



# Being the best: An interview with William Yeung and NiQ Lai, HKBN

HKBN was founded in 1992 by two entrepreneurial cousins as an alternative long-distance call provider. The company's initial capital was just HKD 1 million and it employed ten people. After establishing itself as the largest long-distance alternative around 1999, the founders looked at next-generation network (NGN) technology and its capabilities, strongly believing that an advanced NGN would be crucial for Hong Kong's future economic development and its people's further development. Coupled with a thorough business case, this led to the vision to roll out a nationwide broadband network. The Hong Kong Broadband Network's name itself reflects the ambition to become the new Hong Kong Telecom (now PCCW), but founded upon next-generation technology.

William Yeung was appointed Group Executive Director and CEO in 2008, having joined the group as COO in 2005. He looks back on over 18 years of experience in the telecommunications industry and holds BA, MBA, and MS degrees.

NiQ Lai is HKBN's CFO, Company Secretary, and Head of Talent Engagement. He joined the group in 2004 and has extensive experience in the telecommunications industry as well as in research and finance. He holds an Executive MBA degree.

**McKINSEY: Why did you decide to roll out your own network infrastructure and not use some of the existing operators' network?**

**WILLIAM YEUNG:** First of all, we can never be the best when we lease capacity or network equipment from the

incumbent, since we will always be dependent on the incumbent's network and service quality. Second, if we were to use the existing telecoms infrastructure in Hong Kong, we would be limited to DSL technology – a technology that will most likely never be able to accommodate down- and upload speeds of 100 Mbps to 1 Gbps. Then, we could never provide our customers with an experience similar to what people in Japan or Korea enjoy today, nor could they use similar high-bandwidth applications.

**NiQ LAI:** From the beginning, we chose independence from the incumbent. When you share infrastructure, your performance can never be better than your competitor's, and we need to be the best to succeed. Continuously striving to be the best is one of our core values. One of our core purposes is to experience the emotion of competition, winning, and crushing competitors. We really want to build a legacy in Hong Kong. We want to be around in 20 to 30 years from now and be the leading operator. Most new entrants around the world have the goal of attaining a certain niche market share and profitability. We aspire beyond this, we want to have the majority share and dominate the market. This is why we need the best network for the people of Hong Kong. Leasing the incumbent's network can't give us that.

**McKINSEY: Precisely how do you intend to achieve these ambitious objectives?**

**NiQ LAI:** To stick with this goal, we take on a ten-year perspective, unlike most other corporations who have a one- to three-year plan. We do get pressure from some of our shareholders for shorter-term optimization, but

we are very transparent about our objectives. Having founding shareholders who still own 58 percent of the company definitely helps us adhere to our objectives.

**McKINSEY: To what extent has the absence of any access regulation driven your decision to invest in infrastructure yourself?**

NiQ LAI: That was a material factor. The Hong Kong market is basically a free market with uncapped returns. There is no mandate to provide open access to our infrastructure, so we are not obliged to open up our network. In other parts of the world, this is not the case – open access is a requirement. This means, the downside is all yours: when you build the network and nobody comes to use it, you carry all the risk. But when everybody wants to use your network, the upside is shared. In other markets, this asymmetric risk profile acts as a disincentive for investment.

**McKINSEY: HKBN is clearly a very ambitious venture. Where do you stand today?**

WILLIAM YEUNG: Today, we are already Hong Kong's largest alternative broadband provider with over 20 percent subscriber market share. We are also the only operator with net market share growth. We have set ourselves a Big Hairy Audacious Goal (BHAG, see "Good to Great" by Jim Collins) to be the largest IP provider in Hong Kong by 2016. This is quite a challenge, but only with a high aspiration will people leap forward.

**McKINSEY: How do you plan to become Hong Kong's largest player?**

WILLIAM YEUNG: We have a clear edge on technology versus our competitors. Today, we are the only broadband provider in Hong Kong that offers speeds up to 1 Gbps throughout our entire network. This is downstream as well as upstream. The incumbent mainly offers 6 to 8 Mbps, with asymmetric speeds. We have passed 1.66 million households – about 70 percent of the market – and will soon have passed 90 percent.

