

BUSINESS REVIEW

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Our lines of business

Our customer-facing lines of business are BT Global Services, BT Retail, BT Wholesale and Openreach. The financial performance of our customer-facing lines of business for 2011, 2010 and 2009 is discussed in this section. We measure the performance of the customer-facing lines of business on an 'adjusted' basis being revenue, EBITDA and operating profits; all stated not including specific items which are not allocated to customer-facing lines of business. Specific items are not allocated to the customer-facing lines of business as this reflects how financial performance is measured by management and reported to the Board and *Operating Committee*. For further discussion of specific items, see pages 56 to 57. A reconciliation of adjusted EBITDA to group operating profit by customer-facing lines of business, and for the group, is provided in **Segment information**, note 1 to the consolidated financial statements. The financial performance commentaries for each customer-facing line of business also discuss movements in operating cash flow. Operating cash flow is defined as adjusted EBITDA less direct and allocated capital expenditure, working capital movements and other non-cash items.

INTRODUCTION FROM THE CHIEF EXECUTIVE



Ian Livingston
Chief Executive

A better business

BT has become a better business in the last year – by staying focused on improving customer service and transforming costs, and by investing in the areas that we believe will deliver future growth. However, we still have much more to do in all these areas.

Our annual report will give you a good summary of the progress we're making – and I'd like to share my thoughts on how we're doing in creating a better future for BT.

Financially, we now have a much stronger base. We've nearly trebled adjusted free cash flow in the last two years – to over £2.2bn. We intend to build on this in the year ahead as we pursue our goal of growing the business whilst continuing to grow our profits and cash flow.

Delivering excellent customer service, 'right first time', is important for our customers and is a critical factor in helping to transform costs. We've made improvements in many areas, though this was masked by problems when a huge upsurge in demand for our engineers – and very poor winter weather – meant we didn't always deliver on our promises. While we are largely on top of things now, lessons have been learnt in making sure that we get better forecasts from our communications provider customers and by having a greater flexibility in our resourcing.

Improvements in our processes have helped drive efficiency with total operating costs reducing by over £1bn in the year. This has freed up financial and other resources which will allow us to invest in potential growth areas. While it's early days, there are positive signs that these investments are starting to pay off.

For example, Openreach's fibre broadband network roll-out is on track to pass 5m UK premises by spring 2011 – well on our way to 10m premises by 2012. Thousands of customers are taking up super-fast fibre-based broadband every week and really like the service. The overall growth in the broadband market has also been the driver of customers seeking to be connected to fixed lines, with the number of copper lines increasing for the first time for many years.

Our BT Retail business grew its share of the broadband market. Our retail market share excluding cable was 36% in the year. This is important as broadband is increasingly the means of accessing a range of services including TV, education and entertainment. After a tough 18 months, BT Business is back on track, signing up small and medium-sized businesses to IT and mobility services.

BT Global Services reached a significant milestone becoming operating cash flow positive a year ahead of schedule. Our investment in the Asia Pacific region – where we are extending our presence to better serve multinational corporations based in Asia and expanding into Asia – is going well. And our sales teams are signing important deals with new and existing customers – building on our position as a global leader in managed networked IT services.

Our BT Wholesale business is successfully moving from being a traditional UK wholesale provider to one that's providing long-term managed network services and network outsourcing to the UK industry.

Communication is ever more at the centre of our customers' lives and businesses. The more they rely on it, the more they expect from BT and we are happy to step up to that challenge. BT is delivering better service and much improved financial results allowing us to invest in the UK and across the globe. We still have much to do, but we are making progress in building a better business with a better future for all our stakeholders.

Thank you for your support.

Ian Livingston
Chief Executive

11 May 2011

£2.2bn

Adjusted free cash flow

5m

UK premises passed by super-fast broadband by spring 2011

36%

BT's retail share of DSL and LLU broadband market

OUR BUSINESS AND STRATEGY

- Who we are
- What we do
- Our aim
- Our strategic priorities
- How we measure our progress

No. 1

Provider of fixed telephony lines in the UK

3%

Improvement in customer service delivery measure

£1.1bn

Operating cost^a savings

£2.5bn

Potential investment in super-fast broadband network


Progress made against all our strategic priorities

This is the BT Annual Report for the year ended 31 March 2011. It complies with UK regulations and comprises part of the Annual Report on Form 20-F for the US Securities and Exchange Commission to meet US regulations. This Annual Report has been sent to shareholders who have elected to receive a copy. A separate summary financial statement & notice of meeting 2011 has been issued to shareholders who have elected to receive a shorter document. Both documents are available on the company's website, www.bt.com.

In this Annual Report, references to 'BT Group', 'BT', 'the group', 'the company', 'we' or 'our' are to BT Group plc (which includes the activities of British Telecommunications plc) and its subsidiaries and lines of business, internal service units, or any of them as the context may require.

References to 'a year' are to the financial year ended 31 March of that year, e.g. '2011' refers to the year ended 31 March 2011, except in relation to our super-fast fibre-based broadband roll-out plans, which are based on calendar years, not financial years. Unless otherwise stated, all non financial statistics are at 31 March 2011 except BT Infinity customer numbers which are at 6 May 2011.

Please see cautionary statement regarding forward-looking statements on page 162.

 Denotes corporate responsibility activities. Being a responsible and sustainable business is integral to the way we work. Our non financial key performance indicators measure our progress. These also include direct costs to BT related to our environmental and social performance, in line with the principles of the connected reporting framework.

^a Before specific items, depreciation and amortisation. See page 48 for details.

Who we are

BT is one of the world's leading communications services companies, serving the needs of customers in the UK and in more than 170 countries worldwide.

What we do

Our main activities are the provision of fixed telephony lines and calls, broadband, mobile and TV products and services as well as networked IT services.

In the UK we are a leading communications services provider. We sell products and services to consumers, small and medium-sized enterprises (SMEs) and the public sector. We also sell wholesale products and services to communications providers (CPs) in the UK and around the world. Globally, we supply managed networked IT services to multinational corporations, domestic businesses and national and local government organisations.

Our aim

Our aim is to drive shareholder value by making BT a better business with a better future. Last year we set out a three-year plan to achieve this aim. Our strategy focuses on three key areas – customer service delivery, cost transformation and investing for the future. These three areas are the building blocks for making BT a better business. The better we serve our customers, the less time and money we spend on fixing faults and by transforming our costs we create new opportunities for investment in our future. By investing in our strategic priorities we expect to deliver growth in 2013.

Customer service delivery

Our strategy starts with customer service and we continually work to improve the level of customer experience. In practice this means keeping our promises, being easy to contact and straightforward to deal with; it means keeping our customers informed and taking prompt action to put things right if they have cause to complain; above all it means trying to do things 'right first time'.

'Right first time' is our key measure for customer service. It measures how often we get things right the first time for our customers: this is important as failure increases our costs. In 2011 we achieved a 3% improvement in this measure which compares with a 10.5% improvement in 2010. This shows that we made further progress this year but the scale was less than in previous years due to a number of issues, particularly a large increase in provision volumes requiring engineer visits. These were up over 25% in the year. In addition, the very poor winter weather both increased repair demand and reduced our ability to deploy engineers effectively. In order to meet these challenges we recruited additional engineers and have now brought repair work in hand to the equivalent of a day and a half's work. Provision lead times improved to an average of 10 days at the end of March 2011. We will learn from what went wrong and will work more closely with our CP customers to ensure that together we provide better volume forecasts and we have a more flexible resource that can meet peaks of demand more effectively.

We did make progress in a number of other areas. Call handling times for consumer sales improved by 19 seconds due to the introduction of Agent.com, a new system that allows our sales agents to process orders faster and more effectively. With the roll-out of a desktop help system, broadband consumer customers can now solve many problems without the need to call our service centres. Within BT Retail, our 'one contact resolution' aims to deal with customer queries in one call. We saw the number of queries dealt with in one contact increase by 15% in BT Consumer and

9% in BT Business. Within BT Global Services' 'right first time' programme, we reduced customer faults by 11%.

We believe the changes we have made, and will make in the next financial year, will deliver significantly improved service levels for our customers.

Cost transformation

Cost transformation goes hand in hand with getting it 'right first time' for customer service – we have continued with our drive to improve operational efficiency across the business, from using IT systems more effectively and driving savings from suppliers, to streamlining internal processes and ways of working.

In 2011 we made good progress with our cost transformation activities, which have contributed to our operating costs savings of £1.1bn, representing a 7% decline in our operating cost base. This represents a cumulative reduction in our cost base of almost £2bn over the last two years. All of our lines of business and internal service units have made a contribution to the delivery of these savings. See **Financial review – Transforming our cost base** on page 47 for further details.

Savings have been delivered from targeted cost reduction programmes which focus on:

- eliminating the cost of failure across the group
- an overhead value analysis programme, which provides a structured approach to reducing costs
- process re-engineering, which reviews processes end-to-end across the group to remove unnecessary steps.

These actions have allowed us to operate more efficiently and consequently reduce our costs while at the same time reducing failure in our processes which assist customer service.


We have also continued to review procurement arrangements with our major suppliers on a group-wide basis and have improved supply terms and service delivery.

As a result of increased efficiency across our operations we have continued to reduce our net labour costs, which were down 7%. As far as possible, we try to retain our permanent workforce through redeployment, retraining and in-sourcing work which has been previously performed by third parties. Around 4,000 people have been re-skilled and redeployed into roles within BT in 2011.

Investing for the future

By being more efficient in customer service and transforming our cost base we can provide services to our customers on a more competitive basis and improve our cash generation. This is critical as it creates the opportunity for us to invest in our strategic priorities as well as reduce our overall level of net debt, support the pension fund and pay dividends to shareholders.

In 2010 we set out five strategic priorities which are underpinned by our views of the markets we operate in. By focusing investment around these strategic priorities we believe we will build a better future for all our stakeholders.

 In 2011 we added a new strategic priority which reflects our work to embed sustainability and corporate responsibility at the core of our business.

Our strategic priorities

Driving broadband-based consumer services

Competition in the UK consumer market is intense and customers' demands are evolving. Around 99% of UK premises now have access to broadband and customers are increasingly buying their line and calls service together with broadband and TV. We already provide a comprehensive broadband service offering many features and offer attractively priced bundles of services.

During 2011 we made the following progress:

- we grew our retail broadband customer base to 5.7m, up 11%
- 144,000 customers now take our super-fast fibre-based broadband service, BT Infinity
- 79% of the total UK broadband market, including cable, is now delivered over the BT network, with our retail share at 29%
- our retail share of DSL and LLU net additions in the fourth quarter of 2011 was 64%, the highest share of quarterly net additions in eight years
- BT Vision's customer base grew to 575,000.

Looking ahead, we are aiming to grow the number of services we provide customers by building on our position as the market leader in broadband. TV is a growth area for us and one that will benefit from the roll-out of super-fast broadband. On-demand TV is becoming more popular and TV services will become increasingly personalised and interactive. It is for those reasons that we are investing in content and delivery, improving the user-interface for BT Vision and participating in the YouView joint venture.

In addition, over the coming years we expect to see the emergence of a range of broadband-based consumer services, building on new and existing services. There will also be new opportunities in the entertainment and networked home space, such as energy usage management and home automation.

Our future plans for driving broadband-based consumer services include:

- continuing to offer attractive bundled voice, broadband and TV services
- enhancing our entertainment offering with services such as online gaming
- seeking new opportunities to differentiate our services, for example by using our wi-fi network.

Being the 'Brand for Business' for UK SMEs

We are the leading provider of fixed-line communications services for SMEs in the UK and we are well-placed to grow our revenue from IT and mobility services. The market remains highly fragmented and we believe this provides us with further opportunities to become the main brand SMEs trust by providing a one-stop shop for all their communications needs, and will help us to increase our market share.

During 2011 we made the following progress:

- improved trends in BT Business compared with prior years, with revenue only marginally down in 2011
- IT services and mobility revenue grew by 17% and 14%, respectively.

Our opportunities for growth include selling new services to our existing customer base and helping customers migrate to cloud-based services, which allow customers to access IT services on a more flexible basis.

Our future plans for becoming the 'Brand for Business' for UK SMEs include:

- increasing the number of SME customers buying our services
- selling more IT services and mobility to our existing SME customers
- offering bundles which combine fixed and mobile communication and IT services.

BT Global Services – a global leader

BT Global Services is already a global leader in the provision of managed networked IT services. Over the past year we have focused on improving the performance of the business by simplifying the portfolio, rationalising systems and networks, industrialising the process of bid management and exploiting standardisation and automation. We adopted an industry sector-based structure to help focus on customer needs in four global sectors: Banking & Financial Markets; Commerce; Consumer Packaged Goods; and Government & Health. We also invested in growth areas such as multi-protocol label switching (MPLS), Ethernet, unified communications, security, customer relationship management, mobility and cloud services. Last year we identified the Asia Pacific region as a target for investment and we are strengthening our ability to support new and existing customers in this growing market.

During 2011 we made the following progress:

- we delivered operating cash flow of £119m, a year ahead of target
- order intake was £7.3bn
- we invested to grow our presence in the Asia Pacific region
- we have been recognised as a leader, winning the award for 'Best Global Operator' at the World Communication Awards 2010.

Our future plans include:

- building on our strong market position in managed networked IT services
- expanding further to serve our customers in fast-growing economies
- developing our relationships with our target customers, and improving their customer experience
- building and enhancing industry based solutions in key sectors
- making our operations more efficient
- generating around £200m of operating cash flow in 2012.

The wholesaler of choice

BT is committed to supplying CPs in the UK and overseas with vital communications infrastructure and services. While we are already the largest wholesaler in Europe, there are significant opportunities for us to win new business. We aim to be the 'wholesaler of choice' in the UK, where we already have more than 1,000 CP customers, provide fixed-line services to the five key mobile operators and are the established partner for carriers. We also operate an international wholesale business, where we serve customers in over 170 countries.

During 2011 we made the following progress:

- our managed network services (MNS) revenue grew by 8%
- 40% of BT Wholesale's external revenue is now underpinned by long-term contracts
- our second generation copper broadband service is available to over 65% of UK premises

- we received the 'Best Wholesale Carrier' award at the World Communication Awards 2010.

Our future plans for becoming the wholesaler of choice include:

- increasing the proportion of revenue under long-term contract by selling new MNS contracts
- making investments in Wholesale Broadband Connect, our second generation broadband service, which we plan to extend to cover around 80% of UK premises by December 2011
- launching IP services that enable our CP customers to enter and exploit new and emerging markets
- increasing capacity on our IP platforms to meet growing customer demand
- continuing to evolve our next generation product portfolio for the global wholesale market.

The best network provider

BT is the largest provider of fixed telephony lines in the UK and through Openreach we manage the 'last mile' of the UK access network. We offer access to this network to other CPs on an open and equal basis.

It is our aim to improve network reliability, extend our Ethernet footprint, continue our super-fast broadband roll-out and put in place systems improvements and transformation programmes to enhance our proposition, reduce our cost base and make it easier for CPs to do business with us.

During 2011 we made the following progress:

- we rolled out our super-fast fibre-based broadband network to reach over 4m UK premises
- we contributed to the growth of the broadband market in the UK by the provision of 7.6m external unbundled lines, up 15%
- we extended our footprint to over 1,000 fibre Ethernet nodes, providing the largest Ethernet network in the UK
- we commenced testing a 1Gbps service over fibre-to-the-premises.

Our £2.5bn investment in super-fast fibre-based broadband will make the UK one of the best connected countries in the world.

Super-fast broadband roll-out plan



Our super-fast fibre roll-out plans are ambitious and we are working to pass two thirds of UK premises by the end of 2015. To deliver this we are installing 30,000 cabinets, connecting 200,000 distribution points, enabling over 1,000 exchanges and laying over 50,000km of fibre. We have developed and refined our systems and processes to enable us to deliver fibre faster and we are upgrading more than 250 cabinets and enabling on average around 80,000 premises each week to access fibre.

We also aim to bring fibre to homes and businesses in the 'final third' of the UK, given the right investment and regulatory conditions and access to Government funds.

We are planning to roll out two solutions as part of our super-fast broadband deployment:

- fibre-to-the-cabinet (FTTC) where new fibre-optic cables link telephone exchanges to road-side cabinets and our copper lines are used to deliver super-fast broadband to premises
- fibre-to-the-premises (FTTP) where new fibre-optic cables are deployed the whole way from the exchange to the premises.

We have deployed FTTC first and are on track to pass around 5m premises by spring 2011. Currently, we are conducting FTTP trials at a number of sites with speeds of up to 1Gbps and full commercial FTTP is expected to be launched in 2011.

