conferencing, high speed fax and faster Internet access.

SDH and ATM

Telecom Italia introduced SDH advanced transmission technology into operation in the long distance fixed network in 1996 and introduced such technology into operation for its local fixed network during 1997. These transmission systems are operating on fibre optics at 2.5 Gbit/s and 155 Mbit/s. Work on the development of the Arianna network which uses the latest generation of SDH technologies and the new optical DWDM technology (Dense Wavelength Division Multiplexing) continued during 2000.

ATM switching technology, introduced in 1996, allows the transfer of information combining data, video and other services over public and private networks both domestically and internationally. Telecom Italia ATM (Atmosfera) and Frame Relay

[72] This section draws heavily upon Telecom Italia, SEC Form 20F, 2000

(business frame) networks are overall networks that work together as a multi-service network, using SDH transmission systems as physical layer. Atmosfera gives the ATM native services with access rate from 2 Mbit/s up to 155 Mbit/s, in 27 POPs (Point of Presence) and acts as backbone also for the IP network.

Fibre optic cables

At December 31, 2000, Telecom Italia had installed approximately 3.1 million kilometres of optical fibre, of which approximately 2.6 million kilometres were installed on long distance fixed lines. Fibre optic cables significantly increase the capacity of the network and permit Telecom Italia to provide new advanced services based on the simultaneous transmission of several kinds of signal, such as voice, data and video. To enable it to offer these services, Telecom Italia is planning to introduce fibre optics in its local access network. In the second half of 2000, a project was also initiated to create an optic fibre ring between Milan and Palermo (I-Bone), which will involve the installation of approximately 4,200 kilometres of cable with 96 optic fibres on two backbones and the laying of two submarine links beneath the Strait of Messina.

International network

Over the last few years Telecom Italia has rationalised its international fixed network and enhanced international transmission capacity. Telecom Italia owns capacity in a number of international cable links and its international network includes fibre optic cables to many countries. During 2000, major digital submarine links were installed in the Atlantic area. In order to satisfy the demand for new services (such as Internet and multi-media applications), the Trans-Atlantic Backbone has been developed through the acquisition of high capacity wavelengths on submarine systems. In addition the following acquisitions have been made in order to increase capacity:

- in South America and the North Atlantic, with the Atlantis 2 system and the upgrade of Columbus III; and
- in the West African and South African regions, with the SAT 3 submarine system.

Moreover, Telecom Italia has developed a new strategy and is building a number of proprietary networks in Europe, Latin America and the Mediterranean area. These multi-serve backbones are optical fibre rings that use the DWDM (Dense Wavelength Division Multiplexing) technology for transmission, while, for access and delivery, the POPs (Point of Presence) use multi-serve platforms (voice, data and IP). These platforms complete the switching functions for voice and routing for data with packet/cell switching IP/ATM technology.

The European optical fibre network (PEB, Pan-European Backbone) is laid in the main industrialised European countries, (i.e. Italy, France, Spain, the UK, the Netherlands, Belgium, Germany, Switzerland and Austria) and is 10,600 kilometres long. The Mediterranean Nautilus (MEN) owned by Mediterranean Nautilus, a company controlled by Telecom Italia, is building a new submarine optical ring. It is 7,000 kilometres long and links the main markets of the Southern Mediterranean area; Italy, Greece, Turkey, Israel and Egypt.

In Latin America, Telecom Italia has launched the Latin American Nautilus. The Latin American Nautilus is a new high capacity backbone in the region, integrated with the transatlantic and European networks. The backbone is an optical fibre ring network both terrestrial and under-sea, 30,000 kilometres long including the Miami-NYC link. The ring, having optical automatic traffic protection and a bandwidth greater than 1 Tbit/s, will link the most important cities of South America to Central and North America.

In 2000, Telecom Italia further rationalised its international fixed network and enhanced international transmission capacity. At December 31, 2000 there were 197,000 international circuit links, including about 4,000 via satellite and 116,331 via cable. The number of exchanges utilised in the international network has been reduced from eight to seven. The digitalisation of the international network exceeded 98.0% in December 2000. In aggregate, Telecom Italia has access to more than 350,000 kilometres of submarine cable. At the same time, Telecom Italia controls a number of satellite earth stations to handle international traffic.

Broadband network/ADSL

Telecom Italia's broadband network, SOCRATE, is capable of supporting advanced telecommunications services and multimedia applications so, for this purpose, Telecom Italia has installed significant levels of fibre optic cables in its fixed network. As at December 31, 2000, the broadband network programme extended to 58 cities, passing approximately 526,000 households, and approximately 1.1 million had been equipped with the necessary transmission equipment and the wiring backbone to receive advanced telecommunications services, cable television broadcast services and multimedia applications (of which 70,000 are customers of Stream).

