EMCC case studies

Industrial change in the telecommunications sector:
Telefónica Deutschland

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Summary

Telefónica Deutschland was established in January 2003 as the result of the merger of two Telefónica subsidiaries: mediaWays and HighwayOne. Both companies were simultaneously operating in the German market. Telefónica Deutschland combined the infrastructure of mediaWays and the product portfolio of both firms to create an integrated offer of IP (Internet Protocol) wholesale services.

The company has enlarged the customer base of the two former companies, and currently holds within its client portfolio large corporations, as well as some of the main Internet service providers (ISPs) in Germany.

Telefónica Deutschland is gradually concentrating its offer in IP broadband services, and recently entered the small and medium-sized enterprises (SME) market with a VoIP (voice over IP) telephony service.

The organisation of the company reflects its approach to the market, with two main business units responsible for business services and wholesale services respectively.

The Telefónica Deutschland workforce is based on that of the two former companies. Changes in the workforce composition, to adjust to the new structures, have been made through hiring and redundancies, with limited impact on the total level of employment. Staff training is mostly through sophisticated online methods, complemented by personal assistance.

Telefónica Deutschland perceives the sector’s future evolution as a process of convergence into ‘triple play’ – TV, telephony and Internet access. Its present strategy is directed towards the high bandwidth market.
Company facts
Since the early 1990s, Spain’s Telefónica Group has developed its international activities extensively, mainly in Latin America. In recent years, it has endeavoured to build up a position in the broadband sector at European level. Its presence in Germany with Telefónica Deutschland, which is fully held by the Telefónica group, forms part of this strategy. Telefónica Deutschland also includes an entity with similar activities, but on a smaller scale, in the United Kingdom.

Telefónica entered the German data market in 2001, through the acquisition, from Bertelsmann, of a 100% share of the IP backbone provider and corporate ISP mediaWays GmbH. In January 2003, mediaWays merged with Highway One.

• mediaWays GmbH, founded in 1996 by Bertelsmann as an IP carrier, was a major alternative carrier in Germany, operating one of Europe’s largest xDSL broadband networks for corporate customers. Services focused on broadband Internet access, traditional voice services and value-added services, such as virtual private networks, firewall solutions, web hosting, managed e-mail services, etc. Its network infrastructure covered 90 cities in Germany and comprised over 630 POPs (points of presence) in Deutsche Telekom data centres.

• Established in 1997, HighwayOne, which mainly targeted SME and corporate customers, was a tier 1 ISP, providing high-speed access in the local loop for data and Internet, deploying digital point-to-point microwave, ADSL, ISDN and leased line technology. The value added service portfolio of the company included hosting, co-location and managing firewall applications, which enabled HighwayOne to provide a one-stop shop for its customers’ Internet connection requirements.

In 2004, Telefónica Deutschland generated a revenue of €319.5 million, a 16.5 year-on-year decrease. The decline in revenues was primarily due to the reduction in revenues from narrowband services that were not fully offset by the increase in broadband business, which accounted for 14.2% of total revenues. Earnings before interest, taxes, depreciation and amortisation (EBITDA) amounted to €3.5 million, compared with €22.3 million in 2003, and the EBITDA margin decreased from 5.8% in 2003 to 1.1% in 2004.

The Telefónica Deutschland offer is centred on the following wholesale services in low and high bandwidth:

• Virtual private network (VPN), based on IP or multi-protocol label switching (MPLS) technology;
• Integrated voice and data services;
• Web hosting;
• Cable TV services;
• Unbundled local loop services for America Online (AOL), currently under negotiation.

In 2004, Telefónica Deutschland launched 1 Mbps (downstream), 2 Mbps and 3 Mbps services for its business grade users, phasing out its 768 / 128 Kbps (downstream / upstream) and 1536 / 192 Kbps services on 1 April 2004. This, in turn, followed the previous launch of Access SDSL, a service with similar speeds of up to 2.3 Mbps in

The company has met commercial success in the German market. The total number of the company’s ADSL users reached 677,000 at the end of 2004 (in the German and UK markets combined), and the company provided services to four out of the five top main ISPs in Germany. This figure outnumbers any other country where Telefónica operates, including major markets in South America.

The customer base of the company includes more than 30 of the main Internet providers (including AOL), and large corporations such as Bertelsmann AG, Bank of China, Mercedes-Benz, Daimler Chrysler, Logica, Lufthansa Systems, Adecco, Xerox, BMG, Gruner+Jahr, Krombacher, Toyota, Toto Lotto Niedersachsen, Walter Bau and Zurich. Other significant accounts have also selected Telefónica Deutschland as provider. Among them, the service MSN Easysurfer from Microsoft; the network linking 700 branches of DM Drogerie Market; a VPN for the international subsidiaries of Fielmann AG; the 2,000 dealers of Renault Nissan in Germany; and Bayern Totto-Lotto’s 4,200 lottery offices.

**Market dynamics and company changes**

Since the beginning of the decade, one of Telefónica’s main strategic ambitions has been to push forward an initiative, across all Telefónica business units, to develop and market e-business and broadband services. Beyond the mere expansion of the markets, the objectives of the initiative are to:

- cut across business unit boundaries to present a coherent, integrated portfolio of broadband IP services;
- accelerate the uptake of broadband and other new technologies;
- improve revenue by bringing value-added services to market faster;
- generate demand for Internet business solutions among Telefónica’s enterprise customers;
- create an ‘ecosystem’ of Telefónica partners for the seamless delivery of Internet business solutions.