We see the Government's creation of Broadband Delivery UK (BDUK) as a positive step in providing services to the 'final third' of premises in rural areas of the country where it is not currently economic to provide super-fast broadband services. We are committed to exploring ways to extend the footprint of super-fast broadband, and our deployments in Cornwall and Northern Ireland demonstrate that commitment.

All parts of the business play a role in the delivery of super-fast broadband:

- Openreach is building the fibre access infrastructure which will offer super-fast broadband to all CPs on an open and equal basis
- BT Wholesale is developing products and services which use the Openreach network so it can offer managed super-fast broadband to its CP customers
- BT Retail and BT Global Services will purchase the BT Wholesale offer and design their own propositions and services for end users, for instance BT Infinity
- BT Innovate & Design and BT Operate both play a key role in leading the design, development and end-to-end testing of the platforms, systems and products that will underpin our propositions for customers.

Through Openreach we have continued to invest in our market-leading UK Ethernet footprint. Ethernet is a data service primarily used by businesses to create their own private networks and can run over copper or fibre.

Being the best network provider is not just about expanding coverage. Openreach has made substantial progress in improving the copper access network in recent years. Network resilience has been improved through an extensive programme of work, accompanied by efficiency gains with regard to provision and repair times. As a result of these efforts, customers now experience a copper line fault once in every 14 years compared with once in every nine years as experienced four years ago.

Our future plans for becoming the best network provider include:

- continuing with our super-fast broadband roll-out
- providing new access products such as duct and pole access
- improving our overall efficiency while improving the resilience and reliability of our networks
- increasing our potential FTTC speeds to up to 80Mbps.

A responsible and sustainable business leader

We believe that long-term profitable growth can be aided by supporting the communities in which we operate and through sustainable business practices. We are committed to contributing positively to society, the economy and the environment through our operations, our employees and our products and services. We aim to provide products and services which enable our customers to be more sustainable by making use of innovative communication and managed networked IT services.

Even though this is a new strategic priority, we are already recognised as a responsible and sustainable business leader. For example we have:

- cut our absolute carbon footprint by 53% since 1997 and reduced energy consumption by 2.5% in 2011
- invested money and in-kind contributions worth £27.6m supporting responsible and sustainable business activities, exceeding our commitment to invest at least 1% of group pre-tax profits
- launched a new online fundraising service for UK charities called MyDonate, the first online fundraising service not to charge a subscription fee or commission
- maintained gold sector status in the Dow Jones Sustainability Index and 'Platinum Plus' level in the Business in the Community Corporate Responsibility Index. We also won awards such as the World Communication Award 'Green Award'.

More details of our corporate responsibility activities can be found at **Our corporate responsibility** on page 36.

An increasing number of customers are seeking to source from suppliers that can demonstrate a strong track record in improving the sustainability of their own businesses. Our credentials as a responsible and sustainable business leader support our ability to win and retain customers. We also plan to contribute in many other ways through the responsible use of resources; through our employment; and through our community involvement. Our drive for BT to be a better business with a better future is therefore linked to our commitment to be a leader in corporate responsibility and sustainability.

Our future plans for maintaining and enhancing our position as a responsible and sustainable business leader include:

- building stronger communities through the power of our technology and people
- reducing carbon emissions and our impact on the environment through our operations and products
- behaving responsibly towards our customers, people and our suppliers
- promoting MyDonate for the benefit of charities and fundraising.

How we measure our progress

We measure our overall progress by three key performance indicators: adjusted earnings per share, reported free cash flow and customer service improvement (see **Our strategy – Key performance indicators** on page 6).

OUR MARKETS AND CUSTOMERS

- UK consumers
- UK SMEs
- Global networked IT services
- Wholesale
- Access
- Regulation

51%

BT's share of the UK fixed-line market

c.£5.7bn

Value of UK pay TV market

c.£29bn

Amount UK SMEs spend on IT and communications services

US\$584bn^a

Value of global IT services market

We compete in a number of markets including the consumer and SME markets in the UK and delivering managed networked IT services globally. We also offer a range of wholesale and access products and services to CPs, both in the UK and internationally.

In the UK, regulation and the open, commercial marketplace have created one of the most competitive telecoms markets in the world. Some of the products and services we offer in the UK are regulated because of our significant market power in some sectors. See **Regulation** on page 17 for more information. We also offer access services on an open and equal basis to all CPs.

UK consumers

The consumer fixed-line telecoms market in the UK is highly competitive, with more than 160 companies offering broadband and/or voice services. Although total UK residential fixed-line call minutes have declined 18% over the past three years, the total number of UK residential lines is up 2% over this period according to Ofcom data. The decline in fixed-line call minutes can be attributed to factors such as consumers increasingly using mobile phones rather than fixed-line phones, while the continued growth in fixed-line broadband has helped slow the decline in the number of residential lines.

BT is the leading provider of fixed-line voice and broadband services in the UK consumer market. We provide consumers with a range of services including fixed-line voice, broadband and TV products and services. We also provide directory services – both in print and via directory enquiries – and sell telephones and computer equipment through our online retail presences.

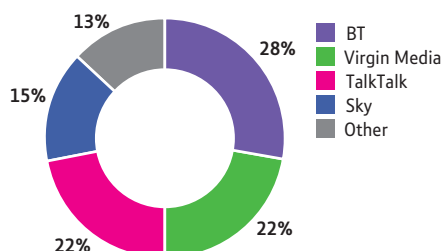
BT's share of the fixed-line market has declined from 69% to 51% over the past three years, reflecting the competitive nature of the market and continued growth in local loop unbundling (LLU). The share of the fixed-line market provided by cable has remained flat at 18% over the same period.

An important change in the consumer market occurred when regulation was modified to allow us to sell our products and services in bundles to customers for one price. This has allowed us to compete with other providers in offering attractive bundles: 40% of UK consumers currently buy triple-play services of broadband, pay TV and fixed-line telephony.

We sell our services to consumers online – directly and via selected affiliates – and through our call centres. We also advertise across a range of media including TV and social media, such as Facebook. More information about our products and services for UK consumers can be found in **BT Retail** on page 26.

The UK broadband market is highly competitive. Following a period of industry consolidation, our main competitors are Virgin Media, TalkTalk Group and Sky. Between us we account for 87% of the broadband market.

Share of UK broadband market at December 2010



^a IDC Global IT services Market size. Source Worldwide Black Book Q1, 2011.


The UK consumer broadband market has grown to reach more than 17.7m households. BT has contributed to this growth by supplying LLU over which suppliers can deliver broadband services. The UK is now the sixth largest broadband market in the world by number of households.

Broadband penetration has increased year-on-year and the fixed broadband penetration rate now exceeds 65%. This has been driven by the increasing use of the internet by consumers. The number of adults accessing the internet every day has increased 42% over the past three years.

We believe that fixed broadband will remain most popular with customers and mobile broadband will be largely complementary. The increasing importance of broadband-enabled services in our daily lives and initiatives such as the Government sponsored Race Online 2012 have contributed to continued growth in the broadband market.

Pay TV services remain popular with customers and this sector continues to grow in size. The UK pay TV market is estimated at around £5.7bn and has increased by over 30% in the past three years. Customers value the convenience of internet-based TV content. Ofcom data shows that 31% of internet-enabled households watched catch-up TV online, up from 23% a year earlier.

There are a number of companies in the UK market supplying pay TV, video-on demand, and catch-up TV services. YouView, the joint venture between the BBC, ITV, Channel 4, BT and others is expected to be launched in calendar year 2012 and will make a significant contribution to the UK TV market.

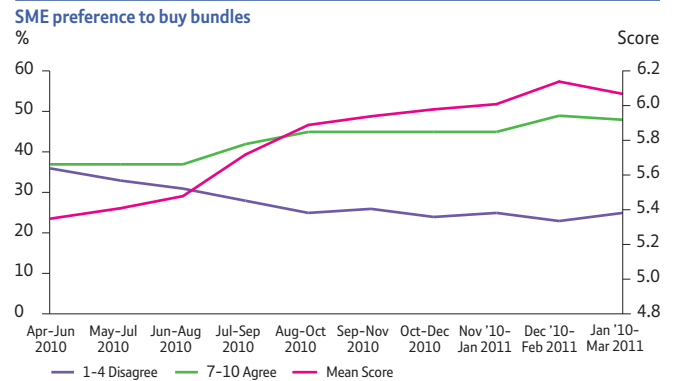
 Consumers are increasingly demanding more ethical and environmentally-friendly business practices from their suppliers. A growing number of customers want to buy services which will allow them to improve their own sustainability performance by improving efficiency and reducing emissions. We have met this demand by developing products such as our Home Hub 3 which uses 39% less power than previous models.

UK SMEs

The overall SME market in the UK is estimated as having 4.8m customers with spend on IT, broadband and network services estimated at about £29bn. Competition to supply services to SME customers remains fragmented, with many of our competitors typically focusing on specific segments of the market depending on customer size, focus and geography. Our competitors include companies focused on providing services to SMEs such as Daisy and Opal, larger companies such as Virgin Media and Cable & Wireless Worldwide, and mobile operators and IT services companies such as Phoenix IT and Computacenter.

We are the leading provider of fixed-line communications services for SMEs in the UK market. Our share of the fixed-line market is 52% and we have around 1m SME customers, characterised by their diversity. They range from start-ups and 'microbusinesses' with fewer than 10 employees to medium-sized business with up to 1,000 employees.

The recession has had an impact on SMEs' spending levels with the markets for fixed-line voice and data, mobile services and IT services all declining since 2008. IT services spend is expected to resume growth in calendar year 2011, while we expect the fixed-line voice and data market to continue to decline, driven in part by the significant fall in fixed-line business call minutes. A positive trend in the market is SME customers' increasing preference to buy bundled services, comprising fixed lines, mobile and broadband.



Source: GfKNOP on behalf of BT. Survey of SMEs with fixed-line, broadband and mobile. Agreement with statement 'your organisation prefers to buy complete Comms/IT products in combined package' with score 1 to 10.

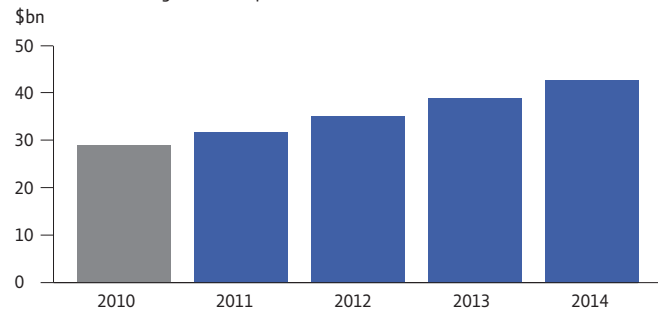
Calendar year 2010 saw a modest recovery in the economy with GDP growth becoming positive after shrinking 3.5% the previous year, but conditions for SMEs remain challenging. We have seen a 14% reduction in the 2010 calendar year in the number of companies going into liquidation, but levels remain above historical trends.

Global networked IT services

The global market for networked IT services is fragmented with a wide range of products and services and with many different competitors, from large IT corporations and network-based vendors, such as BT, through to niche technology suppliers.

Estimates of industry size and growth trends vary. The global IT services market is estimated to have a value of US\$584bn^a. After several years of relatively flat spend on IT services due to economic conditions, many industry analysts are forecasting higher rates of growth for 2012.

Forecast increase in demand for managed networked IT services
Multinational managed service spend



Source: IDC Market Model 2010. Forecast includes 1P VPN, Ethernet, Network management, Applications Visibility, Control & Optimisation and Managed Security for multinationals over 1,000 employees.


^a IDC Global IT services Market size. Source Worldwide Black Book Q1, 2011.

Demand for network based IT services continues to evolve with customers increasingly seeking to unify their communications (where an organisation’s infrastructure, mobility, desktop and applications work together more effectively). They are also looking to virtualise their infrastructure (virtualisation or cloud services where customers’ business applications can be provided across BT’s network rather than from their own premises, for example virtual data or contact centre solutions). They continue to want their networked IT services delivered securely, efficiently and globally.

Increasingly, our customers are asking us to help them capture the opportunities in a recovering economy, as well as reducing costs and improving efficiency in their businesses. In addition to helping customers reduce their capital expenditure, virtualised services, such as virtual data centres also provide energy savings.

We are a global leader in the networked IT services market with around 7,000 large corporate and public sector customers.

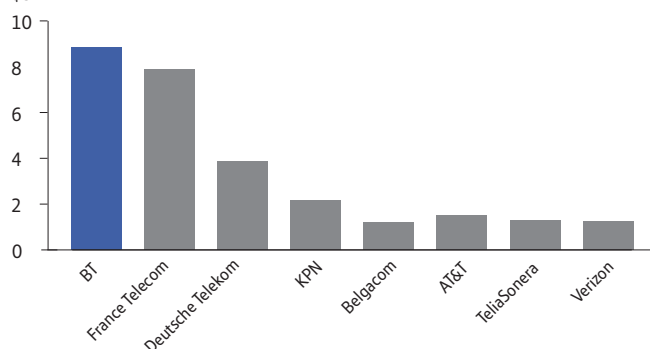
We supply networked IT services to national and local government organisations and other public sector bodies around the world. We are one of the largest suppliers of networked IT services for the UK Government. The UK Government, collectively, is BT’s largest customer, but the provision of services to any one of its departments or agencies does not comprise a material proportion of our revenue. Except as described in **Our relationship with HM Government** on page 18, the commercial relationship between BT as a supplier and the UK Government as a customer is on a normal customer and supplier basis.

 We are also seeing customers maintaining a focus on energy efficiency, ethical supply chain and other components of responsible and sustainable business practices. Through BT Conferencing we are a leading supplier of videoconferencing services globally and we have seen growing demand for videoconferencing, a service which helps both to drive business efficiency and limit emissions by reducing travel.

Wholesale

BT operates in wholesale markets in the UK through BT Wholesale and Openreach, and outside of the UK primarily through the wholesale arm of BT Global Services. BT’s wholesale customers are fixed and mobile operators, internet service providers (ISPs), broadcasters and other CPs. We have over 1,000 such customers in the UK and many more around the world.

European wholesale revenue, 2009
\$bn

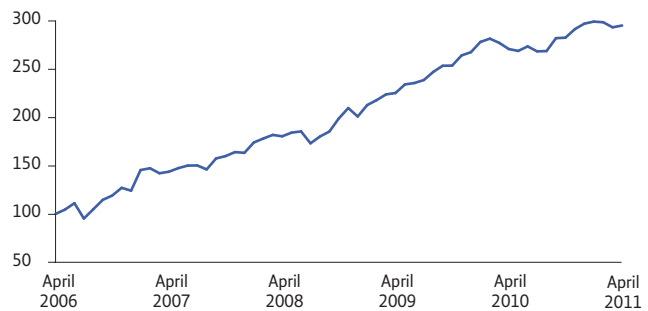


Source: Ovum

The landscape for wholesale communications remains competitive following the significant market consolidation of recent years. Competition continues to increase as a result of wholesale carriers rolling out their own IP network infrastructure and the switch from legacy to next generation products. Our competitors in the UK include Cable & Wireless Worldwide, TalkTalk Group, Virgin Media and COLT, as well as a range of equipment vendors. Many of these competitors are also customers. Internationally, we compete with the wholesale divisions of local incumbents and alternative network operators as well as global wholesale players.

The wholesale market is beginning to adopt next generation communications services like IP voice, higher speed broadband over copper and fibre and Ethernet for data connectivity. We have seen continued bandwidth growth with capacity more than trebling on our network over the past five years. To support the rapid growth of high bandwidth services such as video over fixed lines and mobile networks, a number of service providers are buying wholesale managed services to meet this demand quickly rather than building their own infrastructure.

Growth in bandwidth consumed on the BT broadband network



Bandwidth consumed measured in gigabits and rebased to April 2006 = 100

We expect the sale of wholesale managed network services to continue to grow in line with developments in services like fixed and mobile broadband and internet-based TV.

In the UK, Ofcom regulates some of our wholesale broadband products based on geographic markets: in Market Three, which contains the most competitive exchanges (mainly urban areas) our wholesale broadband products are not regulated; in Market Two where there is some competition (mainly suburban areas), and in Market One where there is very little or no competition (mainly rural areas), our products are regulated.

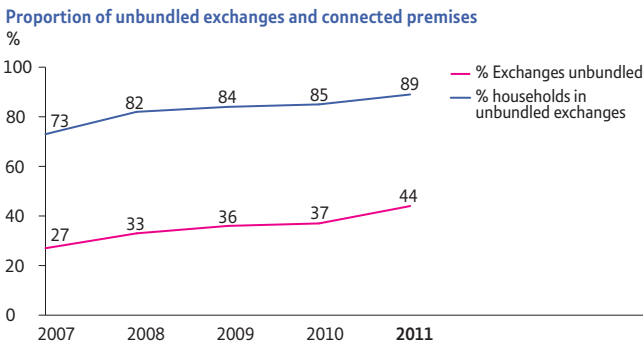
Access

In the UK, we manage the ‘last mile’ of the access network – the copper wires and fibre connecting homes and businesses to their local telephone exchange – through Openreach. We offer wholesale access products and services on an open and equal basis to CPs so that they can offer voice and broadband services to their own end customers.