In connection with access services using ADSL technology, in 1999 the technical and commercial trials with fast Internet access for residential and SOHO (small office-home office) customers, begun in Rome and Milan at the end of 1998, were concluded. In the second half of the year, commercial services with access to ADSL technology for business customers and ISPs (Internet service providers) were extended to 25 cities. The commercial services for business customers include the use of ADSL technology in urban areas to supply access to the 'RING' services (IP, Frame Relay and ATM) of Telecom Italia's data networks. The services for ISPs supply ATM access based on ADSL technology to the public, leaving the commercial interface with the final customer to the service provider. At the end of 2000, the 'local exchange areas' covered by ADSL technology numbered 644, covering 110 local areas; in 2001, 800 local areas and 1,500 local exchange areas are to be served.

CORPORATE INFORMATION: COMPANY STRUCTURE[73]

As at the 2000 financial year the company was divided into a number of distinct operating areas. A restructuring was planned for early 2001 that will be reflected in the company's next set of accounts.

[73] This section draws heavily upon Business.com

Mobile Telecommunications Services

Telecom Italia Mobile (TIM) S.p.A. operates mobile phones over the whole of Italy. The company was set up on July 14, 1995 to run the mobile phone operations of Telecom Italia. TIM offers telephone services on the TACS (Total Access Communication System) and GSM (Global System for Mobile Communication) networks. The company also offers paging systems, centralised answering systems and data and fax transmission. Additionally, TIM sells telephones and accessories and offers after-sales services and repairs through a network of 37 own outlets and over 4,000 authorised retailers. Mobile phone operations accounted for 91% of 1999 revenues and sales of telephone products and accessories 9%.

TIM offers both digital and analogue mobile services. The GSM digital service uses digital technology and is standard throughout Europe. Roaming agreements have been reached with 177 operators in 124 countries. The analogue service is based on the TACS 900 standard. TIM's customer base consists of TACS subscribers, customers holding TACS prepaid services, GSM subscribers and customers holding GSM TIM Cards. At December 31, 1999, the number of customers for TIM's TACS and GSM mobile services was approximately 18,527,000 (of which 15,351,000 were GSM customers, consisting of 2,442,000 GSM subscribers and 12,909,000 GSM prepaid customers).

At March 31, 2000, TIM's customer base had grown to approximately 19,221,000. By the end of 2000 it had 19.5 million subscribers, making it Europe’s first ranked mobile operator.[74] Figures circulated in the press in the course of 2001 put the number of its subscribers in Italy at approximately 22.6 million. The company also has around 28.3 million equity customers through stakes in cellular operations in Asia, the Middle East, South America and other European countries. As of 2000 TIM had a workforce of 9,634.

Domestic customer growth for TIM was 54% in 1998, 30% in 1999 and 17% in 2000. Gross operating revenues from TIM totalled L11,904 billion, L14,425 billion and L15,352 billion in 1998, 1999 and 2000, respectively.[75] Growth figures such as these have made it something of a jewel in Telecom Italia’s crown.

In Table 3 it can be seen that while TIM is controlled by Telecom Italia, which has a majority stake, it also includes a number of influential international shareholders such as Fidelity International and Merrill Lynch. These minority shareholders have expressed their discontent with the financial plans of the parent company on various occasions over the last few years.

[74] African Cellular Web site

[75] Telecom Italia, SEC Form 20F, 2000

Table 3: TIM Shareholders

Group	Per Cent Holding (as of July 2001)
Telecom Italia	60.15
Traded shares/other institutional etc	29.95
Banca d'Italia	1.77
Société Générale	1.29
Bankers Trust	1.00
Fonditalia	0.92
Europacific Growth Fund	0.77
Arca	0.71
Finanza & Futuro Fondi Sprind	0.66
Nomura International	0.65
Fidelity International	0.62
Merrill Lynch & Co	0.60
National Bank of Abu Dhabi	0.46
Adia European Investment Authority	0.45
Total	**100**

Source*:* African Cellular Web site

TIM is a publicly traded company quoted on the Italian, German and US (OTC) stock exchanges. From 1997 its share price rose steadily from under $3 at the beginning of that year to over $15 at the height of the bull market for telecoms stocks at the beginning of 2000. Since then, in common with other technical stocks, it has fallen back significantly, standing at just over $5.50 in August 2001. Looking at its performance over the five years to August 2001 its price increased by 146%. The one-year figure stood at minus 42%.[76]

An explicit part of Colaninno's strategy for TIM was to increase its involvement in overseas markets, with the company progressively strengthening its position in South America and the Mediterranean Basin. While Telecom Italia's debt position restricted its involvement in the foreign auctions for third generation mobile licences, TIM did bid successfully in Spain, France, Serbia, Greece and Turkey.[77] In 2000 Telecom Italia announced a restructuring which would bring all the mobile businesses outside Italy under the control of TIM. This move was designed to remedy a number of idiosyncrasies present in the company's structure which were legacies of its state-controlled origins.[78]