The company has placed long-term and high expectations in Germany although, at the time Telefónica Deutschland was formed, Germany had one of the smallest growth rates in the euro zone. The decision to invest in the German broadband market relied on two major elements. Firstly, the German market provided a test of the markets’ response to a technology not yet sufficiently consolidated, in terms of its capacity to channel all types of interactive services. In this respect, Telefónica Deutschland has developed its own product portfolio and a differentiated marketing method. Secondly, the viability of a project required large initial investments, and the maintenance of high investment levels over a long period of time.
Telefónica Deutschland has been supporting its competitive strategy by:

- integrating all communication services into a single, uniform format – Internet Protocol;
- offering a distribution network with high capillarity (more than 44,000 kilometres);
- ensuring customer care through the establishment of a control centre of network operations, open 24 hours a day, 7 days a week;
- pricing, with the use of local tariffs throughout Germany and the implementation of a countrywide IP platform over DSL.

**Main organisational and business process changes**

The organisational chart of Telefónica Deutschland is as follows:

Market concerns are functionally divided into two departments: wholesale services and business services. Product development and network and service delivery functions have also been given a departmental category. The importance of regulatory, financial and strategic matters is reflected in the specialised units created for dealing with them.

Management functions are closely integrated into the local structure of the company. Nevertheless, strategic issues and overall performance of the company are linked to a unit within the Telefónica group in charge of EMEA (Europe, Middle East and Asia) subsidiaries.
Workforce issues

The total number of employees currently stands at 470, of which about 30% are in sales. The structure is primarily centred on projects, rather than on strict functions or positions, to ensure flexibility.

The staff of Telefónica Deutschland has been formed from the previous workforces of the merged companies. According to the company, no ‘cultural’ clashes have surfaced, as the business practices of the respective companies were comparable.

Adaptation was necessary, however, as the company was moving towards the business and corporate services market. Sales and marketing staff were reorganised and new personnel hired. The company has not had any particular difficulties in identifying and hiring individuals with the appropriate skills, other than meeting the high salaries demanded by some specialised workers. At the same time, the company has also made around 50 to 60 redundancies. Overall, the total number of employees has remained stable.

All employees of Telefónica Deutschland have an employment contract and a reward scheme consisting of a fixed annual salary and a variable bonus, arranged within a programme of incentives that spans the entire company.

Employees at Telefónica Deutschland are not unionised. However, there is an internal unit responsible for labour issues.

Education and training programmes are fully in line with the training policies of the parent group, which tries to minimise the negative effects of geographical dispersion on educational resources. The use of e-learning allows a more targeted and goal-specific training. A dedicated coaching programme complements this approach.

Lessons learned

Vision of evolution of the sector

Carriers like Telefónica Deutschland are looking at IP application platforms as a means of beginning their slow migration to fully convergent, IP-based networks and services. Some carriers view these highly personalised services as the ultimate ‘sticky’ applications that will encourage greater customer loyalty and help reduce customer turnover.

The managers interviewed believe that Telefónica Deutschland has a real opportunity to access the high bandwidth market. This market is being shaped around types of packaging services in order to reduce prices substantially. The trend is especially clear for newcomers, which are either owners or renters of a network, as is the case of Telefónica Deutschland.

As networks’ bandwidth rapidly increases, the varied types of network operators have an opportunity to engage in triple play (voice, TV and Internet access). For diversified companies, such as those in the Telefónica Group, all the possibilities are seen as positive, including those available in the long term through the addition of wireless access to services – thus transforming triple play into a ‘quadruple play’.
The necessary bandwidth for triple play can be estimated, in the case of a residential user having three TV sets and a PC, as approximately 10 Mbps. All networks are currently reaching or going beyond that limit; there are some ADSL working experiences of speeds over 40 Mbps. As today’s figures show, the penetration of high bandwidth in residential users in Germany of 18%, with a potential maximum of 70%, means that the market has already opened up to triple play competition. Cable operators with old and non bi-directional networks do not have the capacity to access this market. Players will probably find a tough market, leading to a consolidation process, after which no more than two or three network operators would remain. This probable scenario could only be distorted by the regulatory issues that are still in place.

**Innovative strategies**

Acting in the competitive arena that has been described requires that Telefónica Deutschland pay special attention to some key management issues:

- attaining volume in order to reduce costs;
- rolling out proprietary infrastructure that allows better control, and obtaining additional revenues per network exploitation;
- continuing the initial evolution from a single client, single product (70% of the turnover in 2002 came solely from AOL), to a greater client base with a larger number of offered services (only 30% of turnover came from AOL in 2004);
- diversifying markets in order to reduce the dependence on wholesale clients;
- focusing on quality in service provision as a means of reinforcing the reputation of the brand Telefónica.

**New working practices**

Telefónica Deutschland is striving for internal efficiency by means of:

- carefully designed operations;
- project focused work teams;
- sales efforts tightly focused on target accounts, supported by sophisticated market analysis tools;
- an immersion in the common culture of the Group, looking for a more effective use of the available and proven methods, procedures and practices;
- at the same time, optimised simplification of internal bureaucracy, with own rules independent from those of the Group;
- adoption of processes of a central or corporate nature, such as procurement, for improving efficiency;
- fine tuning of local tools, such as customer relationship management or the billing system;
- outsourcing specialised tasks, such as the deployment of the final part of the network.
Contact details

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Source list

Telefónica Deutschland GmbH, http://www.telefonica.de/