We know our competitors well. We are the only market player growing market share. The incumbent's market share has dropped to about 50 percent and the other two players – the distant numbers 3 and 4 – will most likely be marginalized in the future. The incumbent has so many different technologies – ADSL, VDSL, etc. – and we don't believe they are willing to abandon this any-

time soon. Thus, we believe we will keep our technological edge over the coming years.

Finally, our product offering is vastly superior to that of our competitors. We offer a 100 Mbps broadband package at USD 13/month and USD 25/month for our triple-play offer. Beyond the pricing, we also provide an 80 percent speed guarantee. If this is not achieved, customers will be refunded. We only had to refund eight customers in 2009 and our churn hovers below 1 percent a month, indicating that our customers are indeed satisfied. In short, we are well on track to achieve over 50 percent market share by 2016.

**McKINSEY: How can you be profitable when you sell 100 Mbps broadband connection at USD 13/month?**

NiQ LAI: We run our operations very lean and our capex is much lower compared with other countries. Using standard off-the-shelf Cisco routers has huge cost advantages. A typical router sells at a list price of USD 1,200 and serves up to 24 customers. We have a 75 percent utilization rate on those and obviously get substantial discounts on the list rates. This means that the cost per user becomes very low.

For our standard broadband product, we only need to connect the Category 5e (CAT5e) cable from the router to the home, then our customers can connect to the Internet. We don't have the added costs of end-user equipment and installation is standardized – it takes around one hour to pull the cable into the apartment, which is often done in batches. The total capex cost per house passed is less than USD 200 – more than a fifth lower than other major FTTH deployments elsewhere in the world. Those typically range from USD 1,000 to USD 2,000. Upgrading the equipment is also much cheaper than in traditional telecoms networks, since we merely need to upgrade the end routers. This has made the network future-resilient.

We also manage our operating costs closely. For example, half of our 3,000 employees – mostly call center agents – are based across the border in Guangzhou, China, where labor costs are only a third of what they are in Hong Kong. This gives us a substantial cost advantage over our competitors who have a higher Hong Kong base mix. Even with our low retail prices, we still are able to generate an 80 percent gross margin and achieve close to 35 percent EBITDA margin, which is steadily increasing.

**McKINSEY: What type of network architecture have you deployed?**

NiQ LAI: As mentioned, we have deliberately chosen to run an off-the-shelf, computer-like network, which works very well in high-density areas such as Hong Kong. A typical building in Hong Kong has 30 stories and 20 apartments per floor – i.e., 600 apartments per building. We bring fiber to the building and fiber up the vertical. Then on approximately every 10 to 20 floors, we connect the fiber to a router that serves a couple of hundred apartments. From the router, we connect a CAT5e cable to the customer premises. We even bypass the incumbent's wall socket by providing our own. By keeping the CAT5e to within 100 meters, we can actually provide 1 Gbps speeds. Our network is basically the same as corporate LAN, but then taken to 1.66 million homes. In less dense areas, we have complemented this network with a G-PON fiber architecture.

**McKINSEY: What type of commercial model have you opted for?**

WILLIAM YEUNG: We do the bulk of our distribution in-house, since we are almost paranoid about quality. We like to control our product end-to-end. This is why most of our products are sold through our own channels: retail outlets, street kiosks, online channels, and telesales. We do have some dealers, but we keep this to a minimum. Our broadband product still represents around 70 percent of our revenues. Cross-selling is obviously important for us. We are continuously improving our TV offer and our triple play includes free national calls. We are able to keep the costs of cross-selling low by using our call centers and installation personnel who are highly incentivized to do so.

**McKINSEY: Your chairman recently stated that you have gone on the attack to lead the market into a price war, rather than wait for your competitors to initiate one. That's quite a remarkable strategy.**

WILLIAM YEUNG: For us, price is an offensive weapon for long-term growth. We want to bring prices to a level where they actually do not matter anymore to consumers. Most operators want to avoid commoditization of their product. Our objective is quite the opposite: to turn 100 Mb service into a commodity, which plays to our strengths. Moreover, at current price levels, HKBN is the only operator that can operate profitably thanks to our lean cost structure. Incumbent operators have a

much higher cost base; thus, they have no incentive to invest in fiber rollout at current price levels. This will ensure that we will be a technology leader for many years to come.