Fixed Telecommunication Services

Through Wireline Telecommunications Services Italy, Telecom Italia at December 31, 1999 had approximately 26.5 million fixed subscriber lines, including

[76] Bloomberg.com
[77] *Financial Times*, 27 February, 2001
[78] *Financial Times*, 28 July, 2000

approximately 19.2 million residential lines (including multiple lines for ISDN), approximately 6.9 million business lines (including multiple lines for ISDN) and 361,000 public telephone lines. At the same date, Telecom Italia had approximately 3,048,934 ISDN equivalent lines with approximately 2,481,034 equivalent basic rate ISDN subscribers and approximately 567,900 equivalent primary rate ISDN subscribers.[79]

DECT (Digital Enhanced Cordless Telecommunications)

In December 1997, the Ministry of Communications authorised Telecom Italia to start marketing DECT technology among its customers and, at the beginning of 1998, Telecom Italia launched a DECT commercial service called 'FIDO'. DECT technology allows a variety of applications and services. By means of the DECT technology, a cordless phone can be used for calls both within and outside the home using the same phone number. This service was only made available in some urban areas. As at December 31, 1999 there were approximately 73,000 DECT technology aerials in use and DECT services were provided to 147,000 customers.[80]

Leased Line Service

The leased line service involves making a permanent connection for telecommunications services between two geographically separate points that can be used to handle high volume voice, data or video transmissions and is an alternative to the public switched telecommunications networks. As at December 31, 1999, there were approximately 448,000 lines leased to business customers (including direct leased lines for voice telephony), of which 240,000 were related to data transmission.[81]

Data Services

Data services consist mainly of data transmission and network services for business customers as well as online services for business and residential customers. Telecom Italia provides a broad range of data transmission services, integrating voice, data and video elements. These data services are based upon a wide spectrum of technological platforms ranging from traditional technologies, such as digital leased lines and the X.25 protocol technology (used in Business Packet services), to advanced transmission technologies based on SDH and ATM systems (which is used in Telecom Italia's ATMosphere service).[82]

Internet Services

Telecom Italia plans to continue its development of Internet services over the next few years. The company introduced Internet services for residential customers (the Telecom Italia Net Service) and business customers in 1996. At December 31, 1999, Telecom Italia had signed up approximately 1,990,000 subscribers for its Internet services. A year later the figure stood at 3,997,000. The company's Internet

[79] Business.com
[80] Business.com
[81] Business.com
[82] Business.com

operations are co-ordinated through Tin.it. The Internet side of the business was seen as a key strategy area for Colaninno who increased its scope through the Seat merger.

Satellite Systems and Services

In this area, Telecom Italia operates through Telespazio and its subsidiaries. Telespazio, a wholly owned subsidiary of the company, designs, develops and manages satellite telecommunications systems for a variety of commercial uses and manages such systems for the group, including the public network utilised by Telecom Italia.[83]

International Telecommunications Services

Telecom Italia owns TMI, which offers advanced telecommunications services to multinational business customers in Asia, Europe and America such as point to point digital connectivity, X25 and Frame Relay services, IP services, international VPN services, messaging services and outsourcing services. At December 31, 1999, TMI was directly active in 45 countries and had more than 102 installed POPs (Point of Presence).[84]

Multimedia Services

Stream, which at the time was a wholly owned subsidiary of Telecom Italia, launched a commercial offering of digital video broadcasting services via cable at the end of 1996. During 1998, Stream launched a commercial offering of digital video broadcasting services via satellite.

Later Stream increased its interest in pay-TV through its involvement with Rupert Murdoch's News Corporation, the Cecchi Gori media group and a number of Italian soccer clubs.

This move was bound to raise political eyebrows since, as the FT pointed out, "Politics and television have always made for a heady mix in Italy, even before media tycoon Silvio Berlusconi opted for a political career…".[85] The involvement of Murdoch, whose global ambitions are widely questioned in Italy, raised the political temperature even more. So too did the fact that Vittorio Cecchi Gori, the Chairman and Managing Director of the group, was himself a politician. He was elected as a senator for the Partito Popolare Italiano in 1994 and 1996, putting him on the opposite side of the political divide from the powerful Mr Berlusconi.

