EMCC case studies

Industrial change in the telecommunications sector: ONO

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Summary

ONO is the third largest broadband cable communications company in Spain, behind Telefónica and Auna. In 2004, the company generated €500 million in sales.

The company, founded in 1997, has invested over €2 billion in creating a high capacity, digital-ready, fibre-rich network that offers extensive coverage in its franchise areas. These areas do not include those of Madrid and Catalonia which are the most important in the Spanish market. The company developed some of the most innovative financial formulas in the sector in order to fund the capital-intensive expansion of its network.

Since its inception, ONO has the financial backing of a strong combination of both national and international shareholders. It has also maintained the same chairman and board of directors. These facts have resulted in a lasting and stable financial base as well as a steady strategy for the future.

ONO operates in the television (TV), telephony and Internet access markets, also known as ‘triple play’. The current competition in the Spanish telephony and Internet access market focuses on price reduction. To avoid a ‘price-only’ competition, ONO pursues the following strategies:

• import innovations from abroad in order to reduce the technological gap between Spain and more advanced countries;

• develop imaginative and simpler pricing models;

• offer niche solutions, such as a combination of triple play services, new design of services and thematic TV channels;

• enter early in the market of video on demand (VoD);

• roll out its own network as to improve technology and lower operating costs.

The company, based on an open and free flow of communication, with very few organisational levels, has maintained its stability. At the time of the sector crisis in 2000–2001, ONO changed its structure from region-based corporate services, to a central organisation aimed at improving efficiency and reducing costs. The present trend is to decentralise again, to be closer to customers and gain a better understanding of regional differences. Workforce reduction, resulting from the 2000 crisis, took place through an outplacement programme in cooperation with other companies of the sector, with which ONO maintains strong business relations.
Company facts

ONO is one of the leading cable communications companies in Spain. In 2004, the company ranked third on the basis of total turnover at about €500 million and second in terms of own-network turnover. These figures compare with

- Telefónica, accounting for a turnover of around €10 billion;
- Auna at around €1.3 billion, of which some €500 million were raised from their own networks.

Figure 1 illustrates the development of ONO’s financial results in between 2000 and 2003.

Figure 1: ONO revenue and gross margin, 2000–2003

ONO offers direct access telecommunications, cable television and high-speed Internet access services to residential and business customers in five geographically defined areas of Spain, with an estimated market of seven million homes.

ONO obtained the necessary licenses to start operations between 1996 and 1997 from the regulation authority. The company has invested over €2 billion in creating a high capacity, digital-ready, fibre-rich network, which offers extensive coverage in its franchise areas. This network is linked to a national network grid. Its scale also allows ONO to offer advanced value-added data services and applications to the business sector throughout Spain.

Since its inception, ONO has been backed by a stable combination of strong national and international shareholders: Bank of America (11.5%), Caisse de dépôt et placement du Québec (11.5%), General Electric (23%), Grupo Ferrovial (9.7%), Grupo Multitel (8.7%), Santander Central Hispano (18.3%), and VAL Telecomunicaciones (9%). The ONO group was formed in February 2004, after the acquisition of Retecal, the regional

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1 At the time, the Spanish national market was divided in 42 franchises, each franchise requiring an operating license.
cable operator of Castilla y León, by Sodinteleco, which acquired an 8.3% stake. The total investment in cash equity has amounted to approximately €1.2 billion.

ONO’s management team has extensive experience in the telecom, cable and media sectors in the markets of Spain, other European countries, Asia and North America. The company currently employs 2,200 people of which 350 work in Madrid. Of these, 60% to 70% have university degrees. However, hardly any of the 400 call centre employees have degrees, as opposed to 50% of the 265 sales people who have higher education qualifications.

The company’s operations are divided into five geographical areas: Mediterranean (eastern Spain), South East, Andalusia (southern Spain), Cantabria (northern Spain) and Castilla y León (central Spain). The largest telecom markets in Spain, Madrid and Catalonia, are excluded from the company’s operations because of distribution orders mandated by the regulatory authority.

