

Master Thesis

Portugal Telecom adapting to the market

MEO, the new future

Rita Martins

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A Business Strategy Case Study

Advisor: Nuno Magalhães Guedes

Abstract

Title: Portugal Telecom adapting to the market: MEO, the new future

In 2007 the Portuguese telecommunications market changed. With the spin-off of PT Multimédia from Portugal Telecom, a new company was born: Zon Multimédia. Portugal Telecom was the incumbent operator in telecommunications providing all the main telecommunications services. With the spin-off, PT ran out of the valuable Pay-TV service for the consumer.

The Case Study presents the strategy of PT when in face of the spin-off, and its response with the creation of MEO, a new product mainly focused on TV services, with irreverent features that would change the normal way to watch TV.

The Master Thesis also includes a Literature Review and a Teaching Note. The Literature Review provides a theoretical approach to the main subjects addressed in the Case and the Teaching Note is the analysis of the Case Study.

Resumo

Título: Portugal Telecom adapta-se ao mercado: MEO, o novo futuro

Em 2007 o mercado Português das telecomunicações mudou, com o spin-off da PT Multimédia da Portugal Telecom, nasceu uma nova empresa: Zon Multimédia. Portugal Telecom era o operador incumbente nas telecomunicações fornecendo os principais serviços das telecomunicações. Com o spin-off, a PT ficou sem o seu serviço valioso para o consumidor a televisão por cabo.

O Caso de Estudo apresenta a estratégia da PT para enfrentar o spin-off, e a sua resposta com a criação do MEO, um novo produto focado principalmente nos serviços televisivos, com características irreverentes que podem mudar a maneira de ver televisão.

A Tese de Mestrado também inclui uma Revisão de Literatura e uma Nota de Ensino. A Revisão de Literatura oferece uma abordagem teórica para os principais temas retratados no Caso e a Nota de Ensino é a análise do Caso de Estudo.

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Contents

Abstract	i
Resumo.....	i
Acknowledgements.....	ii
List of Exhibits	v
Introduction.....	1
Case Study	3
History of the company	3
Pros and Cons of the Spin-off	7
Taking MEO from an idea to a brand	8
Competitors.....	11
MEO going to the public.....	14
Exhibits	15
Literature Review.....	21
Innovation	21
S-Curve	23
Sustaining Technologies and Disruptive Technologies.....	24
Competitive Advantage.....	25
Competitive Advantage and Innovation/ Technology.....	26
The Strategic Benefits of Competitors	28
Company Analysis	30
Management Style and Leadership.....	30
Key/Critical Success Factors.....	32
Network Externalities.....	33
Teaching Note.....	35
Case Summary	35
Learning Objectives.....	36
Suggested Assignment Questions.....	36
Class Plan.....	37
Market Analysis (40 minutes)	37
Strategy Analysis (35 minutes).....	38
Predicting the future (15 minutes).....	38
Analysis.....	39
Market Analysis (40 minutes)	39

Portugal Telecom adapting to the market: MEO, the new future

Strategy Analysis (35 minutes).....	48
Predicting the future (15 minutes).....	56
Recommendations	59
What happened next?	59
Conclusion	63
References.....	64
Articles.....	64
Books.....	64
Other Sources	65
Companies Annual Reports	66

List of Exhibits

Case Study

Table1 : Portugal Telecom Wireline Operating Data	5
Exhibit 1 - Portugal Telecom EBITDA	15
Exhibit 2 - PT Group Composition in the end of 2007.....	15
Exhibit 3 - Operating Revenues of Wireline and Mobile, Portugal Telecom 2007	16
Exhibit 4 - Reasons for not having a fixed line Telephone	16
Exhibit 5 - Traffic Originated in the fixed Network (minutes)	17
Exhibit 6 - Distribution of voice traffic originated on fixed and mobile network	18
Exhibit 7 - Most Valued Attributes (excluding price)	18
Exhibit 8 - Zeinal Bava Profile	18
Exhibit 9 - Manuel Rosa da Silva and Vera Pinto Pereira Profiles.....	19
Exhibit 10 - TV Cabo/ZON Group's cable television subscriber share	19
Exhibit 11- Sonaecom revenues per service in 2007, per business	20