Later Cecchi Gori and the soccer clubs withdrew from the arrangement, leaving Telecom Italia and News Corp. in joint control. Cecchi Gori continued to play a part in Telecom Italia's TV ambitions, however, when it entered into negotiations to sell it (through the Seat subsidiary) two Telemontecarlo TV channels. The deal was in keeping with Colaninno's plans of pursuing TV interests through Seat as part of his broader Internet strategy. Apart from threatening the media interests of Berlusconi, the acquisition also had a wider political dimension in that it was rumoured that the

[83] Business.com
[84] Business.com
[85] *Financial Times*, 26 July, 2000

then Italian government would favour the deal since it would keep national TV channels in Italian hands. As the FT put it, "the ramifications of Telemontecarlo's sale are as much political as financial and industrial".[86]

Value Added Services

SARITEL is the developer of Internet products and services for the Telecom Italia group. It is a wholly owned subsidiary of Telecom Italia that provides value-added services 'on-the-net'. SARITEL's products and services include Internet hosting services, Internet customer care services, Internet managed services and interactive voice services.[87]

CORPORATE INFORMATION: COMPANY STRATEGY [88]

Telecom Italia's corporate strategy was spelled out in its 2000 Annual Report. The following section is adapted from that document as it relates to wireline, wireless and Internet services. After these sections the specific strategies of the two most recent Chairmen of the company, Colaninno and Tronchetti, are briefly reviewed.

Wireline

The group's wireline strategy was to be driven by data/internet growth, significant cost cutting and minimising market share loss on voice services. In particular, Telecom Italia intended to:

- exploit its leading position in providing network access to fixed line subscribers by providing value added services (such as flat pricing schemes, bundling of services and increases in bandwidth), while focusing on opportunities to retain its client base by enhancing customer loyalty (through billing, CRM and customer contact);

- pursue growth opportunities by developing innovative pricing schemes, integrated data/services offerings, offers targeted to content and service providers, and by pursuing opportunities in the wholesale market (increasing revenues through sales to alternative operators and ISPs);

- manage efficient operations and continue its cost cutting programme (personnel, real estate, general and administrative); and

- maintain competitive services and focus investment on enhancing network evolution and innovation (through optical transport, Voice Over/IP, etc).

[86] *Financial Times*, 26 July, 2000
[87] Business.com
[88] This section draws heavily upon Telecom Italia, SEC Form 20F, 2000

Wireless

The group's strategy was to be driven by client loyalty and types of services offered, and would focus on core aspects of domestic business and international expansion. In particular, TIM intended to:

- concentrate on the most profitable market segments, the quality of its services, the consolidation of its leading position with corporate clients and the stabilisation of its churn rate as new competitors offer similar services;

- offer innovative services to develop voice and non-voice revenues;

- improve core business profitability through the rationalisation of costs and the reallocation of resources; and

- increase value creation from international activities, focusing on South America and the Mediterranean Basin.

Wireless: value added services

In 2000, TIM improved its range of value added services, combining it under the new i-TIM trademark. This included, in an integrated solution, WAP, SIM ToolKit technology, voice information and UNI.TIM applications (a universal number which makes it possible to operate voice, fax, e-mail and surfing the Internet in an integrated manner). The i-TIM service would also allow access to the Internet directly in a fast, simple way. TIM was building its brand as a platform for content providers by entering into partnerships and developing business synergies. TIM introduced WAP in May 2000 and entered into over 200 partnerships and commercial agreements with primary content and service providers, such as SEAT-Tin.it, Yahoo!Europe, Sonera Zed, Caltanet, Kataweb, Sit.com and Excite. TIM also entered into agreements with leading Italian banks and financial institutions for the development of online trading and mobile banking (see the Joint Ventures section above).

In August 2000, TIM launched the General Packet Radio Service (GPRS) in Rome and Milan and GPRS national coverage was completed in December 2000. The GPRS service was offered to business customers in the first quarter of 2001 and was extended to consumer segments starting from May 21, 2001.

On January 18, 2001, TIM announced that it had entered into a joint venture with KPN Mobil N.V. and NTT DoCoMo, Inc. to provide mobile Internet services across Europe. Initially, the services, which are expected to include gaming, exchange of messages and images, and certain Internet based transactions, would be introduced in Italy, Germany, the Netherlands and Belgium (an estimated total market reach of approximately 165 million customers). The handsets to be used in connection with these services would be combined i-mode/WAP handsets, which were expected to be available at the end of 2001 at the earliest. TIM expected that these services would be rolled out in Italy late in 2001.

Internet and Other Information Services

Telecom Italia intended to leverage its technological and market leadership to reach the largest possible audience and create highly attractive, flexible and innovative services. In particular, Telecom Italia intended to:

- leverage on Telecom Italia group networks (e.g. fixed, mobile, satellite, narrowband and broadband networks);
- develop a multi-device portal accessible by Internet, mobile devices and TV;
- sustain leadership on portal technological and service innovation;
- exploit its market leadership to attract partners/providers; and
- continue to expand internationally.

In order to accelerate the achievement of these strategic goals in the Internet market, Telecom Italia acquired control of SEAT during 2000 and proceeded to merge Tin.it with SEAT.