The milestones in ONO’s company history are:

- 1998 – ONO obtained 11 cable franchise areas around Spain and the ONO brand was launched; the first client of the company was connected in October; and direct access telephony, television and Internet services were offered

- 1999 – ONO was the first cable operator in Spain to offer pay-per-view football; ONO included in its offer free local calls between customers in its franchise areas and telecommunications services for businesses; the company had over 40,000 customers by the end of the year;

- 2000 – ONO presented its movie pay-per-view service, FilaONO; ONO acquired a 12th franchise area; the company offered the first true flat-rate tariff for narrowband Internet services in Spain; shareholders of ONO invested an extra €250 million in capital; the company made Spain's first broadband Internet portal available, ONO.com; ONO closed the year with 168,000 residential and 3,000 business customers;

- 2001 – the company surpassed the one million homes milestone; ONO shareholders agreed to €300 million investment in capital; the company acquired Telia Iberia, a provider of value-added services to business customers in Spain; over 330,000 residential and 4,800 business customers were reached by the end of the year;

- 2002 – cable works in the centre of Valencia were concluded after four years and an investment of over €150 million; first quarter of positive EBITDA was achieved; ONO surpassed 100,000 broadband Internet customers; and over 480,000 residential and 8,500 business customers by the end of the year.

ONO’s offer is based on the so-called ‘triple play’: pay TV, voice and broadband Internet access. The development of its residential and business market shares is illustrated in Figure 2, 3 and 4.

Figure 2 shows the rate at which homes connected to the ONO network, as well as the company’s growth rate in the residential sector between 2001 and 2003.
Figure 2: Evolution of homes connected to the ONO network and residential customers of ONO, 2000–2003.

Figure 3 shows the development of ONO’s business market, assessed in terms of growth in business customers and the increase in residential units generating revenue which clearly indicate the rising profitability of the residential market.

Figure 3: Evolution of business customers and residential revenue generating units of ONO, 2001 – 2003.

Figure 4 shows the revenue breakdown per services for 2002 and 2003. By the end of 2004, the business market generated around 10% of ONO’s turnover; the current objective is to reach 15% –20%. The business market tends to be centred on small and medium-sized enterprises (SMEs), rather than large accounts.
Market dynamics and company changes

The sector underwent structural changes and competitive dynamics when the telecom liberalisation process began in the mid-1990s.

Market structure and competition

Liberalisation process

The milestones of the telecommunications liberalisation process in Spain include:

- the liberalisation in 1994 of the mobile telephony service and the arrival of Airtel (now Vodafone) in 1995, and Retevisión (now Auna) in 1996;
- the legal framework including the initial law on the liberalisation of telecommunications in 1995, which divided the Spanish territory in 42 franchises, followed by the law on the liberalisation of telecommunications in 1997, which created a regulatory agency;\(^2\);
- the unbundling of the local loop on 1 January 2001;
- the 2003 modification of the law on the liberalisation of telecommunications which established three different categories of carriers: 1) carriers deploying infrastructures only, 2) carriers deploying infrastructure and offering services; and 3) carriers offering services through third parties’ networks only.

\(^2\) Commission of the Telecommunications Market (CMT)
Liberalisation has led to a proliferation of new services and cost reduction. With regard to the cable industry, these developments generated over-optimistic expectations. Following the 1995 cable law, the initial predictions foresaw a market of 11.5 million residential users, and 2.5 million business users by 2007. These figures now seem unrealistic, largely due to the delays in the deployment process, the excessive launching costs and the little added-value associated with exploitation of the network (excluding revenues from services provided over the network).

Recent trends in the Spanish telecommunications market

The Internet services market, operated by a stable number of around 150 Internet Service Providers (ISPs), experienced a massive increase in 2003. After exceeding the 5 million user mark the previous year, customer growth was slower in 2004. In 2003, ISP revenues were above €1 billion; 82% of revenues came from access services, an increase from the 72% of revenues generated in 2002 due to the expansion of broadband services.

In 2003, the average year-to-year growth rate of cable operators was over 24%. Direct access to cable increased by 30%, equivalent to 11% of the total direct access market. However, the fastest growth in broadband access technologies has recently been in ADSL, now the most widely-deployed high bandwidth technology. In 2003, ADSL generated about 80% of all revenues in the Internet market, compared to 19% generated by cable. The ADSL ARPU is about €427 per year, compared to the €285 per year of cable.