The competitive challenge we face in the UK access market varies according to geography. We face direct competition in urban and metropolitan areas with some competition in rural areas. We also face competition from cable and mobile across our footprint.

We supply a range of access products directly to large and small CPs. This includes products such as LLU (which enables CPs to lease the local loop infrastructure from Openreach to offer voice and broadband to their own customers), Wholesale Line Rental (WLR) and Ethernet products. Under new obligations, we will also be offering products which give greater access to our underlying network infrastructure such as access to ducts and poles.

In the traditional fixed-line access market, we continue to see a steady rise in the number of households in unbundled exchange areas, which over the last three years has risen by around 5%.



In the UK local access market, the roll-out of BT's super-fast broadband network will improve the services available to customers. Other companies have also embarked on rolling out high-bandwidth broadband networks, making this a competitive sector. Demand for high bandwidth Ethernet access services also continued to grow.

We also provide backhaul services for mobile voice and data. We expect to see more demand for these services with the increasing use of smartphones and tablet devices. We believe that this market will continue to develop in the coming years with the roll-out of next generation access networks and high bandwidth applications.

Regulation

Regulation in the UK

Electronic communications regulation in the UK is conducted within a framework set out in various EU directives, regulations and recommendations. The framework has been reviewed and amended directives are expected to be implemented by late May 2011 in the UK and other EU member states.

Ofcom

Ofcom was set up under the Office of Communications Act 2002 to provide a single, seamless approach to regulating the entire UK communications market. Its principal duties are to further the interests of citizens in relation to communications matters, and to further the interests of consumers in relevant markets, where appropriate by promoting competition. Ofcom regulation takes the form of sets of conditions laid down under the Communications Act 2003 (Communications Act) and directions under these conditions. Some conditions apply to all providers of electronic communications networks and services; others apply to individual providers, which Ofcom has designated as universal service providers or as having significant market power (SMP) in a particular market.

Conditions applying to all providers

Although these general conditions are concerned mainly with consumer protection, they also include requirements relating to general access and interconnection; standards; emergency planning; the payment of administrative charges; the provision of information to Ofcom; and numbering. A separate condition regulates the provision of premium rate services. The Electronic Communications Code applies to all CPs authorised to carry out streetworks and similar activities for network provision.

Conditions applying to BT

Universal service obligations (USO) are defined in an order issued by the Secretary of State. BT is the designated supplier of universal service for the UK, excluding the Hull area where KCOM Group is the designated provider. Our primary obligation is to ensure that basic fixed-line services are available at an affordable price to all citizens and consumers in the UK. Other conditions relate to payphones and social needs schemes. The UK Government's plans for the digital economy have created a fund of up to £830m that is available via competitive tender to bidders in order to deliver the Government's ambition for rural next generation access. This is not part of BT's USO, but BT is likely to be one of the providers eligible to bid for such funds.

Significant market power designations

Ofcom is also required by EU directives to review relevant markets regularly, and determine whether any CP has SMP in those markets. Where Ofcom finds that a provider has SMP, it must impose appropriate remedies that may include price controls. In 2011 Ofcom completed market reviews of the Wholesale Local Access (WLA), Wholesale Broadband Access (WBA), WLR, and ISDN30 markets, covering products such as LLU and IPstream. Ofcom's WLA review conclusions include new obligations on BT to provide a fibre-based Virtual Unbundled Local Access (VULA) product and an obligation to share our ducts and poles for fibre-based broadband purposes.

In the WBA market, Ofcom increased the size of the mainly urban deregulated geographic market (Market Three), and introduced a price regulation obligation in the rural areas (Market One) subject to further consultation on appropriate charge controls (see SMP charge controls below). Ofcom has deregulated the ISDN30 market at the retail level and proposed charge controls at wholesale level subject to further consultation (see SMP charge controls below). Later in the 2011 calendar year, Ofcom is expected to begin a market review of the business connectivity markets covering products such as retail and wholesale leased lines.

SMP charge controls

As a result of SMP designations, the charges we can make for a number of wholesale services are subject to regulatory controls which are designed to ensure that our charges are reasonably derived from costs, plus an appropriate return on capital employed.

These include:

- network charge controls (NCC) on wholesale interconnect services – we operate under interconnection agreements with most other CPs
- partial private circuits (PPC) charge controls applying to certain wholesale leased lines that BT provides to other network operators
- certain wholesale Ethernet access and backhaul services
- LLU and WLR.

Ofcom is currently consulting on charge controls for WBA Market One, LLU, WLR and ISDN30 Wholesale products.

Ofcom has imposed SMP charge control regulation on the mobile call termination market with effect from April 2011. Termination rates charged by mobile network operators will fall to 0.69 pence per minute by April 2014. This will enable us to lower the cost of calling mobiles from fixed lines.

Regulatory decisions by Ofcom are subject to appeal.

BT's Undertakings

In response to Ofcom's 2005 strategic review of telecommunications, we proposed a number of legally-binding Undertakings under the Enterprise Act 2002 (Enterprise Act). These Undertakings, which included the creation of Openreach, were accepted by Ofcom and came into force in September 2005. The Undertakings are intended to deliver clarity and certainty to the UK telecommunications industry about the way BT will provide 'upstream' regulated products to support effective and fair competition in related 'downstream' markets. Ofcom acknowledges that BT's delivery of the Undertakings has enabled deregulation in more competitive downstream markets. The vast majority of the commitments in the Undertakings have been delivered.

Business rates

The European Commission formally investigated the way the UK Government set the rates payable on BT's infrastructure and those paid by KCOM, and whether or not the UK Government complied with EU rules on state aid. The Commission's decision in October 2006 that no state aid had been granted was appealed. In January 2011, the appeal was rejected as inadmissible.

Our relationship with HM Government

We can be required by law to do certain things and provide certain services for the UK Government. For example, under the Communications Act, we (and others) can be required to make and implement plans for the provision or restoration of services in connection with disasters. Additionally, under the Civil Contingencies Act 2004, the UK Government can impose obligations on us (and others) at times of emergency and in connection with civil contingency planning. Also, the Secretary of State can require us to take certain actions in the interest of national security and international relations.

Regulation outside the UK

BT must comply with the regulatory regimes in the countries in which we operate and this can have a material impact on our business.

European Union

Communications regulation in each EU country is conducted within the regulatory framework determined by EU directives, regulations and recommendations. The manner and speed with which the existing directives have been implemented vary from country to country. National regulators are working together in the Body of European Regulators for Electronic Communications to introduce greater harmonisation in their approach to the assessment of SMP and the imposition of appropriate remedies.

The rest of the world

The vast majority of the communications markets in which we operate around the world are subject to regulation. The degree to which these markets are liberalised varies widely, and our ability to compete is constrained, to a greater or lesser degree, in many countries. We continue to press incumbent operators and their national regulatory authorities around the world (including in the EU) for cost-related non discriminatory wholesale access to their networks, where appropriate, and for advance notice of any changes to their network design or technology which would have an impact on our ability to serve our customers.

Competition law

In addition to communications industry-specific regulation, BT is subject to the Competition Act 1998 in the UK and to EU competition law.

OUR RESOURCES

- Brand and reputation
- People
- Networks and platforms
- Global research capability
- Suppliers
- Property portfolio

92,600

People worldwide
(full-time equivalent employees)

c.120m km

Length of copper cable on our network

£684m

Investment in global research
and development

16,700

Suppliers

8,400

Properties worldwide



official communications
services partner of the
Olympic and Paralympic Games

BT's resources include our people, physical networks and property estate; our expertise and intellectual property; our brand and reputation; and close relationships with people and organisations, including major customers and suppliers. We seek to steward these assets and relationships in a responsible and sustainable manner. We strive to recruit and retain talented people, so that the company can best serve its customers, build relationships, remain innovative and reduce its impact on the physical environment. We are investing to enhance our resources in the long-term interests of the company and all its stakeholders. For example, as described elsewhere in this report, we are committing £2.5bn to build a super-fast broadband network in the UK, while expanding activities outside the UK, with a particular focus on the Asia Pacific region. We continue the innovation which is vital to any company in our sector – we filed 62 patent applications over the past year.

Brand and reputation

When we develop our relationships with customers, when we make innovative and useful products, we build our reputation. BT is proud to be one of the UK's most trusted brands – our latest research shows that consumers' engagement with our brand has gone up 4.5% over the past year. Being a responsible and sustainable business leader contributes to this.

Our brand values underpin how we like to get things done at BT. They outline the behaviour our employees can expect from each other and what our customers can expect from us.

- trustworthy: we do what we say we will
- helpful: we work as one team
- inspiring: we create new possibilities
- straightforward: we make things clear
- heart: we believe in what we do.

As the official communications partner to the London 2012 Olympic Games and Paralympic Games, we are providing the critical communications infrastructure to power the Games. The partnership is already delivering real benefits and it is also helping us to engage with local communities. Six out of 10 BT people who were surveyed as part of our annual employee survey say the partnership makes them feel proud to work here.

As well as the Games themselves, the BT Paralympic World Cup in Manchester in May 2011 is in its second successful year. Our 'Road to 2012' project with the National Portrait Gallery celebrates those who are collectively making the Games happen.


People

Our people are a key resource and we are proud of what they achieve for our business. We continually work on improving the engagement and motivation of our people as this leads to better business performance and higher levels of customer service.

We recognise the quality of our leadership is vital to the success of BT. We ensure leaders at all levels understand what is expected of them in leading and developing their teams.

Part of valuing our people is to recognise our responsibility when the requirement for various skills changes over time. We have a successful track record of redeploying people by helping them learn new skills and find jobs within BT's growth areas or while seconded to another organisation.

We have people on different types of working arrangements including part-time, term-time and job share. Our resources at 31 March 2011 were equivalent to 75,660 full-time employees in the UK, and around 16,940 outside the UK.


 We continue to support an inclusive working environment where people can develop their careers and expect to be treated fairly, regardless of their race, sex, religion/beliefs, disability, marital or civil partnership status, age, sexual orientation, gender or caring responsibilities. We also work with specialist recruitment agencies to enable the recruitment of people with disabilities and we run a retention service to ensure that people can stay with us even if their capabilities change.

 Diversity of the BT workforce

Target 2012	2011	2010	2009
BT will maintain a top 10 position in four of five major diversity benchmarks; four UK based, and one global	✓	✓	✓

We look to improve customers' experiences of BT by giving our people the up-to-date skills, tools and experience needed to do their jobs. This starts with our nationally-recognised apprentice schemes, which recruited nearly 500 engineers during 2011, and continues with opportunities to learn and develop throughout an employee's career. In BT Retail, we ran two programmes to provide apprentice qualifications in job-related skills: customer service and business administration for our advisors and leadership for our managers. During the year 8,100 people successfully completed these qualifications.

In order to help deliver super-fast broadband, Openreach has recruited 200 ex-armed forces personnel, who will become part of a mobile engineering workforce. They will be bringing their experience of complex engineering tasks, their skills and technical expertise to bear on one of the UK's largest infrastructure projects.

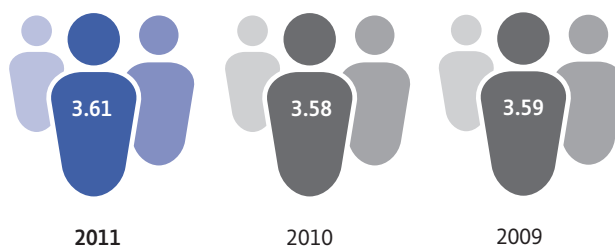
 BT people are also encouraged to participate in their local communities. We run a formal volunteering programme to help them do this. In 2011 BT people volunteered over 49,000 days, the value of which we estimate at £13.8m. The community benefits from this involvement and the business gains from the opportunity given to our people to enhance their existing skills or acquire new ones.

People engagement and communication

Keeping our people informed of what is happening in BT is important. We use a range of communications channels including a daily online news service, a quarterly magazine, podcasts and web chats. We have a record of stable industrial relations and constructive relationships with the recognised unions in the UK and works councils elsewhere in Europe. In the UK we recognise two main trade unions – the Communication Workers Union (CWU), which represents the engineering, administrative and clerical population and Prospect, which represents managerial and professional employees. We also operate a pan-European works council, the BT European Consultation Committee.

We measure how engaged BT people are through a quarterly survey and we ask 50,000 people each time to tell us how they feel about their job, their team, their manager, senior leaders and BT. Last year, despite challenging economic conditions, we held engagement steady. This year we have seen improvements in how motivated people feel to do their best work. We use this regular and extensive feedback to let line managers know more about their teams, how engaged they feel and what makes BT people feel proud about what they do.

Employee engagement is measured on a five point scale 



Reward and recognition

Because we value our people, we ensure that the reward they receive is fair for the job done against external market comparisons. We conduct a market review of salaries every year. In 2010 we agreed with the CWU a three-year pay deal which provides considerable stability for both employees and the business. Discussions with Prospect reached an agreement for 2011 and more recent discussions have concluded a further two-year pay deal, also providing stability through to 2013. The same principles of fair pay for the work done are similarly applied in all other countries in which we operate.

Our managers are rewarded with bonuses linked to the success of the business and their personal contribution to it. Our most senior managers are also eligible for long-term incentives, but again, payment is related to business success measured by BT's corporate performance over a three-year period. For more information see the **Report on directors' remuneration** on page 69. Different arrangements apply to the most senior managers in Openreach but remain entirely related to business performance.

We also provide savings-related share option plans in 25 countries. Under the BT employee share investment plan we enable employees in the UK to participate in a tax and national insurance-efficient share purchase scheme. We are pleased that more than 50% of BT people participate in one or more of these share plans.

Pensions

Key parts of the reward package are the pension and retirement benefits for our people. In addition to statutory retirement arrangements, BT provides retirement plans for staff in over 50 countries. The largest of these plans is the BT Pension Scheme (BTPS), a defined benefit plan in the UK. The BTPS has around 51,000 contributing members, 188,000 pensioners and 88,500 deferred members. The BTPS was closed to new members on 31 March 2001. Benefits are based on pensionable salary and service.

We also offer the BT Retirement Saving Scheme (BTRSS), a defined contribution plan for eligible UK employees, which has around 17,500 active members. It is a contract based, defined contribution arrangement provided by Standard Life, a leading UK insurance company. The scheme members receive benefits at retirement linked to contributions paid, the performance of each individual's chosen investments and the annuity rates at retirement.

Health and safety

The health and safety of our people remains of paramount importance and we continue to seek improvements by focusing on behavioural and/or lifestyle changes to reduce risk and improve health. Details of time lost to injury and sickness and their cost to BT are shown in the table below. The rise in lost time injuries is largely attributable to accidents associated with the extended period of ice and snow in the UK winter and some contribution from an increased overtime requirement in the field engineering workforce.

Lost time injury rate – lost time injury cases expressed as a rate per 100,000 hours worked on a 12-month rolling average

Non financial performance			
Target 2012	2011	2010	2009
Reduce to 0.200 cases	0.225	0.209	0.160

Financial performance			
Cost to the business arising from injuries resulting in time off work	£6.1m	£5.6m	£7.0m

Sickness absence rate – percentage of calendar days lost to sickness absence expressed as a 12-month rolling average

Non financial performance			
Target 2012	2011	2010	2009
Reduce to 2.29%	2.41%	2.46%	2.17%

Financial performance			
BT sick pay costs	£90.1m	£95.4m	£85.2m

Networks and platforms

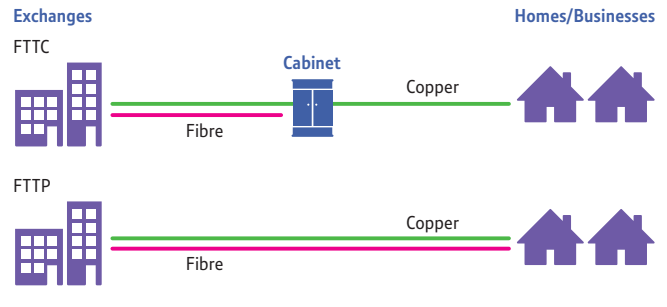
One of our most valuable resources is our fixed-line communications network, which is the most comprehensive in the UK with around 5,600 exchange areas, 670 local and 120 trunk processor units.