Colaninno's Strategy

As outlined earlier much of Colaninno's strategy for Telecom Italia centred around internal financial restructuring, a form of corporate navel gazing which was forced upon him due to the capital structure underlying the company.

In mid-2000 it was announced that Olivetti and Tecnost, its 73% owned subsidiary used as the vehicle for the Telecom Italia take-over, were to be merged. The move was designed to simplify Telecom Italia's chain of control and allow the newly merged entity to directly receive dividend payments from Telecom Italia, thereby reducing its debt more quickly. That debt stood at around Euro 17.5.[89] With the merger complete Olivetti would own directly the 55% stake in Telecom Italia acquired through Tecnost the previous year.

With this restructuring accomplished, Colaninno indicated that his next challenge was "to transform Telecom Italia into Telecom Mondo or Telecom World", an indication that he aimed to increasingly move the company's focus beyond the Italian home market.[90]

Despite this global rhetoric, however, the first part of his strategy was to launch a restructuring programme designed to improve the competitiveness of the company's traditional fixed line operations in Italy. With new competitors arriving the company could no longer rely on its quasi-monopoly position in this area. This restructuring also involved the disposal of non-core operations such as Italtel (the manufacturing business), Sirti (the installation business), Meie Group (insurance) and Teleleasing,

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[89] *Financial Times*, 15 May, 2000
[90] *Financial Times*, 19 May, 2000

the revenues from which were offset against Olivetti's large level of debt (see the Corporate Activity section above for details of these disposals).

Second, he sought to strengthen the mobile business, expanding to overseas markets. It was in the mobile area where Colaninno seemed true to his word on taking a global approach. During his tenure TIM made various forays into foreign markets.

Finally he embarked upon the 'third phase' of the strategy aimed at turning the group into Italy's Internet leader. In early 2000 Italy was in the midst of Internet fever with Tiscali, Italy's free Internet pioneer, seeing its share price increase by 1,900% in the first four months as a listed company.[91] The deal with SEAT (see above) was designed to tap into this growth market. Throughout 2000 Telecom Italia was in talks with large publishing and media groups as it attempted to strengthen the content of its overall Internet services.

But whatever else was going on in terms of strategic planning the bulk of Colaninno's time was still spent trying to wrestle with Telecom Italia's internal capital structure. As the FT observed, "Roberto Colaninno's Olivetti has a precarious grip on TI".[92] Any attempt to issue more stock in Telecom Italia or TIM, for example, to finance take-overs, would dilute that control. As such the company was seen as falling behind in the process of alliances and cross-border acquisitions which was characterising the European industry during this period. In the FT's view this "Achilles heel" of the Italian operator meant that it a lacked "a credible European strategy".[93]

Mr Colaninno took exception to the FT's comments on this occasion and in a letter to the publication stated that rather than "splashing out" shareholders' money on take-overs the company was adopting a more prudent approach in areas such as Latin America and the Mediterranean basin. He also took the opportunity to reinforce his philosophy of "…creating maximum value for all shareholders", a response to the frequent allegations that Telecom Italia's minority shareholders were rarely considered.[94] Given his record at Telecom Italia such comments seem somewhat out of place.

Colaninno did, however, seem well aware of the limitations which its corporate structure placed upon Telecom Italia's strategic options. The plan to reduce Olivetti's debt through the conversion of non-voting shares (see above) was explicitly designed to 'unlock' Telecom Italia. Colaninno seemed prepared to give up Olivetti's majority control of the company in order to make Telecom Italia a more merger-friendly operation. Unfortunately for Colaninno he was ousted before he could develop this strand of his strategy. While he was in charge at Telecom Italia, though, he pursued numerous joint ventures with other Italian and international companies. This may have been as close as he could get to participating in the restructuring taking place within the industry given the company's virtual exclusion from the mergers and acquisitions market.

[91] *Financial Times*, 15 March, 2000
[92] *Financial Times*, 17 July, 2000
[93] *Financial Times*, 17 July, 2000
[94] *Financial Times*, 18 July, 2000

Tronchetti's Strategy

In terms of the company's strategy after the fall of Colaninno, the *New York Times* implied that it would be more of the same; trimming costs at Telecom Italia through disposals and looking for strategic alliances (with TIM seen as a natural partner for Deutsche Telekom's T-Mobile).[95] Despite a change of control, then, the basic strategy seemed largely unaffected. Needless to say, with Telecom Italia's chain of control even more complicated than before, Tronchetti will have to dedicate much of his energy to reconciling the various conflicting interests with the company's own corporate structure.

In early interviews with Tronchetti there was also a sense that he had no ready-made strategy for the new acquisition. Responding to questions relating to his lack of firm proposals he did little to allay the idea that his particular corporate faction was taking a step into the unknown, commenting that:

> "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"[96]

As indicated above, however, he did hint that Telecom Italia might shed SEAT, thereby divesting itself of its TV interests and eliminating a source of conflict with Prime Minister Berlusconi. His understanding of the workings of the Italian political/industrial nexus seemed to be rather better than his knowledge of Telecom Italia.

