

## **INITIAL IMPACT ASSESSMENT OF OPERATIONAL SEPARATION, AS AT 30 March 2007**

### ***Summary***

As part of our operational separation process discussions with MED, Telecom undertook a bottom up implementation impact analysis. The key findings of that analysis are:

- Initial Separation cost ranges from about \$200m. to \$500m. capex with a best estimate of \$330m. Additional opex rising to about \$40m. p.a. Taking into account the requirements of operational separation only (i.e. excluding Equivalence of Inputs (EoI) costs) we still have cost estimates between \$150m. and \$ 300m. Given that most of this cost is IT system related, experience suggests the costs will be towards the upper end of this range.
- More critically, to deliver in the assumed timeframe (fully complete by 2010) a potential peak of 700 staff may be required (in 07/08). The specific requirements of operational separation are for 450 people in 07/08, in an environment where we have 250 technical vacancies today. The likelihood of us attracting and then retaining the required resource is very low due to a tight labour market coupled with an unattractive employment proposition in terms of work content.

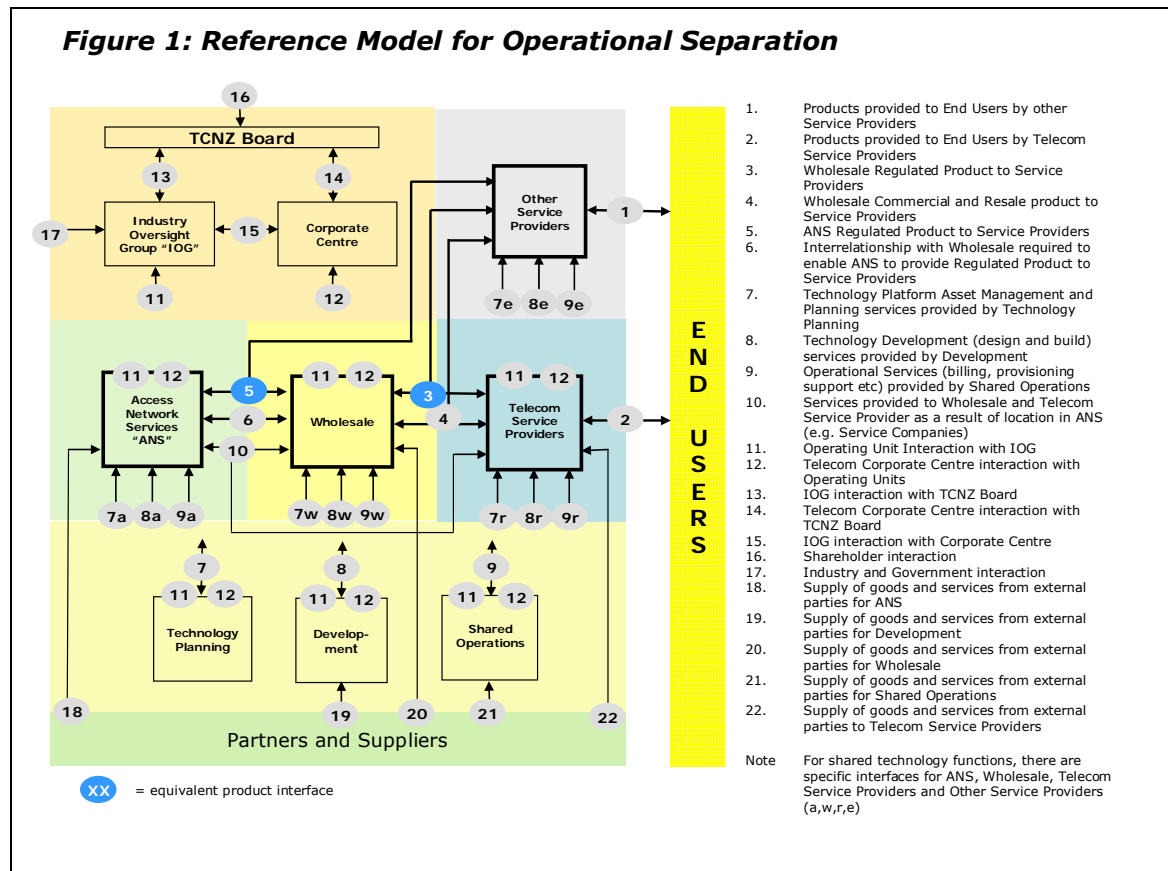
As expected there is a large amount of uncertainty around these estimates, as the determination process has not yet been completed, nor has the detailed design process been started. Risks are extreme, in particular those arising from operational and indeed process complexity and the availability of the necessary human resource skills. Execution would be impossible to the level of certainty required by Government and the Telecom Board within expected time horizons.

### ***Reference model and assumptions***

As part of the MED operational separation process and our own implementation planning process which has commenced in anticipation, we:

- defined a reference model and a scenario based on the requirements as set out by the legalisation — see Figure 1 below (please note this is Telecom's reference model as we do not know for certain what the Minister will require);
- articulated the assumptions in that model, including a required timeframe for delivery;
- undertook an impact analysis in the dimensions of products, processes, technology, accounting, KPI's and governance;
- assessed the cost and resource requirements required to execute the changes against the scenario.

We then undertook a risk analysis with PwC which identified the key risks, the probability of the risks emerging, the impacts if the risks emerged, and the controls we have in place to manage risks.



Key assumptions used in the impact analysis scenario are:

- Process complete by 2010.
- A three box model as defined under the legislation.
- A high degree of sharing of common platforms and operations.
- EoI is limited to new broadband products only and LLU – no EoI on legacy products.
- ANS is a standalone organisation with service company management responsibility.
- The Corporate Centre has some degree of influence on the operating units, setting policy, developing and deploying common management systems – decisions are exercised through advice to the CEO and ultimately the Board.