We own and maintain the ‘last mile’ of the UK’s local access network – the copper wires and fibre connecting homes and businesses to the core network – operating approximately 120m kilometres of copper. In addition, our plans for deploying super-fast broadband in the UK will result in the installation of over 50,000 kilometres of fibre.

BT continues to invest in broadband in the UK, offering a range of services delivered over copper and fibre. Our copper wire broadband service offers speeds of up to 8Mbps (ADSL) and up to 20Mbps where we have upgraded service to ADSL2+. Already, around 99% of UK premises can receive ADSL service. We aim to make ADSL2+ services available to around 80% of properties by December 2011.

Our super-fast fibre-based broadband offers speeds of up to 40Mbps (FTTC) and 100Mbps (FTTP). We aim to deploy super-fast broadband to two thirds of UK premises by the end of 2015. Our FTTC product links roadside cabinets to telephone exchanges and our copper local loop is used to deliver super-fast broadband to customer premises. FTTP involves installing fibre into homes or premises, superseding the copper local loop. Our fibre services are competition ready from the day they are installed – other CPs can buy access to the fibre on wholesale terms and then sell to customers in competition with BT Retail.

Our next generation access technologies



BT’s deployment of FTTC and FTTP will underpin the communications infrastructure for the future UK economy. In so doing, the enhanced internet speeds made possible by super-fast fibre-based broadband increase the ability of our customers to work from home and access services without travel, yielding environmental benefits. In addition to facilitating lower carbon alternatives for customers, we continue to look for ways to reduce the energy consumption associated with delivering super-fast broadband.

For business customers, we have also continued to extend our fibre Ethernet footprint, from 600 nodes in 2009 to 1,000 nodes in 2011. Ethernet is a next generation data connectivity service offering high-speed, lower cost connectivity for large volumes of data between sites.

For non-domestic customers requiring international services, our international MPLS network provides coverage and support around the world. It provides the performance, reliability, and security of a leased-line network with the scalability and flexibility of an internet protocol (IP) network. The BT MPLS service allows customers to prioritise traffic based on application, ensuring essential data applications are served irrespective of the growth of competing, lower priority traffic.

Global research capability

Creating attractive and competitive propositions for customers is critical to the future of BT. We operate an open innovation model, whereby our research and development team works with customers, partners and universities around the world. They do so in partnership with our dedicated innovation scanning teams in the US, Asia, Europe and the Middle East, which identified more than 400 new technologies, business propositions and market trends over the year.

BT also seeks to drive agility and efficiency in the development process through our global development centres, which are located in the UK, US, Europe and India. In so doing, we bring our innovation scanning and research teams closer to our customers, designers and product development teams, so that we can quickly capitalise on the opportunities they uncover. In 2011 we invested £684m (2010: £789m) in global research and development to support our drive for innovation. This investment comprised capitalised software development costs of £295m (2010: £345m) and research and development operating costs of £389m (2010: £444m).


This year, we have applied our research and innovation capability to a number of strategic areas for the business – in particular enhancing BT Vision and the delivery of other information and entertainment to customers. We have also supported BT’s wi-fi service with the development of BT’s first smartphone application. In 2011 we filed patent applications for 62 inventions (2010: 63). We routinely seek patent protection in different countries including

the US and China, and we currently maintain a total worldwide portfolio of around 5,600 patents and applications.

Suppliers

BT works with around 16,700 suppliers across the world, spending approximately £11.3bn per annum with them, with the top 100 suppliers accounting for more than 65% of this spend.

We source products and services from across the world and have procurement professionals located in 25 countries.

 We operate a strategic sourcing process for the vast majority of spend to derive maximum value and to meet BT's cost transformation goals. We ensure that appropriate suppliers are engaged, underpinned by a set of purchasing principles which ensure we act in an ethically and commercially responsible way in our business dealings with our global supply base.


We work with our suppliers to ensure the goods and services we procure are made, delivered and disposed of in a socially and environmentally-responsible manner. Sustainability factors such as energy usage, environmental impact, and labour standards are embedded in our sourcing and adjudication process, and influence supplier and product selection.

Supplier relationships – a measure of the overall success of BT's relationship with suppliers, based on our annual supplier survey

Non financial performance	2011	2010	2009
Target 2012			
To achieve a rating of 80% or more based on a response of 'excellent' or 'good' to the question: 'How would you describe the quality of your company's relationship with BT?'	86%	86%	85%

Financial performance

	2011	2010	2009
Total spend with external supply base	£11.3bn	£12.0bn	£13.0bn

 **Ethical trading** – a measure of the application of BT's supply chain human rights standard

Non financial performance	2011	2010	2009
Target 2012			
To achieve 100% follow up within three months for all suppliers identified as high or medium risk, through our ethical standard questionnaires	70 risk assessments with 100% follow up	180 risk assessments with 100% follow up	78 risk assessments with 100% follow up

Financial performance

	2011	2010	2009
Value of spend where our suppliers agree that BT ensures its purchases are made, delivered, used and disposed of in a socially and environmentally responsible manner (extrapolated from supplier survey responses)	86% of supplier spend	86% of supplier spend	83% of supplier spend

Payment of suppliers

In normal circumstances, BT's payment terms for contracted suppliers will be to pay each due, valid and undisputed invoice between 60 and 73 days from date of receipt from the supplier. There are variations to this policy. For example interconnect payments to other telecommunications operators, low value spend, various customer-specified requirements and rates are paid in shorter timescales. In 2011 the average number of days between the invoice date and the date of the payment run for the invoice was 64.


In the UK, BT provides access to a supplier financing scheme which offers contracted suppliers the opportunity to obtain payments in advance of the agreed terms of between 60 and 73 days from receipt of a valid and undisputed invoice. In addition, BT subscribes to the Better Payment Practice Code, details of which can be found at www.payontime.co.uk

Property portfolio

At 31 March 2011 we occupied around 6,500 properties in the UK, and around 1,850 properties in the rest of the world. The majority of the UK properties are owned by – and leased from – Telereal Trillium, which is part of the William Pears Group.

Approximately 89% of the UK portfolio consists of operational telephone exchanges which contain exchange equipment and are needed as part of our continuing activities. Other general purpose properties consist chiefly of offices, depots and computer centres. Approximately 87% of the properties in the rest of the world are operational sites.

In recent years, our strategic focus on cost transformation has led to significant reductions in our total labour resource. This has resulted in vacant space and under-utilisation of buildings within our UK property estate. Accordingly, in 2010 we initiated a property rationalisation programme to consolidate office space within the estate which has continued in 2011. See page 57 of the **Financial review** for further details.

 Our group property team has instigated a number of initiatives to reduce waste to landfill, including changing contracts on its general waste to a recycling-led company and implementing new recycling schemes at many sites.

 **Waste to landfill and recycling** – a measure of BT's use of resources

Non financial performance

Target 2012	2011	2010	UK only 2009
BT Group will reduce the tonnage of waste sent to landfill by 20% from 2011 levels	69% reduction in waste to landfill from 2010	15% reduction in waste to landfill from 2009	17% reduction in waste to landfill from 2008

Financial performance

	2011	2010	2009
Net benefit to the business of the waste programme	£2.03m	£2.86m ^a	£3.79m ^a

^a 2010 and 2009 figures are restated following a review of expenditure categorisation.

OUR LINES OF BUSINESS

BT Global Services

During 2011 we consolidated our position as a global leader in networked IT services. Order intake in the year grew by 10% as we signed contracts with major corporate and public sector customers. We have implemented a new global operating model and industry sector strategy, and have achieved our operating cash flow target a year ahead of plan.

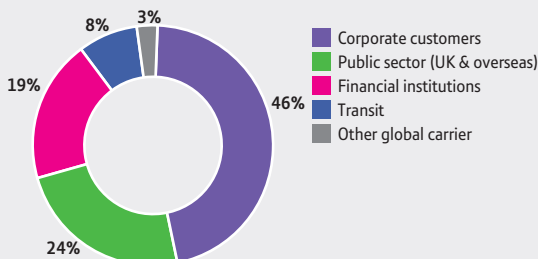
£8,047m

Revenue

£593m

EBITDA

BT Global Services revenue by sector



£119m

Operating cash flow

£7.3bn

Order intake



World Communication Awards 2010

BT Global Services
Best Global Operator

Business overview

BT Global Services is a global leader in the provision of managed networked IT services for large corporate and public sector customers. We provide services to around 7,000 large corporate and public sector customers with operations across the world in a wide range of sectors such as banking and financial services, consumer packaged goods, logistics, pharmaceuticals and manufacturing. We serve customers in the public sector in the UK, including central Government and local councils, as well as public sector organisations in countries outside the UK.

We operate domestic businesses in key markets in Europe such as Italy, Germany, and Spain, where we serve both multinational corporations and SME customers, and have local network infrastructure including high-speed fibre networks in key cities. We have operations across the Americas, and a strong business in Latin America based on an extensive satellite network. In 2010 we announced, and started to deliver on, a strategic investment plan to strengthen our business in the Asia Pacific region.

Our customers benefit from BT's global scale and operating model. Products are sold globally, and customers are served locally by our teams in their own countries and sectors who understand their specific business challenges and create locally relevant solutions. We call this 'operating globally and delivering locally'.

We make this possible through our assets and skills. These include our global IP network, data centres, solution design and integration professionals and IT security experts. By combining network, IT and professional services we create managed solutions that help our customers to operate more efficiently.

Products and services

Networked IT services

We connect our customers to their customers through our Virtual Private Network (VPN), connectivity and value added services. We provide a range of products and services to do this such as BT MPLS, BT Etherflow and BT Application Assured Infrastructure (services to optimise application performance over networks).

Unified communications

We provide a range of communication services to enable organisations to collaborate and communicate better. This spans from the provision of PSTN and ISDN services, to our global managed services for IP telephony, and collaboration tools, either hosted on the customer site or as a cloud-based service.

Customer relationship management (CRM)

Through the combination of our professional services, cloud platforms and global inbound voice services, we offer a suite of CRM tools that give our customers the flexibility and value they require when dealing with their end customers.

Security

We provide a range of security and risk management products from professional services to assess risk and vulnerability, through to a suite of proactive managed security services.

Data centre services

With our global estate of data centres across the world, we provide a range of hosting and managed services. With the launch of our virtual data centre offering, BT Virtual Data Centre (VDC), we have a new generation of cloud-based services, giving our customers the flexibility and agility that comes from a cloud computing environment.

Mobility

We provide a range of value-added services to help customers exploit the benefits of mobile computing, from flexible working solutions through to services to enable customers to improve the efficiency of both their supply chains and workforces.

Operating review

Last year our focus was on improving the business through better financial and operational execution and the implementation of a strengthened controls environment. In 2011 we have reshaped and refocused our business to serve our customers better and established a significantly more competitive cost base.

We have continued to improve the efficiency of our operations, and reduce costs, helping to deliver a 7% reduction in net operating costs. We achieved this through:

- improving service levels to take out cost of failure
- working with our external suppliers to improve contract terms
- reviewing our network and changing our network topography
- rationalising our network assets and our operations
- improving the service we get from suppliers around the world.

We have made changes to our global delivery model to improve contract execution. We improved our bid management processes and created three global bid management centres to standardise processes and share best practice. We have continued improving the start-up of major contracts, including standardised and accelerated start-up processes to improve contracts in the early stage of delivery.

During 2011, as part of our commitment to global customers in key industry sectors, we created four global strategic sector teams to sit alongside our four regions: Banking & Financial Markets; Commerce – comprising manufacturing, logistics and pharmaceuticals; Consumer Packaged Goods; and Government & Health. Customers in these sectors will benefit from a range of industry focused products, solution design and infrastructure, as well as sector specific customer management and service teams.

GLOBAL BANKING & FINANCIAL MARKETS	GLOBAL COMMERCE (MANUFACTURING, LOGISTICS & PHARMACEUTICALS)	GLOBAL CONSUMER PACKAGED GOODS	GLOBAL GOVERNMENT & HEALTH
UK			
EMEA & LATIN AMERICA			
UNITED STATES & CANADA			
ASIA PACIFIC			

During the year we signed contracts with a total order value of £7.3bn, up 10% over £6.6bn last year. The market environment continues to be challenging with fewer very large deals, longer lead times and pricing pressure all having an impact.

Notable contracts signed in the year include:


Customer	Contract
Unilever	A four-year extension to our existing contract to supply managed services in over 100 countries.
UBS	A new five-year contract for the provision of global voice and data network services, including a videoconferencing network and audio conferencing services.
Network Rail	A two-year extension of our networked IT services contract.
Defence Fixed Telecommunications Service (DFTS)	A three-year extension to our DFTS agreement with the UK Ministry of Defence.
Southwest One (working in partnership with Somerset County Council, Taunton Deane Borough Council, Avon and Somerset Police and IBM)	Provision of a high-speed network to 269 schools and educational establishments in Somerset, UK.
Ministerio de Defensa de España, Spain	Provision of internet access, security platform, and on-site professional services to the Spanish government.
DigitPA (Agency for the Digital Public Administration), Italy	A seven-year contract to connect 340 offices in 125 countries, providing communication services and managing a global network.

During the year we continued to execute on our larger customer contracts, for example working with other London 2012 Olympic and Paralympic Games technology partners, under the direction of the London 2012 Organising Committee, BT is building the communications infrastructure that will support the communications needs of the event. The project is on track.

We have made good progress on our large NHS contracts. Our work delivering clinical information systems at 80 NHS organisations across London and the South of England is now enabling around 170,000 healthcare professionals to provide better, safer patient care. N3, the secure national broadband network built and managed by BT for the NHS, now serves over a million NHS users. The Spine, the secure database and messaging service delivered by BT, continues to support the increased use of key transformational services, such as Choose and Book, the electronic appointment booking system, which saw the number of appointments booked electronically recently exceed 25m.

During the year the UK Government announced a review of all public sector spending and BT entered into discussions with the Government on new arrangements designed to deliver efficiencies. In October 2010 BT announced the signature of a Memorandum of Understanding with the UK Government under which all of BT's central Government contracts remained in place.

During 2011 we launched new products and service enhancements, such as virtual data centre offerings, and a series of enhancements to our OneVoice collaboration and communications tools. New industry specific products and services were also launched, such as the collaboration suite for financial markets which includes a next generation range of trader voice and collaboration services.

 We have also launched a range of products and services which help our customers reduce their environmental footprint including:

- our sustainability practice and carbon impact assessment offer
- a professional services smart grid offering in the US.

In May 2010 we announced a strategic investment plan to strengthen our business in the Asia Pacific region. We are recruiting up to 300 additional people in the key customer markets of Australia, China, Hong Kong, India, Japan and Singapore, in order to build up our sales and professional services teams, bid and project management, and service operations teams. This will allow BT to provide enhanced service delivery capabilities as customers invest throughout the region. Our continued commitment to the region and our customers was recognised through us winning the Telecom Asia – Best Managed Services Provider award for the second consecutive year.

During the year we made steady improvements in managing customer service – we had fewer abandoned calls, order accuracy improved and we reduced customer faults by 11%.

We were pleased to see our achievements recognised by external industry commentators, for example at the World Communication Awards where we won 'Best Global Operator' and in our placements in key reports such as the March 2011 Gartner Magic Quadrant for Pan-European Network Services^a, and IDC MarketScape: Asia/Pacific Next-Generation Telecom Services 2010.

Financial performance

	2011 £m	2010 £m	2009 £m
Revenue	8,047	8,513	8,628
Net operating costs	7,454	8,056	8,367
EBITDA	593	457	261
Depreciation and amortisation	734	815	776
Operating loss	(141)	(358)	(515)
Capital expenditure	498	599	886
Operating cash flow	119	(482)	(912)

In 2011 revenue decreased by 5% (2010: 1% decrease). Excluding the negative impact of foreign exchange movements and the reduction in low-margin transit revenue, underlying revenue excluding transit decreased by 4%, reflecting reduced UK calls and lines revenue. In addition, last year included revenue of around £100m from the early delivery of contract milestones.

	2011 £m	2010 £m	2009 £m
Products and services			
ICT and managed networks	5,310	5,281	5,273
Calls and lines	822	956	1,055
Transit	623	782	869
Broadband and convergence	318	334	321
Other global carrier	206	229	237
Other products and services	768	931	873
Total	8,047	8,513	8,628

^a The Magic Quadrant is copyrighted 2011 by Gartner, Inc. and is reused with permission. The Magic Quadrant is a graphical representation of a marketplace at and for a specific time period. It depicts Gartner's analysis of how certain vendors measure against criteria for that marketplace, as defined by Gartner. Gartner does not endorse any vendor, product or service depicted in the Magic Quadrant, and does not advise technology users to select only those vendors placed in the "Leaders" quadrant. The Magic Quadrant is intended solely as a research tool, and is not meant to be a specific guide to action. Gartner disclaims all warranties, express or implied, with respect to this research, including any warranties of merchantability or fitness for a particular purpose.