CORPORATE INFORMATION: COMPANY DATA

Employees

In 1999 Telecom Italia had 120,000 staff. *Business Week* indicated that it would have to cut around 40,000 in order to stay competitive.[97] In September 1999 Colaninno indicated that 13,000 jobs were to be cut over the following two years.[98]

By disposing of a number of non-core operations, such as Italtel (14,500 employees) and Sirti (11,700 employees) during 2000, Colaninno further reduced the company's wage bill.

Financial Data

The table below shows that Telecom Italia's turnover has been fairly stable over the last five years, with 1998 standing out as an exceptional year. Its net profit was slightly up for 2000 on the previous year even though turnover was down marginally. As mentioned earlier, a report by Credit Suisse First Boston in June 2001 forecast that the company's net profits would fall by 14% to $1.5 billion during 2001.

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[95] *New York Times*, 4 August, 2001
[96] Quoted in the *Financial Times*, 1 August, 2001
[97] *Business Week*, 3 May, 1999
[98] *New York Times*, 3 September, 1999

Table 4: Financial Data

	2000 ($m)	1999 ($m)	1998 ($m)	1997 ($m)	1996 ($m)
Turnover	25,424.0	25,989.0	29,302.0	24,203.0	24,153.0
Net Income (Profit)	1,784.0	1,666.0	2,317.2	1,475.0	1,033.0

Source: WSRN.com

The table below shows the percentage contributed to Telecom Italia's operating revenues by each of its main major business areas before the re-organisation of the business segments at the beginning of 2001.

As can be seen, the contribution made from the fixed-line business decreased significantly over the three-year period, with mobile services becoming more important. According to data from Hoovers, TIM had revenues of $7.5 billion in 2000 (up from $7.2 billion in 1998) with a net profit of $1.8 billion (up from $1.6 billion two years earlier).[99]

The international division also grew significantly as the company expanded its number of overseas interests. The manufacturing side of the business was affected by the sale of Italtel. Likewise the contribution made by 'Installation' was lower following the sale of Sirti.

Table 5: Revenue Breakdown by Operating Area

	1998 (%)	1999 (%)	2000 (%)
Fixed-line services - Italy	64.1	59.0	52.6
Mobile services - Italy	22.9	26.1	26.3
Satellite services	1.1	0.8	0.9
International telecommunications services	2.6	5.8	13.3
IT software and services	3.9	4.1	3.8
Manufacturing	2.1	1.8	0.7
Installation	2.5	1.6	1.4
Other activities	0.8	0.8	1.0
	100	100	100

Source: Annual Report, 2000, SEC Form 20F

[99] Hoovers.com

Operational Data

The following table sets out, for the periods indicated, certain selected statistical data for the fixed-line and mobile domestic Italian businesses. The obvious growth areas are ISDN, mobile and the Internet. Despite the increase in the number of mobile users, however, it can be seen that their average expenditure is falling. This reflects the shift of the industry away from high-spending business users towards more occasional users.

Table 6: Customers and Subscriptions

	1998	**1999**	**2000**
Subscriber fixed lines at period-end (thousands	25,986	26,502	27,153
Subscriber fixed line growth (%)	1.1	2.0	2.5
Subscriber fixed lines per full-time equivalent employee at period-end	332	354	409
ISDN equivalent lines at period-end (thousands)	1,735	3,049	4,584
Mobile customers at period-end (thousands)	14,299	18,527	21,601
Mobile customers growth per annum (%)	54.1	29.6	16.6
Average revenue per mobile customer per month (L)	77,600	67,600	59,100
Cellular penetration at period-end (TIM customers per 100 inhabitants)(%)	25.0	32.5	37.5
Cellular market penetration at period-end(%)	36.0	53.1	73.3
Internet subscribers (Tin.it) (thousands)	396	1,990	3,997

Source: Annual Report, 2000, SEC Form 20F

Competition

Fixed-line

As Telecom Italia has lost its monopoly position it has had to face up to a growing number of competitors. In April 2001, the number of licences for the provision of both fixed voice telephony service and building public telecommunications networks, granted by the Ministry of Communications and the National Regulatory Agency, were approximately 20.

Telecom Italia is now facing increasing competition in international and domestic telecommunications services. Telecom Italia, itself, mentioned the following companies as providing the main fixed-line competition:[100]

- Infostrada (now fully controlled by Omnistrada, a holding fully controlled by Mannesmann);
- Albacom (a joint venture between British Telecommunications, Banca Nazionale del Lavoro, ENI and Mediaset);
- Wind (a joint venture between Deutsche Telekom, ENEL, the Italian electrical utility company, and France Telecom);
- TISCALI (90% Renato Soru, 10% KIWI Venture Capital); and
- Tele2 (Italian branch of the Sociètè Europeenne de Communications S.A.).