In 2003, the number of land lines decreased by 3% and, for the first time, the total number of minutes per line decreased 10%. This was due to the migration of Internet dial up users to xDSL technologies and the expansion of mobile telephony, with substitution between mobile and fixed telephony.

Consolidation process

Over the last two years, the telecommunications operators have concluded the process of adjusting their operations to the after-effects of the telecommunications and Internet crisis. Cost reduction efforts in telecom companies during 2003 resulted in an increase of 36% in operating results, despite the reduction of over €11 million in operating revenues. Financial figures thus suggest that telecommunications companies have now a healthier financial standing than in 2002.

Consolidation is the most recent trend driving change in the sector; this was confirmed by people interviewed at ONO. Larger corporations and carriers have adjusted their operations by downsizing their personnel, reducing debt and concentrating on their core businesses.

Mergers and other internal efforts have been made in search of reducing operating costs, rationalising business processes and obtaining economies of scale. Carriers have focused their efforts on reaching commercial agreements with other agents, in particular with content providers, rather than maintaining existing levels of investment or developing their own content.

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3 Average Revenue per User
This evolution of corporate strategy has led to the creation of geographically decentralised clusters centred on network carriers. Following this trend, ONO is on the way to acquiring Mediapark, a content provider with around 80 employees.

**ONO’s market position**

In comparison to other European countries, Spain had limited cable deployment when the liberalisation process began. Now Spain is the European country counting the highest number of operators with their own network. There are thus high *de facto* barriers to entry for new actors in the market (i.e. mainly resellers).

According to company managers, ONO had to develop new and innovative financial instruments in order to fund over €2 billion invested in the design and roll out of a completely new network. Accordingly, the ONO network, very modern compared to those deployed during the 1960s and 1970s in the rest of Europe, was ready to deliver broadband Internet access services, voice, digital video and other interactive services from the start. While fully adapted to easily respond to new service requirements, the company has yet to commit funds for further infrastructure.

As ONO’s products are centred on triple play, the company believes that its main competitors are:

- Telefónica, the incumbent operator in Spain, with the largest number of users and the widest fixed network. Telefónica has a modest cable network, but is able to compete in the triple play market with bandwidth-increasing ADSL connections, even offering video on demand (VoD) through its subsidiary Imagenio;
- the free broadcast public television model in Spain, which influences user-behaviour, not prone to pay for higher quality TV programmes;
- Sogecable is a Spanish company offering satellite pay TV, though it does not represent a direct competitor, as it functions in a market niche with a steady user base of around 1.8 million people.

As a result of the 2003 legal framework, the risk of new competitors entering the market will force the present operators to offer more innovative and triple play-convergent services. In the near future, new services and new combinations of services will appear in the triple play field, with all actors looking for market niches to achieve a higher average revenue per unit (ARPU).

**Main organisational and business process changes**

**Impact of the telecom crisis**

During the telecom crisis, ONO changed its structure from region-based corporate services, to a central organisation, in order to improve efficiency and reduce costs. The present trend is to de-centralise again, aimed at getting closer to users and gaining a better understanding of regional differences.
ONO has the same shareholders since its foundation, and its chairman and board of directors have remained unchanged. This has resulted in a lasting and stable financial base as well as a steady strategy for the future.

In 2002, as was the case with other firms in the sector, the crisis forced the company to downsize. Some 25% of the workforce has been made redundant, reducing staff from 2,000 to 1,600 employees. The company met the legal requirements for redundancy in force from July 2002 to December 2004.

The redundancy process was generally uniform across all of ONO. The impact was felt slightly more in the engineering and construction departments, as the company stopped the previously scheduled construction of network parts.

**Customer care**

ONO has focused on the simplicity and flexibility of its services, allowing clients to decide the degree of service they want. For example, ONO provides Internet access with a cable modem; if the user wants Wi-Fi, the company allows the user to buy her own access point to build a wireless network.

ONO tries to take account of customer demands in developing its services through:

- regular market surveys and analysis;
- an internal project called ‘satisfied user’, consisting of a rolling panel of over 100 indicators and 1,300 customers;
- a move towards including user satisfaction indicators in its management control system, followed up on a daily or monthly basis.