Literature Review

Figure 1: Dimensions of Innovation	21
Figure2. Innovation 'space': the type and degree of innovation.....	22
Figure 3: Relationships between factors.....	22
Figure 4: The technology S-Curve	23
Figure 5: The Impact of sustaining and disruptive technological change, Christensen Model ...	24
Figure 6: Three Generic Strategies	26
Table 1: Innovation and Competitive Advantage	26
Figure 7: Porter's Value Chain Framework.....	27
Table 2: The strengths and weaknesses of CSFs.....	32

Teaching Note

Figure 1: Key Success Factors	41
Table 1: Companies - Services provided	42
Figure 2: Characteristics of MEO	53
Figure 3: Three Generic Strategies	58
Table 2: Number of MEO clients.....	60
Table 3: Subscribers market share of services provided in bundle in the end of 2011	62
Table 4: Subscribers market share of services provided in bundle in the end of 2012	62

Introduction

The Master Thesis presents the analysis of the strategy of a Portuguese telecommunications company, Portugal Telecom, when facing a new competitor in the market, Zon Multimédia. Portugal Telecom was the incumbent operator in the market, being the leading provider of telecommunications in Portugal. The main services of Portugal Telecom were fixed telephone, mobile phone, internet and cable television. After a failed hostile take-over bid launched by Sonaecom, a company from a Portuguese multi-business group, in order to separate Portugal Telecom and PT Multimédia (the multimedia services company from Portugal Telecom), in November 2007 the spin-off between Portugal Telecom and PT Multimédia took place. With the spin-off, Portugal Telecom was no longer a Pay-TV provider, a service that belonged to PT Multimédia. PT Multimédia changed the name to Zon Multimédia which provided internet, fixed telephone and Pay-TV services, the triple-play. With the triple-play offer Zon was a threat for Portugal Telecom, since TV was the service most valued by the consumer, being the principal component in the consumer choice. To face this situation Portugal Telecom created MEO, a new product that offered triple-play with innovative characteristics that would improve the consumer experience.

The main objective of this dissertation is to understand the position of Portugal Telecom in the telecommunications market, because even big companies can suffer big changes that could place the company in a risky position. To better analyse this situation the Master Thesis is composed by three parts: Case Study, Literature Review and Teaching Note.

In the Case Study the context of the telecommunications market after the spin-off is presented. And also was the strategy planned by Portugal Telecom to face the new competitor, Zon Multimédia, and to improve the telecommunications offer in Portugal. In the Literature Review some theoretical strategic concepts are proposed in order to help the analysis of the Case Study. The last part is the Teaching Note which analyses the Case Study. This part could be used by the instructor during the class as a guideline. However, it is expected that other comments should be added during the

Portugal Telecom adapting to the market: MEO, the new future

class by the instructor and students, in order to stimulate the discussion of the Case Study.

Case Study

In the 3rd of April 2008, Manuel Rosa da Silva, member of Portugal Telecom Executive Committee, and Vera Pinto Pereira, director of MEO, from Portugal Telecom (PT), were about to launch MEO, with the intent of offering innovative services in the telecommunications industry. With a revenue volume of 6148,4 million euros at the end of 2007, PT was developing a strategy in order to create a brand to fight Zon, a competitor that originated from the previous spin-off of Portugal Telecom Multimédia, PTM, from PT in November 2007. After the spin-off, Zon rapidly became a competitor for PT and a leader in Pay-TV.

Taking advantage of its leading position in the Pay-TV market, Zon had launched its triple play offer, internet, fixed telephone and pay-TV, in 2008, which could prove to be a challenge for PT's core business, fixed communications.