Wireless

In its latest annual submission to the SEC, Telecom Italia provided the following comments on competition within the Italian mobile market:

> "In 2000, TIM faced competition for providing mobile telecommunication services not only from Omnitel, the second mobile operator which commenced operations in 1995 but also from WIND which commenced operations in March 1999 and from BLU S.p.A., which obtained the license as fourth national operator on August 4, 1999, and began commercial operations with a DCS 1800 service from May 2000
>
> "Management believes that the increase in competition in the mobile market may cause TIM to grow more slowly in the future. Although the entry of the fourth operator further increased penetration in the Italian market to 73.3% or approximately 42.2 million customers, TIM's overall subscriber growth was only 17% in 2000 (compared to 30% in 1999) and its overall market share declined to 51% in 2000 from 61% in 1999". [101]

Table 7 shows the share of the Italian mobile market of each of the four operating companies. As can be seen TIM continues to enjoy a strong position although, as Telecom Italia's comments above indicate, it is gradually losing market share to its competitors.

[100] Telecom Italia, SEC Form 20F, 2000
[101] Telecom Italia, SEC Form 20F, 2000

Table 7: Italian Mobile Market

Company	Subscribers	Market Share (%)
TIM	19,483,000	54.9
Omnitel	12,800,000	36.0
Wind	3,150,000	8.9
Blutel	80,000	0.2
Total	**35,513,000**	**100**

Source: African Cellular Web site (figures for November 2000)

The three mobile competitors to TIM are now looked at in more detail.

Wind (ENEL)

ENEL was Italy's former state-owned electricity monopoly. In 1997 it entered telecommunications through a joint venture with Deutsche Telekom (with France Telecom also taking an interest). The new venture aimed to capture almost a quarter of Italy's mobile market and one-sixth of its fixed telephony by 2005.[102] The business operates under the Wind brand.

Omnitel

Omnitel was Italy's second mobile phone company, competing with TIM. Set up in 1990 its main shareholder was Olivetti (with almost 36% in 1995). Other shareholders included Bell Atlantic, AirTouch, Cellular Communications and Telia.[103] Another shareholder, Mannesmann, was to take control of the company after Olivetti's bid for Telecom Italia.

Following Mannesmann's subsequent take-over by Vodafone, Omnitel became part of the world's largest mobile operator (with Vodafone holding 77% and Verizon Communications 23%). In Italy it now benefits from the Vodafone brand and is second to TIM with almost 16 million customers (2001 figure). Its sales for 2001 (year end March) stood at around $4.4 billion compared with TIM's 2000 figure (year end December) of $7.5 billion. Most recent figures put its number of employees at 6,903 (up over 42% from the previous year) compared with TIM's fairly stable figure of around 9,600.[104]

The company ranks third in Europe by subscriber numbers, no mean achievement in a national market which also includes TIM, Europe's leading mobile company.

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[102] *The Economist*, 18 October, 1997
[103] *The European*, 24 March, 1995
[104] Hoovers.com

Blutel

Blutel is led by the Autostrada motorway group, in partnership with BT. It is the most recent Italian operator, only starting its operations in May 2000.

UMTS Licence

The Italian government awarded five UMTS licences in Italy in November 2000. TIM, together with Omnitel, Wind, Andala S.p.A. and IPSE S.p.A. were awarded licences to provide third generation mobile services. TIM has committed to pay L4,680 billion for its licence, with approximately L4,000 billion having been paid in December 2000. The remaining L680 billion will be payable over a three-year period. The licences are valid for 15 years starting from January 1, 2002.[105]

OTHER THREATS

In its 2000 submission to the SEC, Telecom Italia's management outlined the following list of perceived threats:

- Telecom Italia's ability to continue the introduction of new services to stimulate increased usage of its fixed and wireless networks to compensate for declines in its fixed line business due to market share loss and pricing pressures;

- its ability to achieve cost reduction targets in the time frame established or to continue the process of rationalising its non-core assets;

- the impact of regulatory decisions and changes in the regulatory environment;

- its capacity to achieve the expected return on the significant investments and capital expenditures it has made in Latin America and in Europe;

- the continuing impact of rapid changes in telecommunication and related technologies;

- the impact of political and economic developments in Italy and other countries in which the company operates;

- the impact of changes in currency exchange and interest rates;

- the company's ability to realise the benefits of its investment in UMTS licences and related capital expenditures;

- the impact of litigation or decreased mobile communications usage arising from actual or perceived health risks or other difficulties relating to mobile handsets or transmission masts;

- the company's ability to realise the benefits of the merger of SEAT and Tin.it; and

[105] Telecom Italia, SEC Form 20F, 2000

- SEAT's ability to complete successfully its Internet strategy.[106]

A few of the threats outlined by Telecom Italia, namely regulation and exposure to foreign investment risk are now looked at in some more detail.