**Internal efficiency**

ONO is structured around organisational processes. Workflow is supported and automated in the company. The company is heavily reliant on its customer relation management (CRM) system which controls most of these processes. During 2004, ONO replaced its existing billing system with a more modern system. This new system will be fully functional in the second quarter of 2005. The main advantages that ONO expects of this new system, are added flexibility in the portfolio of products offered to clients and personalised relationships with clients.

The following figures show the scale of this operation: 400 people have been implementing the changes while more than 1,200 people will need training on the new system. The estimated training budget is over €500,000.

Changes in the billing system are considered key for future success of the company. This is not only because of the associated cost-reduction in the billing process, but also because the new system will result in higher flexibility and an increase in response time to customer needs. This will combine with the implementation of new services in a hyper-competitive market.
Present strategy focus

Market competition and complexity are increasing daily, particularly if the trend to compete in the triple play market (pay TV; voice; and Internet access) is considered.

In the voice market, due to the maturity of fixed-line telephony, the newcomers have focused their strategies on price reductions as a way to increase market share, rather than providing new innovative services. This behaviour is resulting in a progressive decline in prices, which is barely being compensated by the increase in usage.

On the other hand, despite campaigns and subsidies in high bandwidth access offers, Telefónica’s position in the market does not seem to weaken. This confirms the importance of the brand in its ISP commercial strategy.

Cable share in the Spanish television market is only about 20%, which is very low compared to the average of about 50% in the rest of Europe. In fact, it seems that the Spanish consumer is not yet accustomed to paying for TV services. ONO has devoted great amounts of energy to understanding why consumers opt for pay-TV. They strive to know what these consumers want to watch, how much they are willing to pay for it, etc. To this end, ONO will introduce a series of changes in its TV products in the near future, including the introduction of VoD, which is expected to drive the growth of this service.

To avoid competition purely based on price, ONO’s strategy includes importing innovations developed abroad, taking advantage of the technological gap of about 2 years between Spain and other more advanced countries, like the US, Japan and other European countries.

According to ONO’s managers, new strategic approaches for increasing market share could involve

- imaginative and simpler pricing models;
- niche solutions, as combinations of triple play services, new designs of services or niche’s thematic TV channels;
- early entry into the market of video on demand; and
- rolling out its own network so as to better manage the technology and lower operating costs.

ONO believes that the telecommunications and entertainment business is one of economies of scale. In this sense, its strategy focuses on growth in order to access better content, reduce operating costs and be more competitive. The company has primarily grown through acquisition; in 2004, for example, it acquired Retecal to speed up this process.

When ONO acquires a new company, the process is managed slowly and methodically, trying to understand the acquired company; formal issues and communication are handled cautiously. All of ONO’s management processes are transferred to the smaller company, while trying to retain beneficial practices developed inside that organisation.
Workforce issues

The ONO human resources policy is based on an open and free flow of communication, with very few hierarchical levels. This open communication policy includes running special events such as:

- work breakfasts at a regional level, or with the chief executive officer;
- internal and external magazines;
- meetings of directors;
- functional roles based on projects rather than positions, along with the creation of opinion groups;
- leisure groups;
- a volunteer portal, currently under development.

The company’s workforce is made up of engineers for infrastructure deployment, maintenance and IT support, and salesmen. However, some commercial projects can occasionally be subcontracted.

Commissions on sales and a bonus system supplement fixed salaries and act as the standard reward system in the company. The bonus system is based on company or personal objectives, reviewed every six months and covers all members of staff. Every employee can check the evolution of his or her bonus account on the firm’s intranet.

Promotions are usually internal. ONO’s Intranet has a vacancy section in which positions are published and interested employees can apply.

There are two main difficulties in recruiting new staff:

- finding adequate sales profiles in some areas of Spain;
- finding specialists in cutting-edge technologies, particularly video on demand and the latest Internet technologies.

ONO’s hiring policy has changed since 2002, when almost 50% of the company’s positions were temporary jobs; today, the company’s policy is to offer permanent full-time employment and almost all temporary positions are in the call centre only.