Revenue from networked IT services remained broadly flat (2010: broadly flat). Excluding the impact of around £100m in the prior year from the early delivery of contract milestones, revenue increased by 2%.

Calls and lines revenue decreased by 14% (2010: 9% decrease) reflecting the impact of the continuing trend of customers migrating to alternative IP based services.

Transit revenue decreased by 20% (2010: 10% decrease) largely due to the impact of mobile termination rate reductions in Continental Europe and the continuing trend of lower wholesale call volumes. Other global carrier revenue decreased by 10% (2010: 3% decrease) due to lower volumes.

Broadband and convergence revenue decreased by 5% (2010: 4% increase). Other revenue, principally comprising global product revenues, decreased by 18% (2010: 7% increase) partially due to foreign exchange movements and lower global demand.

Net operating costs decreased by 7% (2010: 4% decrease) or 6% excluding transit. This improvement reflects further progress with our cost efficiency initiatives during 2011 as set out on page 24.

Our progress in addressing the cost base is demonstrated by the 30% increase in EBITDA (2010: 75% increase) to £593m.

Depreciation and amortisation decreased by 10% (2010: 5% increase) reflecting the reduction in capital expenditure over the last two years.

The operating loss was £141m, a significant improvement compared with losses of £358m and £515m in 2010 and 2009, respectively.

Capital expenditure reduced by 17% (2010: 32% decrease) due to the timing of capital expenditure across certain of our large customer contracts, the application of more stringent investment return criteria and improved procurement and programme delivery.

Operating cash was an inflow of £119m, a significant improvement from an outflow of £482m in 2010 and £912m in 2009. The improvement was achieved through higher EBITDA, improved working capital and lower capital expenditure. We expect to generate around £200m of operating cash flow in 2012.

BT Retail

Broadband performance has been a highlight of the year, with our highest quarterly share of DSL and LLU net additions in eight years. Take-up of our BT Infinity fibre-based broadband product continues to accelerate.

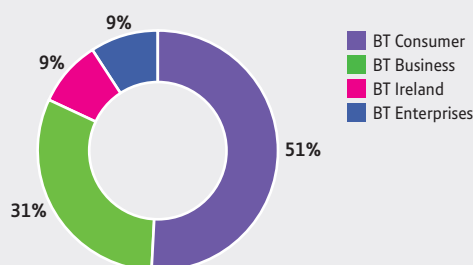
£7,748m

Revenue

£1,784m

EBITDA

BT Retail revenue by division



64%

Retail share of DSL and LLU broadband net additions in the fourth quarter

5.7m

Broadband customers

1m

SME customers

Business overview

BT Retail serves UK and Republic of Ireland consumers and SMEs through four customer-facing divisions: BT Consumer, BT Business, BT Enterprises and BT Ireland. BT Enterprises also serves global customers.

BT Consumer

BT is the leading provider of fixed-line voice and broadband services in the UK market. We offer our customers a range of innovative and value-for-money calls, lines, broadband and TV packages.

Products and services

Calls and lines

We provide call services to over 10m of our fixed-line customers, offering value-added services like call minder, and value-for-money unlimited call plans which include free access to 0800 and 0845 numbers.

Broadband

We serve the consumer broadband market with the BT and Plusnet brands. BT Total Broadband provides value-added services such as online storage, security and free access to the largest network of wi-fi hotspots in the UK, while Plusnet focuses on simple broadband packages for price-conscious customers. BT Infinity is our super-fast broadband product, delivering download speeds of up to 40Mbps using FTTC technology.

TV

BT Vision – our television service – has over 8,000 items of video on-demand content available and offers BBC iPlayer plus TV replay services from ITV and Channel 4. BT Vision also now offers Sky Sports channels on flexible contract terms and HD and 3D movies available for download.

YouView, the TV joint venture between the BBC, ITV, Channel 4, BT and others, will transform the UK TV market, combining free digital channels with free on-demand content from public service broadcasters delivered over broadband. The full commercial launch of YouView is planned for early in the 2012 calendar year.

BT Business

We supply and support business calls and lines, broadband, internet, mobiles and mobile applications, domains and web hosting, data and voice networks and IT services for SMEs. We sell to SME customers through our call centres, online, or via our desk and field-based account teams. We also serve the market via a network of 43 BT Local Businesses – regional franchises with their own sales staff and account management teams. Specialist business units within BT Business include:

- BT iNet: a Cisco centre of excellence specialising in infrastructure, security and unified communications
- BT Engage IT: a leading provider of business-to-business IT solutions and services
- BT Business Direct: an online store providing IT, computing and networking equipment plus associated installation and support services for SMEs.

BT Enterprises

BT Enterprises consists of a portfolio of five separate businesses:

BT Conferencing	Global provider of audio, video and internet conferencing and collaboration services
BT Directories	Directory Enquiries (118 500), operator and emergency services. The Phone Book and online web reviews of businesses
BT Expedite	Software and IT services for medium-sized retailers
BT Redcare & Payphones	Residential and business alarm monitoring and tracking facilities. Managed, prison, card and private payphones, as well as meeting our regulatory obligations to provide a public payphone service
BT Openzone	Provision of premium wi-fi hotspots offering broadband on the move to retail customers and to wholesale customers such as mobile network operators.

Each of these businesses operates as a standalone business, with the support of BT's brand and customer relationships. BT Enterprises also serves larger organisations in the UK and worldwide largely through BT Conferencing.

BT Ireland

BT Ireland operates in Northern Ireland and in the Republic of Ireland. In Northern Ireland we are the leading provider of communication services to consumers, SMEs and the government sector. We are also responsible for providing regulated wholesale access via Openreach. In the Republic of Ireland, we are one of the largest providers of wholesale network services to CPs.

Operating review

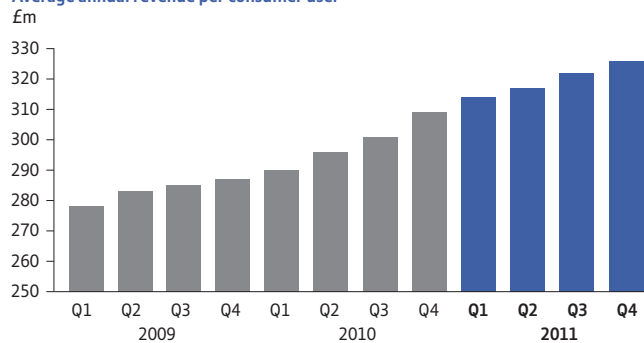
Despite the challenge of highly competitive markets we have grown in broadband, TV and the IT services market while improving efficiency and reducing customer complaints. We remain focused on reducing costs by simplifying, standardising and automating processes.

We have a range of programmes in progress designed to improve customer service and reduce costs which declined 6% in the year. Over the past two years we have reduced customer complaints by 42% while cutting service costs by enhancing self-service capabilities and reducing the number of repeat contacts from customers. A particular area of success has been the expansion of our Digital Care channels where customers can contact us or find self-help support via channels such as Twitter, YouTube and the bt.com community forums.

BT Consumer

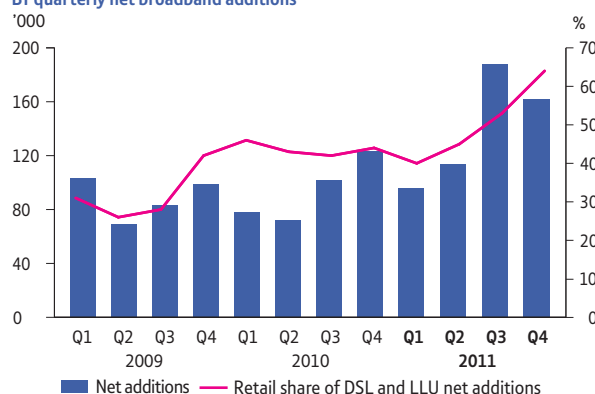
Following the relaxation of Ofcom restrictions in 2009 we have been able to compete more effectively with other companies offering bundled services, combining calls, broadband and TV services. Bundle sales account for around 90% of new broadband installations and 1.4m of our customers now take bundles of services. This has contributed to increased average annual revenue per consumer user (ARPU) up to £326 as consumers take more products from us.

Average annual revenue per consumer user



In the broadband market, BT's retail share of the DSL and LLU base has remained at around 36% despite an increasingly competitive market. Our retail share of net DSL and LLU additions in the fourth quarter was 64% – the highest level achieved in eight years – driven by competitively priced bundles and seasonal promotions supported by marketing activity.

BT quarterly net broadband additions




We have seen significant demand for BT Infinity, our super-fast fibre-based broadband proposition currently offering download speeds of up to 40Mbps and upload speeds of up to 10Mbps. Following the launch in January 2010, our BT Infinity customer base is now 144,000 and, in March 2011, 46% of customers who ordered broadband took BT Infinity in areas where it is available.

We are currently trialling our FTTP solution which will provide download speeds to 100Mbps, offering further benefits to consumers.

The Plusnet brand continued to grow, with 31% of the Plusnet customer base now taking voice and broadband services together. Plusnet's success has been driven by a combination of competitively priced packages, self-care tools for customers, referral discounts and a national marketing campaign. Plusnet also collected a number of industry awards during the year from Simplify Digital, Broadband Genie, PC Advisor and uSwitch. It was also ranked highest in the UK for customer service by JD Power. In April 2011 Plusnet launched its own, competitively priced super-fast fibre-based broadband proposition, offering customers download speeds of up to 40Mbps via FTTC.

Our television service, BT Vision, had 575,000 customers at 31 March 2011 (2010: 467,000). Following the Ofcom pay TV market investigation in March 2010, we launched Sky Sports 1 and Sky Sports 2 on BT Vision in time for the 2010-11 Premier League football season. We also launched the BBC iPlayer service on BT Vision and expanded our range of HD content, adding 3D movies for the first time and enhancing our HD download service to provide a better customer experience.

Our BT broadband customers benefit from free access to the largest wi-fi hotspot network in the UK. Comprising BT Openzone, BT Fon and Business Hubs, our customers can now get online at more than 2.8m locations. We have also launched the BT Fon application for smartphones and tablet computers which automatically connects to the BT wi-fi network and has been downloaded over half a million times.

 In January 2011 we launched our new Home Hub 3, including Smart Wireless which looks for the best wireless channel to ensure the strongest possible connection at all times. It uses 39% less power and its smaller design typically uses 25% less plastic than previous models.

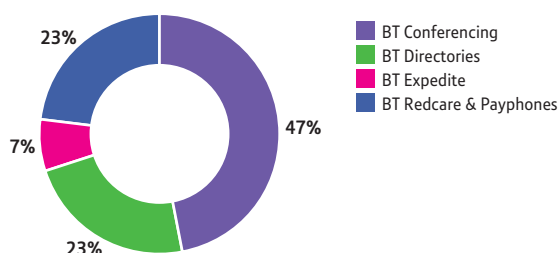
BT Business

BT Business has seen continued growth in IT services and mobility revenue up 17% and 14%, respectively, and an improvement in line losses with net line losses in the second half of 2011 being 35% lower than in the same period in 2010. During the year we launched a range of new business broadband propositions, offering a combination of competitive prices and tiered service levels as well as fibre-based broadband offers.

We have also built our capabilities in the IT services market through BT Engage IT and BT iNet. This year BT Engage IT announced it would offer 'pay as you go' information security from Symantec to offer value and flexibility to customers. BT iNet also now installs, integrates and maintains a virtual data centre hosting solution for SME customers. Our BT Business Direct online store provides IT, computing and networking equipment plus associated installation and support services for SMEs.


BT Enterprises

BT Enterprises revenue by business unit



Note: BT Openzone revenues are currently recognised within other units.

BT Conferencing launched 'Mobile Controller' and 'Desktop Controller' products for audioconferencing services which allow customers to control their audioconferences from their mobile or desktop more easily. We also launched interoperability for our 'telepresence' videoconferencing services.

 In 2011 BT Directories released the compact Phone Book, reducing its size by 15% to fit into letter boxes, saving 2,000 tonnes of paper each year. BT Directories also launched a free Android smartphone application to make The Phone Book available to mobile users.

BT Expedite delivered a new mobile-optimised web site for fashion clothing brand, Lyle & Scott and extended the multichannel capability for Pets at Home with the addition of "Click and Collect".

The volume of traffic carried by the BT Openzone network more than doubled compared with the previous year to around 3bn minutes. In August 2010 BT signed a contract with Starbucks Coffee Company to provide wi-fi across some 140 Starbucks coffee shops in Germany, extending BT's relationship with Starbucks in the UK and Ireland.

BT Ireland

While BT Ireland's revenue was impacted by the challenging economic conditions, profits increased as a result of ongoing cost transformation programmes and the delivery of large retail and wholesale contracts.

During the year we rolled out super-fast fibre-based broadband services in Northern Ireland. This investment, in partnership with Northern Ireland's Department of Enterprise, Trade and Investment (DETI), will result in 89% of lines being connected to a fibre broadband cabinet by March 2012.

In the Republic of Ireland, BT secured a number of significant contracts in the corporate, government and wholesale sectors including Danske Bank, Element Six and Pinebridge Investments.

Financial performance

	2011 £m	2010 ^a £m	2009 ^a £m
Revenue	7,748	8,124	8,491
Net operating costs	5,964	6,347	6,906
EBITDA	1,784	1,777	1,585
Depreciation and amortisation	443	459	426
Operating profit	1,341	1,318	1,159
Capital expenditure	434	417	471
Operating cash flow	1,382	1,566	984

^a Restated. See page 106.

In 2011 revenue decreased by 5% (2010: 4%). Excluding a one-off benefit of £40m in 2010 relating to prior periods, the decrease was 4%. Revenue in the second half of 2011 was down 3%, an improvement on the 5% decline in the first half after excluding the one-off benefit in 2010.

BT Consumer revenue decreased by 6% (2010: 3%) as the reduction in calls and lines revenue more than offset growth in broadband revenue.

BT Business revenue decreased by 1% (2010: 8% decrease), as declines in calls and lines revenue were largely offset by growth in IT services and mobility revenue.

BT Enterprises revenue decreased by 2% (2010: 2% increase) principally due to lower revenue in BT Redcare & Payphones.

BT Ireland revenue decreased by 6% (2010: flat). Excluding the negative impact of foreign exchange movements and the reduction in low-margin transit revenue, revenue decreased by 3%, in a difficult economic climate.

	2011 £m	2010 ^a £m	2009 ^a £m
Products and services			
Calls and lines	4,491	4,953	5,346
Broadband and convergence	1,311	1,258	1,253
ICT and managed networks	551	578	591
Other products and services	949	962	958
External revenue	7,302	7,751	8,148
Internal revenue	446	373	343
Total	7,748	8,124	8,491

^a Restated. See page 108.

Calls and lines revenue decreased by 9% in 2011 (2010: 7% decrease) in what continues to be a competitive market environment.

Broadband and convergence revenue increased by 4% (2010: broadly flat) reflecting the success of our broadband strategy, together with increased revenue from services such as mobility.

ICT and managed networks revenue decreased by 5% in 2011 (2010: 2% decrease).

Net operating costs decreased by 6% (2010: 8% decrease). The prior year included a favourable one-off internal rebate of £15m relating to prior periods. The decrease reflects the reduction in revenue but also our cost efficiency initiatives. Labour productivity efficiencies resulted in a 7% reduction in total labour costs. These savings were offset by the planned investment in subscriber acquisition costs, marketing and product development to drive future revenue growth.

The above factors contributed to a small increase in EBITDA to £1,784m in 2011 (2010: 12% increase). However, excluding the one-off benefits of £55m in 2010, the increase in 2011 was 4%.

Depreciation and amortisation decreased by 3% (2010: 8% increase) due to the lower level of capital expenditure in recent years.

Operating profit increased by 2% in 2011 (2010: 14% increase). Excluding the one-off benefits of £55m in 2010, the growth in 2011 was 6%.

Capital expenditure increased by 4% in 2011 (2010: 11% decrease) as a result of the continued investment in higher speed broadband services and the investment in the fibre-based broadband roll-out in Northern Ireland.

Operating cash flow decreased by 12% in 2011 (2010: 59% increase). This reflects the impact of some strong working capital receipts in 2010.

BT Wholesale

During 2011 we continued our transformation from a traditional product-based wholesale business to one focused on an IP future, entering adjacent markets such as digital content distribution and delivering long-term managed services to our wholesale customers.