Regulation

In its SEC submission Telecom Italian made the following observations on the regulatory environment:

> "The legal framework for regulation in the telecommunications sector in Italy has been completely transformed in recent years, particularly as a consequence of the adoption of the Framework Law (effective November 14, 1995), the Maccanico Law (effective August 1, 1997), the Telecommunications Regulations (effective October 7, 1997) and a series of Orders issued by the National Regulatory Agency which are important to Telecom Italia as it faces increasing competition. To date the regulatory environment has been characterised by an intensive implementation process in order to complete liberalisation. The trend continued in 2000 as additional steps were taken regarding tariff rebalancing, interconnection charges and the initial signing of contracts to permit the unbundling of the local loop".[107]

Italy was long seen as a country where Telecom Italia was protected from competition by the government regulator. This has allowed it to hold onto 89% of the total fixed-line market while this part of the market has been thrown open to competition in countries such as Germany. The EU Directive opening up telecom markets across Europe from 1998 is having an effect, however, and Telecom Italia can no longer rely on a virtual monopoly of the fixed-line business.

In early December 1999 the industry regulator in Italy announced that it intended weakening Telecom Italia's market power by the end of 2000, using a number of measures such as introducing number portability to facilitate the changing of operators by customers.[108]

In April 2001 Italian antitrust authorities fined the company $60 million for abusing its dominant market position.[109]

Following its merger with Seat, Telecom Italia faced a legal challenge from Fininvest, the holding company of Silvio Berlusconi, claiming that the merger contravened antitrust regulations. Berlusconi also tried to block Seat's attempt to acquire television broadcaster Telemontecarlo.[110] It seems unlikely that Berlusconi, who controls Italy's largest private TV stations, will do anything to smooth Telecom Italia's path into television in the future. Having to keep one eye on politicians is unlikely to enhance Telecom Italia's business effectiveness.

[106] Telecom Italia, SEC Form 20F, 2000
[107] Telecom Italia, SEC Form 20F, 2000
[108] *The Economist*, 25 December, 1999
[109] *Business Week*, 2 July, 2001
[110] *Financial Times*, 1 February, 2001

Given this antipathy between Berlusconi and Telecom Italia (under Colaninno) it was perhaps no surprise that Colaninno lost his grip on the company once Berlusconi returned as Italy's Prime Minister. The uncertainty thrown up by such political interest in Telecom Italia could equally affect Telecom Italia in the future. In this sense the company was well advised to include "political developments in Italy" as one of its risk factors. Moreover, given that such developments in Italy tend to be frequent and unpredictable, then Telecom Italia's own future stability could be seriously compromised. With a new government in place in a few years (or months) time, Telecom Italia could conceivably be taken over by a new group of industrial 'barons' with little telecoms experience. The nature of Italian political and corporate life does not seem to bode well for the company's long-term managerial stability.

Latin American Exposure

Like Telefonica of Spain, Telecom Italia is strongly represented in South America with the region accounting for around 15% of its revenues.[111] Hence the company is vulnerable to any economic downturn affecting this area, such as that of 2001.

Investigations and Litigation

While Colaninno is no longer in charge at Telecom Italia the investigation, mentioned earlier, into his (and other Board members') involvement in the Seat deal could potentially prove troublesome for the company. Similarly, Telecom Italia also has legal action pending in the form of the aforementioned case brought by Liverpool Limited at the beginning of 2001. Although no longer the boss at Telecom Italia, Colaninno may well have left behind a number of unresolved problems for his successors to deal with.

Telecom Italia also faces the prospect of a prolonged legal battle over control of Brazil Telecom, in which it has a 38% share. In early 2001 it came into conflict with Opportunity, its local partner (with a 62% stake), over the company's future strategic direction. In the FT's view, "The showdown raises questions about Telecom Italia's strategy in Brazil…".[112] Certainly the possibility of a drawn out struggle for control brings into question Telecom Italia's strategy of taking minority stakes in overseas companies. [In Spain, too, Telecom Italia was "…reported to be at loggerheads" with its partners within the Auna consortium in which it had a 27% stake.[113]]

Further evidence that relations were strained between the two partners in Brazil was provided when TIM chose to compete with Brazil Telecom in the tender for mobile licences in Brazil in March 2001.[114] A company effectively bidding against itself in an auction situation seems like a less than sensible way of conducting an international business.

[111] *Financial Times*, 26 June, 2001
[112] *Financial Times*, 7 February, 2001
[113] *Financial Times*, 27 February, 2001
[114] *Financial Times*, 13 March, 2001