Regarding outsourcing and subcontracting, ONO’s policy advocates in-depth analysis of every new and possible alternative, trying to find the best solution to every problem. Although some tasks are outsourced, it is not the norm. Among the tasks that can be undertaken externally are:

- in-house IT support, which has been subcontracted to an external team of 10 specialists;
- network deployment planning and design;
- network construction;
- licenses and permit management, although on very specific occasions;
- sales IT platform, both for input and output;
- direct sales force.
ONO regularly invests in training, with a view to integration, company loyalty and personal and professional development. Training matters are grouped in categories such as welcome / induction, continuous, specific, masters and languages.

In 2003, every employee attended an average of 2.35 courses, equivalent to more than 25 hours of training per year. As a sign of quality and satisfaction of these internal projects, the assessment of the courses scored an average of 8.5 out of 10 by ONO employees.

The company has a specific training programme for directors, focused on the development of three main skills: communication, leadership and team work. As a result of the need to integrate new technologies, for example with VoD or digital TV, occasionally, major educational programmes are organised for large numbers of employees.

There are 75 internal trainers that enjoy a special bonus system consisting of assets (computers, courses, etc.), useful for their professional development.

All projects in ONO, operational and M&A (Mergers and Acquisitions), are evaluated through the human resources and training perspective.

In the opinion of ONO’s managers, university graduates lack adequate skills and competence in team work, motivation and other matters related to human resources management. In addition, they often fall short on technical skills with respect to state-of-the-art telecommunication technologies. The principle focus of internal training is filling in these gaps.

The labour unions are represented in the company through eight employee representative boards. To a certain extent, the employee representatives are involved in business decisions, a result of the open communication policy.

**Lessons learned**

**Vision of sector evolution**

The market in the next few years will be characterised by the extension of broadband access, both in mobile and fixed access, and progressive convergence of all types of ICT technologies. In this context, there is little doubt that the portfolio of contents, tools, applications and provided services will play a key role in the expenditure profile of the end-user.

In the opinion of those interviewed at ONO, some trends illustrate the evolution of the sector, such as:

- a daily increase in the interconnectivity of networks, with a trend towards hybridised network. This will result in the development of flexible applications that are capable of continuous service provision. The underlying applications will look for the best and cheapest network while continuing to offer an uninterrupted service to the user;

- mergers and acquisitions will continue in order to attain economies of scale, in a process of market consolidation;
• building a cluster of companies around network operators will also be a trend, looking for ‘premium content’ or services not available in other companies;

• Market share will be gained by offering lower prices for the same portfolio of services and by finding specific services or content for niches of users.

Innovative working practices
Among the main lessons learned in the human resources area are:

• the importance of combining intensive training and professional development with career plans;

• the success of the downsizing process was partially due to the outplacement of nearly 60% of redundant people in other companies related to ONO;

• once the crisis was over, some individuals that were made redundant were brought back into ONO. Some were hired as specialist freelancers or external technical consultants for particular projects;

• high importance of fine-tuning the medium and long term plans.

Some innovative working practices have been developed and used at ONO when designing the strategy of the company:

• involvement of all staff and management levels in the business, therefore, a variety of activities are undertaken to enhance group cohesion;

• keeping all communication, including those relating to products, as simple and understandable as possible;

• managers occasionally perform low level commercial tasks to gain a direct understanding of customer needs and requests.

Contact details

Company name: ONO (Cableuropa, S.A.U.)
Website address: http://www.ono.es
Address: Edificio Belagua, Calle Basauri, 7 y 9 Urbanización La Florida 28023 Aravaca Madrid, Spain
Tel: +34 91 180 93 00
e-mail: comunicacion.ono@ono.es
or send from http://www.ono.es/default.asp?p=05&o=02&s=01

Some companies call ‘premium content’ (movies or TV channels) what they produce themselves or distribute through exclusive agreements with content producers.
Source list

The case is based on personal interviews with Ms. Sylvia Carrasco Gauthier, Director of Communications, with Ms. Begoña Landazuri Plaza, Director of Human Resources, and with Mr. Jaime Pont Ferrer, Director of Strategy and Corporate Development, combined with the following information sources:

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- [http://www.ono.com](http://www.ono.com)
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