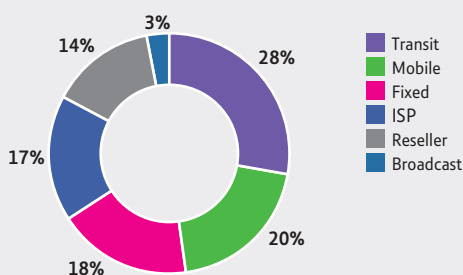
£4,210m

Revenue

£1,316m

EBITDA

BT Wholesale external revenue by customer segment



24%

of external revenue from managed network services contracts

40%

of external revenue under long-term contracts



Business overview

BT Wholesale provides a broad range of voice, broadband and data communications services, including managed network services (MNS) for fixed and mobile network operators (MNOs), ISPs and telecoms resellers in the UK.

Through our Media and Broadcast and agilemedia business units we also support the network needs of global broadcasting organisations, from connectivity and digital media management to production, post-production and interactive audience participation. Through close collaboration with Global Telecoms Markets – the wholesale arm of BT Global Services – the business also supports the needs of communications provider customers worldwide.

Over the last three years we have built a successful MNS business for fixed and mobile CPs with differing requirements, from fully managed network outsourcing for operators with significant network assets to white label managed services designed to help brand extenders with limited or no infrastructure.

We manage and support the network and services requirements of a number of national operators including KCOM Group, Virgin Media, Orange UK, Vodafone, O2 and MBNL. By making our networks and services available to other CPs, we provide them with an alternative to building their own network infrastructure.

We have long-term MNS contracts in place with all of the UK's mobile network operators to help them manage the growth in mobile data and video content generated by 3G services with high speed data connections that link mobile base stations to their and BT's core networks.

Products and services

Wholesale broadband

We are the UK's largest wholesale provider of broadband, nationally measured by reach and revenue. This includes sales to CP customers with their own broadband infrastructure but which choose our services outside their own network footprints, as well as other parts of the BT Group.

We offer a range of broadband services, delivered over copper and fibre with speeds of up to 8Mbps (ADSL), up to 20Mbps (ADSL2+) and up to 40Mbps over fibre. At 31 March 2011 our up to 20Mbps service, was available from exchanges serving over 65% of UK premises (2010: 55%). At the end of March 2011 more than 35 CPs were either selling or trialling our fibre-based broadband service.

Content distribution network

During the year we developed a content distribution network to help our CP customers manage the rapidly rising volume of video content which is being downloaded over fixed and mobile broadband networks. Our network will make this traffic more cost-efficient for CPs to manage and, through the provision of quality of service, will enable assured quality and a range of new business models for digital content.

Wholesale Ethernet

We offer IP-based Ethernet services giving customers high-speed data connectivity at a range of speeds up to 1Gbps. At 31 March 2011 Wholesale Ethernet over fibre was available from over 1,000 nodes throughout the UK (2010: 800 nodes).

Private and partial private circuits

BT Wholesale is a major provider of traditional data circuits in the UK which help our customers to extend the reach of their services and act as infill solutions for their own networks.

Capacity and call-based products

We continue to sell a wide range of capacity and call-based products and services, both regulated and non-regulated, using both traditional and IP technologies. As we refresh our core portfolio with next generation replacements, we are migrating these services to our IP network platform. One of these new products is IP Exchange, BT Wholesale's global IP interoperability platform that allows CPs to manage traditional and IP voice calls on a single gateway, regardless of whether the calls are from mobile or fixed handsets.

White label managed services

Our white label managed services business enables customers with limited or no infrastructure to offer telecoms services such as telephony and broadband without the need to invest capital. We provide a complete service, from accepting and processing new orders through to customer service and end user billing.

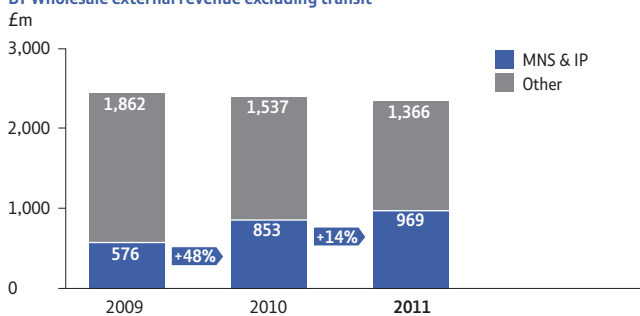
BT Wholesale product portfolio and customers

	VOICE	DATA	BROADBAND	TRANSIT	MNS
MOBILE NETWORK OPERATORS	✓	✓	✓	✓	✓
INTERNET SERVICE PROVIDERS	✓	✓	✓	✓	✓
FIXED OPERATORS	✓	✓	✓	✓	✓
BRAND EXTENDERS	✓	✓	✓	✓	✓
BROADCASTERS		✓	✓		✓

Operating review

We are committed to becoming our customers' partner of choice by continuously improving our service delivery and customer satisfaction, reducing cost, evolving our traditional product portfolio and launching new IP-based services.

BT Wholesale external revenue excluding transit



We reduced operating costs by 11% in the year, largely by eliminating the cost of failure through improvements in the delivery of products and getting services 'right first time'. We have reduced the cost of service delivery by 46% over the last three years, reduced discretionary spend and consolidated our property portfolio to reduce costs.

In May 2010 we announced the availability of our global IP Exchange platform, which is now in use by over 120 fixed-line and mobile operators worldwide. The number of minutes carried over the platform doubled over the last year.

We also launched a 1Gbps Ethernet service nationally in the UK and the sale of our fixed-line Ethernet service increased more than three-fold over the previous year.

In March 2011 we launched our first digital content distribution propositions to the UK market.

The majority of BT Wholesale's largest UK customers by revenue have signed long-term contracts, typically for between three and five years. As a result, the proportion of our external revenue underpinned by long-term contracts remained at 40% in 2011.

Revenue from MNS contracts continued to grow, and accounted for 24% of external revenue in 2011, up from 21% in the previous year. These contracts include a high proportion of products and services with low levels of bespoke development. This allows us to defend existing product and service revenues, as well as creating new opportunities for growth.

During 2011 we signed managed network services contracts with a total order value of £1.2bn (2010: £1.8bn). These included:

Date	Customer	Details
May 2010	Scottish and Southern Energy (SSE)	Re-sign of a long-term agreement for fully managed voice and wholesale line rental services that SSE resells under its own brand to more than 250,000 consumers in the UK.
Feb 2011	KCOM Group	Five-year extension of our national managed network outsourcing agreement with KCOM Group with the addition of a hosted IP Voice service that KCOM is reselling.

A number of our existing managed network services agreements have led to follow-on contracts, such as a power management contract with Virgin Media.

Our commercial satellite services are also helping non-governmental organisations provide critical aid services in hard to reach locations and support the delivery of education services in developing countries. Our satellite services are helping to improve the accuracy of European GPS services and are being used by UK energy suppliers to link remote wind farms in the UK to centralised monitoring systems.

During the year, BT Wholesale was named 'Best Wholesale Carrier' for the first time at the World Communication Awards 2010.

Financial performance

	2011 £m	2010 ^a £m	2009 ^a £m
Revenue	4,210	4,592	4,800
– Internal revenue	980	1,226	1,228
– External revenue	3,230	3,366	3,572
Net operating costs	2,894	3,239	3,444
EBITDA	1,316	1,353	1,356
Depreciation and amortisation	619	680	686
Operating profit	697	673	670
Capital expenditure	329	325	435
Operating cash flow	911	917	903

^a Restated. See page 106.

In 2011 revenue declined by 8% (2010: 4% decline). After reflecting changes in the internal trading model in 2011, which impacted internal revenue by £204m in 2010, revenue declined by 4%. Excluding low-margin transit revenue, underlying revenue declined by 3%.

	2011 £m	2010 ^a £m	2009 ^a £m
Products and services			
Transit	895	976	1,134
Conveyance and interconnect	609	578	728
ICT and managed networks	771	715	518
Broadband and convergence	335	488	543
Calls and lines	282	316	398
Other products and services	338	293	251
External revenue	3,230	3,366	3,572
Internal revenue	980	1,226	1,228
Total	4,210	4,592	4,800

^a Restated. See page 108.

Transit revenue decreased by 8% (2010: 14% decrease) as a result of transit volume reductions and the price impact of regulatory mobile termination rate reductions.

Conveyance and interconnect revenue increased by 5% (2010: 21% decrease) driven by higher volumes.

Broadband and convergence revenue decreased by 31% (2010: 10% decrease) due to securing volumes under long-term MNS contracts and, to a lesser extent, the continuing trend of CPs switching to LLU provided by Openreach.

The declines have been partly offset by an increase of 8% in MNS revenue (2010: 38% increase). The rate of growth has slowed compared with 2010 as the focus on contracts has switched to delivery and achieving key milestones.

Calls and lines revenue decreased by 11% (2010: 21% decrease) reflecting lower circuit volumes as customers seek alternative products and services such as Ethernet.

Other products and services revenue increased by 15% (2010: 17% increase) partly driven by growth in IP-based Ethernet services.

Net operating costs decreased by 11% (2010: 6% decrease) or 5% after reflecting the impact of changes in the internal trading model. Excluding transit, the decrease was 3%. The decrease was partly due to the decline in revenue, but also due to the impact of our cost efficiency programmes principally through reductions in our total labour resource.

The above factors contributed to a 3% decrease in EBITDA (2010: broadly flat).

Depreciation and amortisation decreased by 9% to £619m (2010: 1% decrease).

Operating profit increased by 4% (2010: broadly flat) due to the decline in EBITDA being offset by lower depreciation and amortisation.

Capital expenditure increased by 1% (2010: 25% decrease), reflecting the increased investment in our Ethernet and Wholesale Broadband Connect footprints.

Operating cash flow decreased by 1% in 2011 (2010: 2% increase). After adjusting 2010 for the intra group VAT settlement with Openreach, operating cash flow decreased by 7%, primarily due to the timing of working capital payments and the increase in capital expenditure.

Openreach

During the year we continued to roll out our super-fast broadband at scale and are on track to pass 5m homes by spring 2011. For the first time since we were formed, we have seen growth in our copper line base.

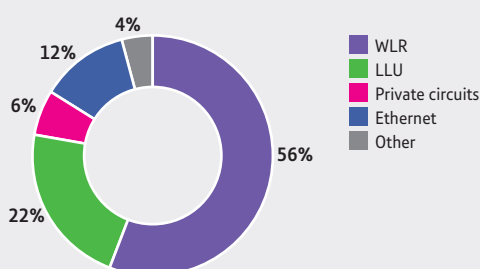
£4,930m

Revenue

£2,132m

EBITDA

Openreach revenue by product



11,000

Growth in copper line base in 2011

62%

Increase in Ethernet connections

Business overview

Openreach is responsible for the 'last mile' of the UK access network – the copper wires and fibre connecting homes and businesses to their local telephone exchange via fixed-line local and backhaul connections. Openreach connects 5,600 exchange areas through approximately 120m kilometres of copper wire. All Openreach customers – currently approximately 490 CPs, including other BT lines of business – are offered fair, equal and open access to its networks. We have nearly 19,000 field engineers who work on behalf of all CPs, enabling them to provide their customers with a range of services from analogue telephone lines to complex networked IT services.

Products and services

Wholesale line rental

Wholesale line rental (WLR) enables CPs to offer telephony services with their own brand and pricing structure over BT's network.

Local loop unbundling

LLU enables CPs to use the lines connecting BT exchanges to end users' premises, and to install their own equipment in those exchanges.

Ethernet

Openreach's Ethernet products offer CPs a wide choice of high bandwidth circuits to build or extend their customers' data networks.

Fibre-based broadband

Openreach plans to make fibre-based services available to 10m UK premises by 2012 and to two thirds of premises by the end of 2015, offering speeds of up to 100Mbps. Super-fast fibre access is provided by our Generic Ethernet Access product which comes in two types: FTTC offering download speeds of up to 40Mbps and upload speeds of up to 15Mbps; and FTTP offering download speeds of up to 100Mbps and upload speeds of up to 30Mbps. There are a number of CPs currently offering or trialling FTTC and FTTP.

At 31 March 2011 Openreach had identified 12 trial sites for its FTTP product and already passed over 12,000 UK premises.

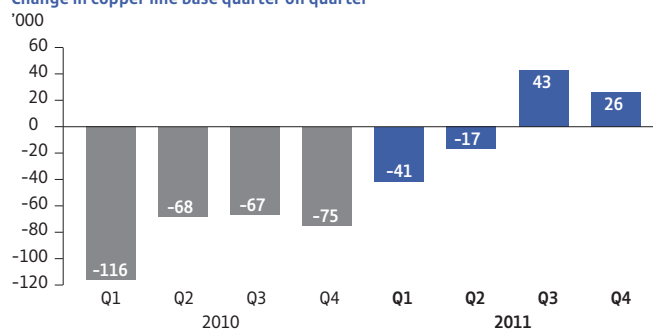
Operating review

2011 was an extremely busy year for Openreach with high levels of demand across our products. At 31 March 2011 Openreach was providing 16.9m WLR lines to other BT lines of business, and 6.2m to other CPs.

By the end of the year, 89% of UK premises were served by an unbundled exchange and there were 15.7m unbundled lines in the UK, up 6.5% on the previous year. Of these, 8.1m were for other BT lines of business to support broadband services and 7.6m were for other CPs. Thirty CPs are providing unbundled services, and Openreach is fulfilling more than 100,000 LLU orders a week.

This increase in LLU uptake was stimulated by further demand in the broadband market and drove overall engineering provision visits up over 25% year-on-year. We completed over 65,000 Broadband Boost visits – where engineers visit homes to improve broadband services.

Change in copper line base quarter on quarter




The 11,000 net increase in the copper line base was the first growth since the formation of Openreach in 2006.

We also began to see an acceleration in the number of end-users on our fibre-based services.

Across other products we continued to grow our Ethernet base with connections up 62%.

Repair visits increased 21% year-on-year partly because of the extra activity in the network. The repair workstack reached its peak during January and this was due to increased provision volumes coupled with very poor winter weather conditions and a 134% increase in faults relating to cable theft and vandalism. These attacks accounted for 85,000 faults on the live network.

Our focus on engineer task times (average task times for repair/provision fell 19% and 10%, respectively) and short-term use of additional engineering resource helped to improve the workstack as we reached the end of the year. The repair workstack increase resulted in a slight fall in our mean time between faults, which stands at one fault every 14 years, but still compares favourably with our historical performance.

 Openreach operates an engineering fleet of more than 21,000 vehicles and is committed to finding innovative ways to minimise its environmental impact. For example, over 18,500 of our vehicles are now equipped with satellite location technology that is designed to improve the efficiency of engineering visits, thereby reducing fuel usage. During the year we have reduced our total fleet by just under 500 vehicles and on a like-for-like basis, considering the increases in both provision and repair visits, we reduced our fuel usage per visit by 11%.

Financial performance

	2011 £m	2010 ^a £m	2009 ^a £m
External revenue	1,459	1,241	1,042
Revenue from other BT lines of business	3,471	3,923	4,189
Revenue	4,930	5,164	5,231
Net operating costs	2,798	3,204	3,235
EBITDA	2,132	1,960	1,996
Depreciation and amortisation	877	856	778
Operating profit	1,255	1,104	1,218
Capital expenditure	1,087	907	951
Operating cash flow	1,078	1,167	1,079

^a Restated. See page 106.

In 2011 revenue decreased by 5% (2010: 1% decrease). After reflecting changes in the internal trading model in 2011, which impacted internal revenue by £204m in 2010, revenue was 1% lower. Higher LLU and Ethernet volumes and provisions activity were largely offset by price reductions and the continued migration from WLR to lower priced Metallic Path Facility (MPF).

External revenue was £1,459m in 2011, an increase of 18% (2010: 19% increase) and reflects the continuing migration of end customers to other CPs' WLR and LLU products. External revenue represented 30% of our revenue in 2011 (2010: 24%).

Revenue from other BT lines of business decreased by 12% to £3,471m in 2011 (2010: 6% decrease). After reflecting changes in the internal trading model, revenue from other BT lines of business decreased by 7% reflecting the shift of WLR and LLU volumes from other BT lines of business to external CPs and the effect of lower Ethernet prices, partly offset by volume increases.

Net operating costs reduced by 13% (2010: 1% decrease). After reflecting the impact of changes in the internal trading model and excluding leaver costs, net operating costs reduced by 5% in 2011 achieved through process efficiencies in volume engineering activities.

EBITDA increased by 9% (2010: 2% decrease) as the cost efficiencies have offset the reduction in revenue.

Depreciation and amortisation increased by 2% (2010: 10% increase) reflecting investment in our next generation broadband, Ethernet and fibre services.

Operating profit increased by 14% in 2011 (2010: 9% decrease).