In other companies, this might be a difficult strategy to follow, since shareholders often want to maximize short-term profitability. Our founders still own the majority of the company. They are sticking to our long-term goal of providing broadband services throughout Hong Kong. As long as we remain independent, this goal will not change.

**McKINSEY: How important is talent management in your organization?**

WILLIAM YEUNG: We have a very strong corporate DNA where attracting talent (we do not have staff) is our biggest challenge. In the long term, it's easy to replicate technology, but it's difficult to replicate talent. This has been translated into our organizational model. For example, we don't believe in the traditional horizontal, functional approach. That would lead to the creation of malfunctioning silos as often seen in incumbent operators. We have structured the company vertically around five geographic areas run by "mini CEOs." They are responsible for sales, network management, maintenance, and customer service – and are fully empowered to best service our customers.

Furthermore, each area is benchmarked monthly against every other, and improvements are continuous. This is the only way to ensure we're close enough to our customers. We have also introduced the "mini CEOs" in other functions; to date, we have about 40 of them throughout the company. All "mini CEOs" bear full responsibility for their P&Ls and balance sheets. All of them, including back-end departments, have been focused on customer engagement.

NiQ LAI: Our compensation is linked to performance at all levels. Salaries for some functions are up to 50 percent variable, based on individual KPIs. Even the technicians installing the broadband at the customer premises have a variable salary component. This part is based on the up-selling they can achieve and on the customer feedback we receive after every installation. Moreover, the company terminates 5 percent of the total salary base each year based on performance reviews. HKBN is a very unpleasant environment for underperformers, but if you're passionate and able, it's a great place to be.

We do invest a lot in our people. For example, we sponsor MBAs for our executives – 70 percent of our top management have postgraduate degrees. We also have a management trainee program for our future leaders, known as “CXO of the Future.” The bar is high though: for example, we expect our CXOs of the Future to pass the CFA Level 1, run half of a marathon, and read at least one management book every two weeks during their 18-month program.

**McKINSEY: What have been the biggest hurdles on the way to where you are today?**

**WILLIAM YEUNG:** As in many other markets, getting access to the individual buildings has not always been easy, and often very time-consuming. We have good legislation in Hong Kong that treats telecoms providers as a utility with mandated access to the buildings without needing to pay any rent to the building owners. In reality, however, there are practical roadblocks, especially in buildings that are owned by larger groups with telecoms shareholdings. These have taken a lot of time to resolve.

**NiQ LAI:** Looking back, it has not always been easy. It is very difficult for a new fixed-infrastructure player to make money. It has taken us seven years to reach free cash flow breakeven, and we have faced substantial restructuring phases in which we had to let many people go. Without our lean cost structure, we would not have been able to survive.

**McKINSEY: Where do you see Hong Kong’s telecoms industry going from here?**

**WILLIAM YEUNG:** Consolidation opportunities could arise in the Hong Kong market, but these will most likely only emerge with a change in the other operators’ shareholders. At that point, the competitive setting in Hong Kong could shift, since incumbent players may start investing heavily in next-generation technology. In the long term, the market will most likely only have room for two serious infrastructure players.

In the meantime, there is always the possibility for partnerships between mobile-only players and fixed-only players. Again, that will only happen with changes in shareholder structures. Currently, it seems unlikely. Fixed players entering the mobile space may not take place, since mobile competition is fierce in Hong Kong and prices are among the world’s lowest. Thus, from a financial point of view, it’s not very attractive anymore.

**McKINSEY: What advice would you give other operators who are thinking about investing in fiber?**

**WILLIAM YEUNG:** Understand the market you are in. No two markets are the same. Understand what will be the technology that will lead the future – e.g., mobile versus fixed, copper versus fiber – and what will be the cost structure, among other factors. Next, if you see that there will be demand for those services, go ahead, but you have to realize, it’s a very long-term game.

**NiQ LAI:** Do your own thing – if there had been two identical HKBNs, we would have both been dead by now.

**William Yeung and NiQ Lai were interviewed by Wim Torfs, a Principal in McKinsey’s Dubai office.**