**Cost and human resource requirements**

Table 1 below summarises the estimated cost of executing to these requirements and model. As indicated above, that estimate does not include any recognition of the feasibility or otherwise of execution.

**Table 1: Estimated total cost impacts, incremental and ongoing – \$m<sup>1</sup>**

	06/07	07/08	08/09	09/10	TOTALS
Programme Costs	3	6	6	3	<b>18</b>
net	3	6	6	3	<b>18</b>
Accounting Separation	3	8	8	4	<b>23</b>
net	3	8	8	4	<b>23</b>
Product Change Costs	1	5	6	3	<b>15</b>
net	0	0	0	0	<b>0</b>
Process Change Costs	1	52	22	13	<b>88</b>
net	1	31	19	0	<b>51</b>
Technology Costs (gross)	18	55	55	55	<b>183</b>
net	15	45	45	45	<b>150</b>
<b>Total Change Costs</b>	<b>26</b>	<b>126</b>	<b>97</b>	<b>78</b>	<b>327</b>
<b>net</b>	<b>22</b>	<b>90</b>	<b>78</b>	<b>52</b>	<b>242</b>
Ongoing Operating Costs	1	34	37	40	

The key drivers of resources and cost are:

- The products defined as relevant.
- The degree of equivalence of relevant products.
- Timing of key separation deliverables.
- The degree to which processes and platforms can be shared.

Table 2 below summarises human resource estimates that would be required for the complete programme of work, including product development, operational separation, accounting separation, etc.

**Table 2: Estimated number of full time equivalent (fte) resource**

	06/07	07/08	08/09	09/10
Programme	20	20	15	10
Accounting Separation	25	35	20	0
Product Change	15	35	40	20
Process Change	10	420	180	105
Technology	65	200	200	200
<b>Total</b>	<b>135</b>	<b>710</b>	<b>455</b>	<b>335</b>
Ongoing Operations	20	250	250	200

### **Key risks that make this look impossible to execute**

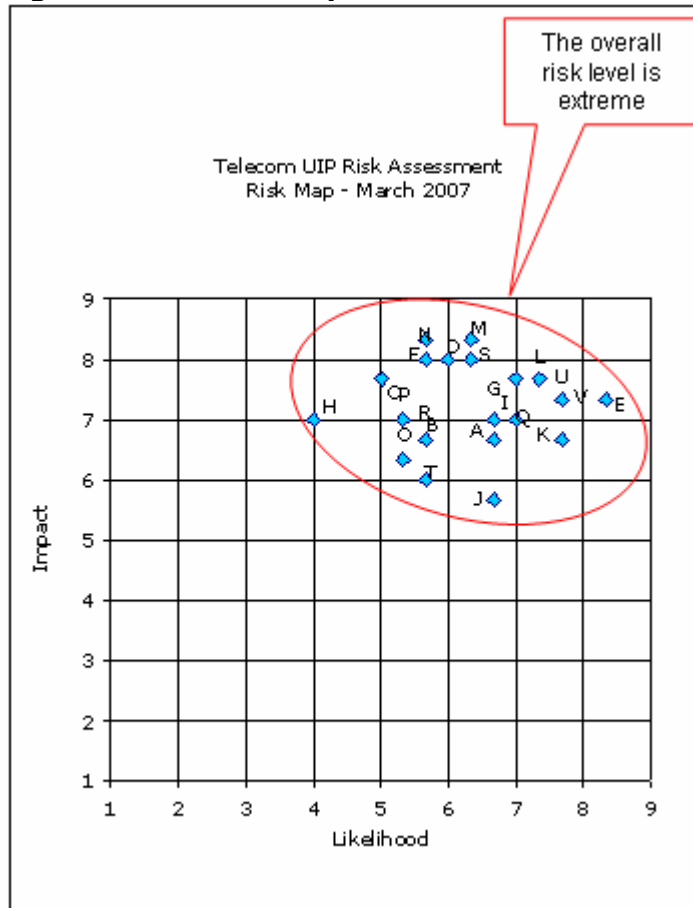
Figure 2 below maps the impact of key risks against their likelihood. The overall risk level is extreme. Execution to the standard and within expected time horizons required by both the Government and the Telecom Board will not be possible. Regardless of being able to access financial and human resources, the ability to navigate operational separation and wholesale product delivery across a multi-dimensional product, process, people and platform environment makes this task impossible in the assumed timeframes.

These risks are the result of complexity and limited resource availability. The changes impact across the whole of Telecom. Thus, for example: 15% of Telecom roles will require major change or be new, significant

<sup>1</sup> Some costs have been excluded from this analysis – e.g. accelerated depreciation, opportunity costs.

redevelopment of Telecom retail products will be required, process redesign will be necessary across customer facing sales and service, product management and technology support, there will be significant additional workload on integration and testing, and all accounting systems will need to change.

**Figure 2: UIP Risk Map**



At peak more than 700 ftes may be required, most in the process development areas, with a significant number also in IT/IS. These estimations assume these resources can be acquired. It is clear that that assumption cannot be met. (Note that there are considerable vacancies across Telecom in NZ, 250 of which are in IT/IS.)

### **Conclusions**

In order to execute operational separation successfully at least one of the following needs to change:

- Required timeframe for delivery of separation.
- Required timeframe for delivery of any EoI.
- The complexity of the model, in particular, the extent to which shared units can support separation through transparent contractual arrangements, and the complexity of mechanisms to implement group controls.