

# AT&T and Apple

## A Strategic Alliance

Randall Stephenson, CEO of AT&T, sat at his desk in January 2011 during a moment of quiet reflection. Verizon Wireless had just announced it would offer the Apple iPhone beginning in a few weeks. AT&T had been the sole carrier of the iPhone since its launch to the market in June 2007, and the strategic alliance between AT&T and Apple that had existed for almost five years would soon end. Stephenson and the AT&T leadership team were now in a position to evaluate whether the Apple alliance had helped AT&T achieve its objectives—and to consider what might happen going forward given that AT&T would no longer be the exclusive service provider for the iPhone.

At the inception of the alliance, AT&T was looking to rebrand itself as a *wireless* phone carrier. Apple was designing the iPhone and looking for the optimal way to launch it into the new smart phone market. The two companies ultimately decided that combining their resources and capabilities in a strategic alliance centered on the iPhone would help both companies achieve their strategic objectives. But now that the alliance was over, the AT&T leadership team needed to look to the future to determine what other strategic initiatives—including other potential alliances or acquisitions—would provide the best vehicles for helping the company achieve its strategic objectives.

## The History of AT&T

The American Telephone and Telegraph Company (AT&T) was founded in 1885 by Alexander Graham Bell after his invention of the telephone. After a merger with the Bell telephone company in 1900, AT&T became the main phone company in the United States. In 1913, AT&T also became a government-sanctioned monopoly of the telephone market, as a result of the Kingsbury Commitment. (Essentially, the company was allowed to be a monopoly “provided [AT&T] is independent, intelligent, considerate, thorough and just.”<sup>1</sup>) The government agreed to allow AT&T’s monopolistic operation after the company agreed to allow independents to interconnect to the long distance network under certain conditions and to abstain from acquiring companies if the ICC<sup>2</sup> objected.

For decades afterwards, AT&T continued to be the only truly nationwide phone company, and it continually had to walk a fine line between being a monopoly and acting like one. Litigation in the 1970s ultimately led to the breakup of the AT&T Bell System in 1982, resulting in AT&T divesting itself of its local telephone operations while still maintaining its long-distance network. The seven new regional Bell operating companies (RBOC), also called Baby Bells, were Ameritech, Bell Atlantic, BellSouth, NYNEX, Pacific Telesis, Southwestern Bell, and US West. Although these Baby Bells remained independent for many years, all were acquired over the years as the industry consolidated into a few players. Major acquisition events are summarized in **Exhibit 1**.

**EXHIBIT 1 Major Acquisition Events of Baby Bells**

Original Baby Bell	Acquisition By	Year
Ameritech	SBC (now part of AT&T Inc.)	1999
Bell Atlantic	Verizon Communications	2000
BellSouth	AT&T Inc.	2006
NYNEX	Bell Atlantic	1996
Pacific Telesis	SBC (now part of AT&T Inc.)	1997
Southwestern Bell (later SBC)	Acquired AT&T Corp., became AT&T Inc.	2005
US West	Qwest, and later Century Link	2000, 2011

The breakup of AT&T led to a new era of competition among the Baby Bells, AT&T, and new entrants into the telecommunications industry. Long distance over local telephone service became an intensely competitive business. Having started from a monopoly position, AT&T would inevitably see its market share fall, and it did—from 90 percent in 1984 to about 50 percent a dozen years later. As a result of new competition and new technologies (primarily fiber optic transmission), prices plummeted by more than 40 percent over the next five years, and volume exploded. In 1984, AT&T carried an average of 37.5 million calls per average business day. In 1989, the equivalent volume was 105.9 million, and in 1999, it was 270 million. In the 1990s, the growth of computers, and then the emergence of the Internet, led to an increasing number of customers wanting to send data, rather than voice, over wired and wireless networks.<sup>3</sup> AT&T, along with other long-distance providers, was looking for new ways to offer services that would meet these new customer demands.

## The History of AT&T Wireless

In 1981, AT&T estimated that the total US market for cellular phone users would be about 900,000 by the start of the twenty-first century, and thus, it was not a compelling market for it at the time. However, McCaw Cellular Communications, founded in 1987, saw cellular technology as a huge opportunity and was a savvy pioneer in the emerging mobile phone market. McCaw quickly outpaced the growth of the Baby Bells through a series of acquisitions and spectrum license purchases, and it became the single largest cellular spectrum owner by 1990, with licenses in most major US cities (spectrum licenses were necessary because cellular technology used spectrum as the vehicle for routing calls). Cellular phone technology became an increasingly important alternative to landlines as the technology was more widely adopted throughout the 1980s and early 1990s. At this point, McCaw's focus turned from acquiring licenses to servicing the network and signing up customers in what was now a maturing technology on the cusp of explosive growth. In order to handle the customer side of the business, McCaw turned to AT&T for technology.

With AT&T's help, McCaw introduced SS7 signaling technology across its entire network, allowing it to effectively tie its network together and to provide customers with the ability to "roam" away from their home network where they were subscribed. They called the new system "Cellular One." In 1992, AT&T purchased one-third of McCaw for \$3.8 billion. At the time, McCaw had two million Cellular One subscribers and was generating \$1.75 billion in annual revenue. AT&T's previous predictions of total wireless users were way off the mark, but now the company was ready to jump into the growing industry.

In 1994, AT&T purchased the rest of McCaw Cellular for \$11.5 billion, creating AT&T Wireless Group under AT&T Corp.<sup>4</sup> At the time, AT&T Wireless was the second largest cellular carrier in the United States thanks to the Cellular One user base, and by the end of 1997, it grew to become the largest cellular provider.