Capital expenditure increased by 20% (2010: 5% decrease) due to the investment in our super-fast fibre-based broadband network and the increase in CP's infrastructure build and provision activities.


Operating cash flow decreased by 8% (2010: 8% increase). After adjusting 2010 for the intra group VAT settlement with BT Wholesale, operating cash flow decreased by 2% in 2011 as the higher capital expenditure was largely offset by the increased EBITDA.

BT Innovate & Design

BT Innovate & Design is responsible for the innovation, design, development and delivery of the processes, networks and platforms on behalf of the customer-facing lines of business. These are run by BT Operate.

BT Innovate & Design has an operating model focused on delivery, with strong cost and quality management, which includes the whole lifecycle of both the network and associated software. In addition, by having the innovation, design and development skills within one team we are able to bring innovation closer to the customer, bringing new ideas, products and services to market faster, cheaper and more effectively for our customers. This is supported through the use of global development centres in the UK, US, Europe and India which improve collaboration, agility and efficiency in network and software development by bringing together the development teams and customers.

We continue to reduce our cost base through a combination of cost controls and efficiency measures. In 2011 we reduced our unit costs by 12% (2010: 31%) through a quality delivery process, which focuses on re-use, consolidation and standardisation, by developing software which can be used to guide decisions about development, and supplier management.

 We embed sustainability into our current innovation and design approach by including energy usage as a design criteria in our network and service architectures both for BT internal use and to enable our lines of business to offer low carbon products and services to customers. For example, in 2011 we developed an ADSL technology called 'Cool Broadband' that configures ADSL lines to be 'always available' rather than 'always fully on' and has the potential to reduce energy consumption by around 30% per line without affecting the customer's experience. During 2011 we successfully conducted customer trials and we are working with suppliers towards a development plan.

To ensure our focus on being a sustainable and responsible business leader well into the future, we have a dedicated research team focused on developing opportunities for future gains in energy and carbon management and on using cutting edge technologies to improve accessibility and inclusion for the hearing, sight and physically impaired.


BT Operate

BT Operate manages BT's IT and network infrastructure platforms as a single converged operation, providing a seamless IT infrastructure. BT Operate also runs parts of other CPs' networks on behalf of the customer-facing lines of business, and is responsible for delivery of the products and services BT sells to its customers.

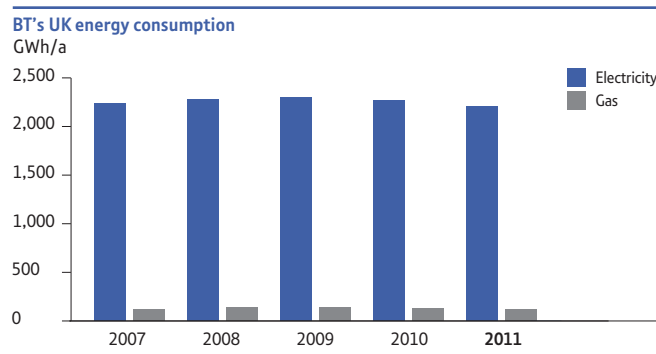
We monitor the reliability of BT's networks and systems, and during 2011 we had challenges but in the fourth quarter we saw an improvement in performance. A key driver to the improvement is due to uplifts on our core network platforms and systems infrastructure.

	Q4 2011	Q4 2010	
Reliability performance measure	28.2% improvement over fourth quarter of 2010	10.8% improvement over fourth quarter of 2009	Reliability is measured as the reduction in frequency and duration of network and system outages for certain product journeys.

We establish and manage security policy and processes throughout BT, enabling us to meet the requirements of our customers, both in the UK and globally.

 BT Operate manages the group's energy strategy which aims to reduce consumption, establish security of supply and reduce carbon emissions. Networks and data centres managed by BT Operate account for a significant amount of BT's energy consumption in the UK.

This year, BT has reduced global energy consumption by 2.5% compared with 2010. This is the second consecutive year that BT has reduced overall energy consumption, despite additional energy required for business growth and expansion of networks. In the UK, energy consumption has reduced by 2.6% compared to 2010.



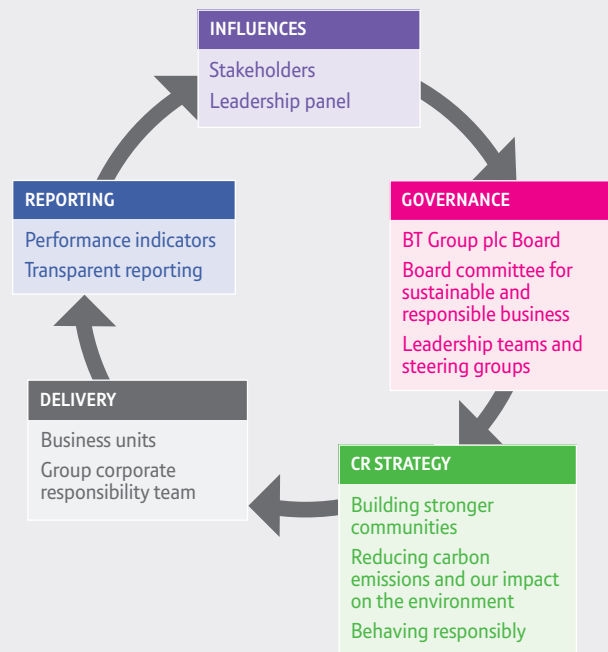
Our energy consumption reductions have been achieved by driving key initiatives including Smart Energy Control by delivering building energy management systems to many sites with further sites planned for 2012. They have also been achieved by replacing energy-inefficient equipment, and decommissioning and rationalising our estate.

OUR CORPORATE RESPONSIBILITY

- Introduction
- Building stronger communities
- Reducing carbon emissions and our impact on the environment
- Behaving responsibly
- Our corporate responsibility risks
- Further information

Taking corporate responsibility and sustainability seriously has been important to BT for many years. To better reflect this, we updated our business strategy this year, so that being a 'responsible and sustainable business leader' became one of our strategic priorities. This will help us to further integrate sustainability into our daily decision-making.

Our approach to developing and delivering our corporate responsibility



Introduction

We have a long track record of acting responsibly and supporting the communities to whom we deliver services. Our support for Children in Need telethons dates back to 1980, and that for Comic Relief to 1988. Our environmental management system dates back to 1991. We have long-standing ethical supply chain management processes and policies on equal opportunities, fair pay and anti-bullying.

One way in which businesses strive to do better in terms of acting responsibly is to compete with others for awards. We enter these to help benchmark ourselves against the efforts of other like-minded organisations. In 2011 we were proud that we maintained gold sector status in the Dow Jones Sustainability Index and 'Platinum Plus' level in the Business in the Community Corporate Responsibility Index, as well as attaining a place in the FTSE4Good Index. We were in joint first place in the Carbon Disclosure Project's Leadership Index, won the World Communication Award 'Green Award' and won the Edie Award for Environmental Excellence in the 'Sustainable Transport' category.

We are focused on a number of strategic priorities and in 2011 we added a new strategic priority – 'to be a responsible and sustainable business leader' – to leave no doubt about the importance we place on acting ethically and in the interests of the environment. This reflects an ongoing commitment to integrate the principles of sustainability into the way we do business.

We measure progress towards our corporate responsibility (CR) goals in accordance with the principles of the Connected Reporting Framework sponsored by HRH the Prince of Wales. Our sustainability report provides full details of our progress and can be found online at www.bt.com/betterfuture

We are focusing our activity on three areas to deliver our new strategic priority:

- building stronger communities through the power of our technology and people
- reducing carbon emissions and our impact on the environment through our operations and products
- behaving responsibly towards our customers, people and suppliers.

The importance of CR is emphasised by the existence of a Board Committee dedicated to CR and chaired by the BT plc Group Chairman. We also receive advice from an external leadership panel of independent experts. See **Report of the directors – Report of the Committee for Sustainable & Responsible Business** on page 68 for more information.

Building stronger communities

We are using our technology and the skills and creativity of our people to make a positive difference to the communities in which we work.

Digital inclusion

The economic benefit of getting everyone online in the UK is estimated at £22 billion (the Economic Case for Digital Inclusion – PricewaterhouseCoopers LLP, October 2009). We help communities enjoy the benefits of technology through our commitment to improve digital inclusion. We aim to get at least 100,000 digitally excluded people online as part of our support for the UK's Race Online 2012. We have underpinned this with our large investment in the UK's digital infrastructure and programmes like our 'Race to Infinity' – an online vote which resulted in winning communities being prioritised as part of our fibre roll-out programme.



We support older and less able customers through our accessible services. In 2011 we launched BT's 'Including You' website, which offers a range of accessible products and services for those who need extra help with communications. We are proud that the initiative was the first to receive a new accreditation mark from AbilityNet, a charity that enables people with disabilities to access technology and the internet.



Skills and training

We support customers who feel they do not have the skills to use our services through our 'Get IT Together' programme launched in 2010.

In many countries around the world we also provide community investment support to address digital inclusion locally. In India, our support for the Katha Information Technology and E-Commerce School (KITES) equips students with the IT skills that will help them to build promising careers in the local job market. We have digital inclusion programmes in the US, Colombia, Spain and South Africa. Our contribution to digital inclusion around the world supports our brand and helps us to contribute to building stronger local communities.

Charitable involvement

We work closely with charities to help them enhance their capacity and their fundraising. We help community and charity groups build an online presence through resources such as our Community Web Kit.

'BT Troubleshooter' is a new free service that gives UK charities access to BT people to help them to tackle particular problems.

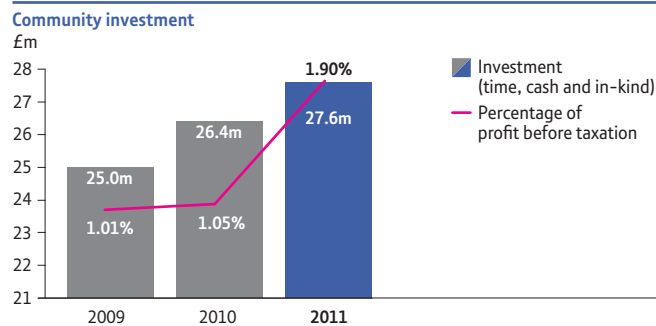
Our support for telethons continues to assist charities with their fundraising. In 2011 our technology and employee volunteers helped Children in Need and Comic Relief raise over £34m through BT supported telethons.



In April 2011 BT launched a new online fundraising service for UK charities called MyDonate (www.bt.com/mydonate), the first online fundraising service not to charge a subscription fee or take commission. We developed the MyDonate service with a number of charities – including Cancer Research UK, Changing Faces, Kid's Out, NSPCC and Women's Aid. We were encouraged that within days of launch, hundreds of charities had signed up to exploit this new platform for giving.

We also support our employees in their involvement in charities and community groups. We did this in 2011 through our employee volunteering programme, our employee charity match programme and through our BT Community Champions programme. In 2010 we asked our people to vote on which charities they wanted to be the company's fundraising charity partners. They chose Cancer Research UK to join ChildLine. We are pleased to work with these organisations.

Overall this year BT invested money, time and in-kind contributions worth £27.6m in supporting responsible and sustainable business activities.

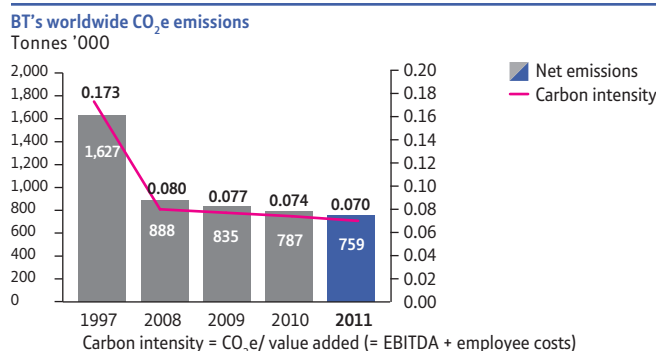


Reducing carbon emissions and our impact on the environment

BT aims to reduce its impact on the environment through a range of initiatives. These include reducing energy and water use, generating our own renewable energy, bringing down waste and implementing responsible product stewardship.

Reducing our own emissions and energy usage

Our aim is to continue to reduce carbon emissions. We have set ourselves an ambitious carbon emissions reduction target linked to our economic contribution to GDP. In 2011 we reduced our carbon emissions intensity per unit of value added (our contribution to GDP) by 59% compared with 1997. We continue to make good progress towards our target of achieving an 80% reduction in our worldwide emissions intensity by 2020, compared with 1997. A description of our energy reduction progress and how it was achieved is included in the **BT Operate** section on page 35.



In 2007 we announced plans to develop our own onshore wind farms so that we can produce around 25% of our electricity from renewable resources by 2016. This has proved challenging in terms of securing planning permission. However, we have had one site agreed in North East England and others are in train.

Engaging with the UK Government

Through our actions and engagement with the UK Government, we are trying to encourage investment in low-carbon electricity generation. One way to help stimulate the creation of a clear market for renewable and low-carbon energy would be to introduce a colour-coded label on all electricity sold in the UK, enabling customers to easily assess the green credentials of the electricity they buy. Such a system has worked successfully in

driving low-carbon purchasing decisions in other markets such as white goods and vehicles.

We believe this type of transparent carbon information, supported by tax incentives, would stimulate demand for green energy, and help the UK to move more quickly to a low-carbon energy market. It would also resolve the problem of ‘double-counting’ of green electricity and remove the confusion surrounding current ‘green tariffs’.

Engaging with vendors

In February 2011 we introduced a new procurement standard requiring all suppliers to measure and report their carbon and greenhouse gas emissions and set reduction targets. This is designed to encourage supplier innovation and to speed up development of low-carbon technologies. We ran workshops in partnership with the Carbon Trust this year to help 80 UK SMEs improve their understanding of climate change and develop action plans to reduce their impact.

Engaging with customers

Reports such as SMART2020 show that the ICT sector as a whole has the opportunity to help society reduce global carbon emissions by as much as 15% by 2020. We work with customers to help them to reduce their carbon emissions and energy consumption through the supply of energy-efficient products and solutions. We encourage business customers to replace travel with digital communications and in the UK we announced a smart metering consortium in partnership with Arquiva and Detica. These and other low-carbon opportunities are realised through our customer-facing lines of business and described in **BT Global Services** on page 23 and **BT Retail** on page 26.

Behaving responsibly

We strive to behave responsibly towards our customers, suppliers, employees and neighbours.

We expect everyone at BT to meet high ethical standards and we want to do business with suppliers and customers we can trust and who share our values.

We have a governance structure in place to monitor that our ethical policies reflect best practice and are routinely applied.

We are implementing an anti-corruption and bribery programme to build on our ethical culture. We have policies and procedures in place to mitigate the risk of any BT employee, or anyone acting on our behalf, breaching our ethical code of conduct.

Ethical performance measure – an index measured on a five point scale of the success of BT’s employee awareness and training.

Non financial performance

Target 2012	2011	2010	2009
Maintain or improve our 2011 index score	4.16	4.10	New in 2010

Financial performance

Revenue support Customer bids with a sustainability element	£2.1bn	£2.1bn	£1.5 bn
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We take our responsibilities as an ISP seriously. Using Cleanfeed – our content filtering solution – BT continues to prevent inadvertent access to images of child sexual abuse as identified by the Internet Watch Foundation. We have shared, without charge, the technical solution with other carriers. To supplement this, in March 2011 BT launched a new range of printed and online safety advice to help parents keep children safe on the internet. At the same time we launched a major campaign to prompt BT broadband customers to consider BT’s free Family Protection parental-control software. The software is offered automatically as part of the install process.

BT is participating in research at the University of Cambridge, Massachusetts Institute of Technology and Tsinghua University, assessing how people react to technological change and how these changes affect the productivity and well-being of individuals and society as a whole.

BT’s approach to privacy and data protection includes both technological solutions and a focus on employee awareness and behaviour. In 2011 we established a number of regional governance committees which oversee our approach and monitor progress.

Disaster response and resilience

Resilience is incorporated into the design of our network, but disasters and emergencies can strike unexpectedly. BT has formal legislative civil contingency responsibilities as a UK Category Two responder. As the largest guardian of Britain’s telecommunications Critical National Infrastructure (CNI) we are responsible for maintaining communications for our customers, including other CPs, as well as national, regional and local government, emergency services and public sector bodies. We also aim to help shape and implement best practice.

We extend this core value of being a responsible business into our community investment focus through engagements with the Disaster Emergency Committee (DEC), the British Red Cross and the American Red Cross and via maintaining a dedicated emergency response team.

Our corporate responsibility risks

We quantify the most significant social, environmental and ethical risks to BT in our corporate responsibility risk register. This is updated twice a year and reviewed annually.

The current corporate responsibility risks which we monitor and report on are:

- health and safety risks to employees and the public exposed to BT operations
- breach of integrity or unintended release of private customer data leading to a loss of trust in BT
- mitigating climate change impacts such as increased costs associated with changing legislation
- adapting our business to reduce our exposure to the direct impacts of climate change, such as severe weather
- ensuring that our activities and their outcomes meet legal or ethical standards for a diverse workforce
- unacceptable supply chain working conditions.

Where appropriate, references are made within the **Our risks** section on page 39 to the aspects referred to above.

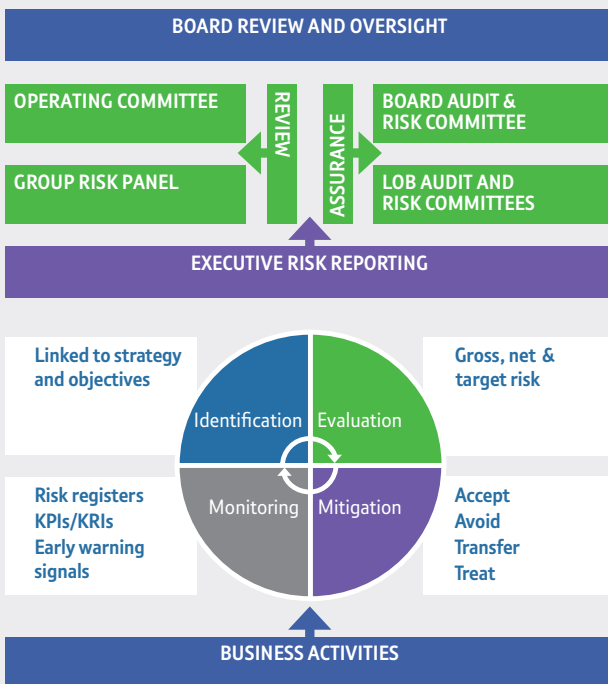
Further information

More detailed information about our CR and sustainability performance is available in our independently verified 2011 sustainability report at www.bt.com/betterfuture

OUR RISKS

- Our approach to managing risk
- Principal risks and uncertainties
- Our risks
 - Security and resilience
 - Major contracts
 - Pensions
 - Growth in a competitive market
 - Communications industry regulation
 - Compliance in a global environment
 - Supply chain

Risk management is integral to our business and is central to the successful delivery of our objectives. Our risk management approach supports the creation and maintenance of shareholder value whilst promoting the interests of our many stakeholders through the safeguarding of our assets – people, property and resources – and of our reputation.



Our approach to managing risk

BT has in place group-wide risk management processes for the identification, evaluation, treatment and subsequent monitoring of risks which may significantly threaten the accomplishment of our objectives and long-term strategic aims. Our risk management processes are operated within BT lines of business (LoB), internal service units, group functions, contracts, projects and programmes and are aggregated at group level. The approach is defined in our group-wide risk management policies.

Management is responsible for identifying, evaluating, mitigating and monitoring risks. Those risks which are significant to the group are reported and monitored through the Group Risk Register (GRR) which is formally updated quarterly. The GRR includes those risks identified from across the group, which are significant as assessed on a quantitative and qualitative basis. Each risk, including those in the GRR, is assigned a management owner who is responsible for the ongoing monitoring of the risk including changes to the risk profile and progress of the mitigations.

The Board has overall responsibility for ensuring that our risks are managed appropriately and, either directly or through its sub-committees, the *Operating Committee* and the *Audit & Risk Committee*, undertakes regular reviews of the management of the risks at group-wide, LoB, internal service units and group function levels.

The Board and the Operating Committee are supported in their oversight of risk management by the Group Risk Panel who review the GRR quarterly, consider new or emerging risks, make recommendations on the strength of mitigations and monitor the work of the Group Risk Management function. Our reporting is structured so that emerging key issues are escalated through management to the Board as appropriate.

Principal risks and uncertainties

In common with all businesses, BT is affected by a number of risks and uncertainties, some of which are not within our control. Many of our risks are similar to those of comparable companies in terms of scale and operation. Economic uncertainty remains a major challenge to businesses globally and we remain conscious of those risks in all our business undertakings. Compliance in a global environment and supply chain are now recognised as principal risks along with those risks reported on last year which were: security and resilience; major contracts; pensions; growth in a competitive market and communications industry regulation.

This section highlights some of those particular risks and uncertainties affecting our business but it is not intended to be an extensive analysis of all risk and uncertainty affecting our business. These risks have the potential to impact our business, revenues, profits, assets, liquidity and capital resources adversely. Our processes are designed to give reasonable, but cannot give absolute, assurance that the risks significant to the group are identified and addressed. There may be risks which are unknown or which are presently judged not to be significant but later prove to be significant.

We have included comment on mitigations that we apply to help us manage the risks; however it is possible that not all of these mitigations will be successful. The principal risks and uncertainties should be considered in conjunction with the risk management process, the forward-looking statements for this document and the **Cautionary statement regarding forward-looking statements** on page 162.

Our risks

Security and resilience

BT is dependent on the secure operation and resilience of its information systems, networks and data. The scale of our business and global nature of our operations means we are required to manage significant volumes of personal and commercially sensitive information.

BT stores and transmits data for its own purposes and on behalf of customers, all of which needs to be safeguarded from potential exposure, loss or corruption, and therefore receives a high level of management attention and security measures.

Certain of our customers require specific, highly sophisticated security provisioning which we are contractually obliged to meet and through our continuing success in meeting those requirements we are able to differentiate our offerings from those of our competitors.

Impact

Failure or interruption of data transfer could have a significant adverse effect on the business. A breach of our security and/or resilience affecting BT's own operations or those of our customers could lead to an extended interruption to network services and even national infrastructure. Such failure may lead to a loss of customer confidence, termination of contracts, loss of revenue and reduced cash resources. Additional reputational damage and financial loss may arise from a breach involving a legal failing such as breaching data protection requirements.

Risk mitigation

We operate well established policies addressing the security and resilience requirements of our operations, our systems and systems operated by us for our customers. We have a corporate resilience strategy and business continuity plans in place designed to deal with catastrophic events including, for example, major terrorist action, industrial action, cyber-attacks or natural disasters.

Our mitigations for this diverse risk are continuously reviewed and updated which, in 2011, led to more stringent application of data encryption and segregation measures, the deployment of increasingly sophisticated anomaly and intrusion detection systems, and migration to distributed and virtual data centre designs that provide much greater inherent resilience.

Major contracts

We have a number of complex and high value contracts with certain customers. The profitability of, and revenue arising from, these contracts is subject to a number of factors including: variation in cost and achievement of cost reductions anticipated in the contract pricing, both in terms of scale and time; delays in delivery or achieving agreed milestones owing to factors either within or outside of our control; changes in customers' requirements, budgets, strategies or businesses; the performance of our suppliers; and other factors. Any of these factors could make a contract less profitable or even loss making.

The degree of risk varies generally in proportion to the scope and life of the contract and is typically higher in the early transitional and transformational stages of the contract. Some customer contracts require significant investment in the early stages, which is expected to be recovered over the life of the contract. Major contracts often involve the implementation of new systems and communications networks, transformation of legacy networks and the development of new technologies. The recoverability of these upfront costs may be adversely impacted by delays or failure to meet milestones. Substantial performance risk exists in these contracts, and some or all elements of performance depend upon successful completion of the transition, development, transformation and deployment phases.

Impact

Failure to manage and meet our commitments under these contracts, as well as changes in customers' requirements, budgets, strategies or businesses may lead to a reduction in our expected future revenue, profitability and cash generation. We may lose significant revenues due to the merger or acquisition of customers, changes to customer strategy, business failure or contract termination. Failure to replace the revenue and earnings thereby lost from such customers will lead to reduction in revenue, profitability and cash flow.

Risk mitigation

We have developed business processes in support of each stage of the major contract life cycle: bid, in life, renewal and termination. Our programme of in-life reviews has been enhanced over the past two years and is designed to validate financial and non-financial controls over delivery of the contracts and incorporates tiered levels of defined review according to the scale and complexity of the contract. All our contracts are subject to regular management review and many are subject to independent review (both internal and external) as part of that governance. Independent review helps us identify lessons learned and to promulgate best practice through the business.

Pensions

We have a significant funding obligation to a defined benefit pension scheme. Declining investment returns, longer life expectancy and regulatory changes may result in the cost of funding BT's main defined benefit pension scheme (BTPS) becoming a significant burden on our financial resources. The triennial funding valuation of the BTPS at 31 December 2008 and associated recovery plan was agreed with the Trustee in February 2010. Under this prudent funding valuation basis the deficit was £9bn and a 17-year recovery plan was agreed. Details of the valuation assumptions and recovery plan are set out in note 23 to the financial statements.

The valuation and the recovery plan are under review by the Pensions Regulator whose initial view was that they had substantial concerns with certain features of the agreement. Their review is now on hold and is not expected to recommence until the outcome of the final Court decision, including any potential appeals, is known on the Crown Guarantee. Accordingly, as matters stand, it is uncertain as to when they will conclude their review. This uncertainty is outside of our control. However, we do not expect this to be before the completion of the next triennial funding valuation as at 31 December 2011. As is usual, BT and the Trustee will engage with the Pensions Regulator regarding the 2011 valuation.

Impact

An increase in the pension deficit and associated funding requirements would have a direct adverse impact on the future cash resources of the group. Indirectly it may also have an adverse impact on the group's share price and credit rating. A deterioration in the credit rating would increase the group's cost of borrowing and may limit the availability or flexibility of future funding thereby affecting the ability of the business to invest, pay dividends or repay debt as it matures.

Risk mitigation

Since the funding valuation at 31 December 2008 there have been a number of significant developments. With effect from 1 April 2009 a number of benefit changes were implemented which reduce the cost of future benefit accruals and the associated risks. During 2011 the UK Government decision to change the indexation of pension benefits from the Retail Prices Index to the Consumer Prices Index has affected some sections of the BTPS and resulted in a significant reduction in the liabilities and associated risks.

The returns generated on the assets since 31 December 2008 have also been significantly greater than assumed in the funding valuation. As a result the Trustee's initial estimate is that the funding valuation had reduced to £3.2bn at 31 December 2010 after the deficit payment of £0.5bn in March 2011. We took the opportunity to accelerate the deficit payment due in December 2011 to March 2011 as it was economically advantageous to do so.

The investment performance and liability experience as well as the associated risk exposures are regularly reviewed and monitored by both the company and the Trustee of the scheme.

Growth in a competitive market

We operate in markets which are characterised by high levels of competition including: regulatory intervention on promoting competition; declining prices; technology substitution; market and service convergence; customer churn; declining rates of market growth; and emerging competitors with non replicable sources of competitive advantage.

A significant proportion of our revenue and profit are generated in the UK telecommunications markets which are experiencing limited growth in revenue terms and in many cases are highly competitive. Revenue from our fixed line calls and lines services to consumers and businesses have historically been in decline. Our ability to deliver profitable revenue growth depends on delivering on our strategic priorities (see page 11).

Impact

Failure to achieve profitable revenue growth through our strategic priorities (see **Our business and strategy** on pages 10 to 13 for further details) may lead to a continued decline in revenue, erosion of our competitive position and might also lead to a reduction in future profitability, cash flow and to a diminution in shareholder value.

Risk mitigation

We have a clearly defined strategy aimed at delivering growth, as set out on pages 10 to 13, the successful delivery of which will address the need for growth in revenue.

Our strategic priorities are underpinned by our view of the markets in which we operate. Performance against our business plans is closely monitored by management allowing interventions where appropriate.

The group has a well developed cost transformation programme in place which has achieved significant savings and which has from a profitability perspective mitigated the revenue declines and helped ensure a competitive cost base.

Communications industry regulation

Some of our activities continue to be subjected to significant price and other regulatory controls which may affect our market share, competitive position, future profitability and cash resources. Many of our wholesale fixed network activities in the UK are subject to significant regulatory controls. The controls regulate, among other things, the prices we can charge for many of our services and the extent to which we have to provide services to other CPs. In recent years the effect of these controls has required us to reduce our prices, although in some recent cases, prices have been allowed to increase in real terms.

Regulatory authorities may increase the severity of the price controls, extend the services to which controls apply or extend the services which we provide to other CPs. These controls may adversely affect our market share, our ability to compete and our future profitability and cash resources. Wholesale customers may also raise disputes with Ofcom, seeking lower prices on wholesale services which are not subject to direct price control.

Impact

In recent years, changes in price controls have required us to reduce our prices and in some instances to make payments in respect of retrospective price adjustments. Additional or more substantial regulatory price reductions could constrain our revenue growth. Regulatory actions may also indirectly affect us. For example, Ofcom has reduced the mobile termination rates that mobile network operators can charge to terminate calls on their network. There will be a stepped reduction in prices over four years starting from April 2011. This regulatory action will have a significant impact on future transit revenues in the UK and Europe.

We may be required to provide new services to wholesale customers on a non-discriminatory basis, increasing our costs and increasing retail competition. Disputes may result either in reduced revenue or increased costs going forward. We may also be required to make retrospective payments to CPs if it is ruled that past charging mechanisms we have applied have overcharged CPs. Appeals may change Ofcom's decisions, which had originally been concluded in our favour.

Risk mitigation

We continuously monitor and review potential regulatory changes and disputes, and maintain a strategic dialogue with regulators and other key influencers on critical issues.

Compliance in a global environment

Some of the countries where we operate have increased their enforcement of local laws and therefore the potential impact of failing to comply with local and international legislative requirements has increased significantly. Legislation is increasingly multi jurisdictional and the potential penalties, including fines, that have been levied against a number of organisations, have grown in frequency and value.

Legal compliance obligations include antitrust and anti-corruption legislation, competition law, data privacy, trade sanctions, import and export controls, taxation and telecommunications regulatory requirements. The UK Bribery Act which comes into effect in July 2011 with increased penalties for non-compliant businesses introduces the offence of failing to prevent bribery. With the breadth of BT's operations and complex commercial relationships we must ensure that we and our business partners are compliant as a continuing priority.

Impact

Failure to comply with legal requirements can have a significant impact and lead to a loss of reputation and damage to our brand with investors, regulators and customers. Non-compliance with legislation, including requirements to maintain adequate systems and controls, may also lead to prosecution, penalties and in some cases could lead to litigation and loss of revenues and loss of profits.

Failure by our employees, suppliers or agents to comply with anti-bribery and corruption legislation (including the US Foreign Corrupt Practices Act and the UK Bribery Act), or any failure in our policies and procedures to monitor and prevent non-compliance, anywhere in the world, could result in substantial penalties, criminal prosecution and significant damage to our reputation.

Risk mitigation

We have in place a number of established controls to address this risk including: a clear and comprehensive code of conduct, 'The Way We Work', which is part of the mandatory training of all employees; compliance policies; global training programmes promoting adherence to applicable laws; a BT Ethics programme introduced to increase the due diligence of our suppliers, contractors, agents and business consultants; and a programme of assurance within the business. On a regular basis, we also review our anti-corruption and bribery measures and are implementing additional procedures.

Supply chain

We are dependent upon our supply chain for the delivery of goods and services on time, to cost and specification. A number of factors, including the continuing economic uncertainty have contributed to a heightening of the risk of this reliance. Failure of any of our critical suppliers to meet agreed deliverables could adversely impact our customer service, product launch, business critical systems updates, revenues or cost efficiency.

BT is committed to ensuring that all dealings with suppliers, from selection and consultation, to contracting and payment are conducted in accordance with our trading and ethical policies.

Our supply chain is truly global and we aim to harness the capability, diversity and innovation of our supply market to add value to our business and customers. Many suppliers are being impacted by the economic downturn and the challenges of globalisation. This is introducing further risk in our supply chain which includes, but is not limited to: increase in supplier insolvency; lack of supplier resilience following a disaster; corporate social responsibility risks in our extended supply chain; and security risks relating to data protection.

Impact

Our suppliers could be adversely affected by economic conditions which in turn could impact their ability to meet their obligations to us or, in the extreme, cause them to fail. If we are unable to contract with an alternative supplier our customer commitments could also be compromised leading to contractual breach, loss of revenue, penalties or increased costs.

A failure in our supply chain to meet legal obligations or ethical expectations could adversely impact our reputation or possibly lead to censure, legal action and financial loss.

Risk mitigation

We continue to mitigate this risk through a number of measures including: globally coordinated vendor management programmes; rigorous bid controls; supplier risk assessments including focus on our most critical suppliers; our Procurement Academy Programme, an internal training initiative; anti-corruption and bribery awareness training; and CR and Compliance Health Checks. We work with our suppliers to ensure that the goods and services that we buy are made, delivered and disposed of in a socially and environmentally responsible manner.