History of the company

PT was founded in 1994. From the merger of three independent operators, Telefones de Lisboa e Porto, TLP, Telecom Portugal and Teledifusora de Portugal, TDP. With the merger PT became the only national telecommunications operator.

PT was one of the largest companies in Portugal, and the leader in the telecommunications market in Portugal. PT had always been considered as a company that was constantly innovating and permanently looking for what could be an added value for the firm. However, not everything was going well with PT. Since 2004, profits started to decrease, mainly because of the fixed communication business. Between 2004 and 2007 the EBITDA declined by 30,91% (exhibit 1). In the end of 2007, the PT Group included several companies in Portugal (exhibit 2) and the main sources of revenues by wireline and mobile services (exhibit 3). PT was also present in the international market with participations in other companies like Vivo (Brazil), Médi Télécom (Marocco), Unitel (Angola), MTC (Namibia), CST (Sao Tome and Principe), CVT (Cape Verde), Timor Telecom (East Timor), CTM (Macao) and UOL (Brazil).

Being the incumbent in the telecommunications market in Portugal, PT Group provided several services to its customers, such as:

- Cable distribution network operator
- Public communications network
- Internet Service Provider
- Voice Over Internet Services (VoIP)
- Telephone service at a fixed location
- Data transmission services
- Satellite communications service
- Voice transport services in CUG¹
- UMTS² services
- Mobile Telephone service

Fixed communications were no longer a service adding value for the company. The number of fixed communications clients was dropping every day. With mobile phones, a fixed phone was no longer a necessary service for many customers. Customers had several reasons to stop using fixed telephones, and the major reason was the higher utilization of mobile phones (exhibit 4). The revenue from international communications was also falling. In addition, the market price of broadband was diminishing because there were many competitors in the market. As Ana Dias, director of innovation of PT Comunicações, said “Everything was going wrong at the time. That can be seen by the number of customers reduction between 2003/2005”.

As can be seen in table 1 the total traffic, of PT Comunicações, was falling.

¹ CUG: Closed User Group, subscribers that could only make and receive calls from members within the group

² UMTS: Universal Mobile Telecommunications System, international third generation mobile communication standard that includes mobile multimedia and telematics services and allows a higher data transmission rates than GSM (Global System for Mobile Communications) technology

Wireline Operating Data	2007	2006	2005	2004	2003
Total Traffic (Million minutes)	12.502	13.442	14.818	16.478	18.255

Table1 : Portugal Telecom Wireline Operating Data

Source: PT Annual Report 2007, page 33; PT Annual Report 2006, page 31; PT Annual Report 2005, page 19; PT Annual Report 2004, page 9; PT Annual Report 2003, page 206

In five years the total traffic of wireline operating data decreased by 31,40%. The fixed line market as a whole in Portugal was decreasing as well (exhibit 5). The electronic communications sector in Portugal had an high return, the operating income growing at a rate of 7,08% between 2003 and 2005. However, after 2005, the numbers stabilized. The numbers matched the situation of PT. However, in the Portuguese telecommunications market (exhibit 6), the traffic of mobile phone was increasing, while the traffic of fixed phone was decreasing.

In 2007, the telecommunications market was suffering big challenges: there was a restrictive regulatory environment for the incumbent, mobile phones substituted fixed phones and there was a strong cable competition. PT made several studies to know what attributes customers valued most, in order to react to the changes in the market. PT concluded that clients valued television, broadband, brand, fixed, and other, being television the most valued attribute. PT rapidly understood that customers were consumers of TV contents. PT also tested different technological platforms, and whether the products should be provided individually or in bundle. Bundles turned out to be the best option (exhibit 7). With the bundle offers of its competitors, PT would lose clients and the management understood that the company couldn't afford to be left out of the TV market.

In February 2006, Sonae, a large Portuguese multi-business company also involved in the telecommunication business, launched an hostile take-over bid for PT, whose main reason was lack of competitors in the market. PT included in its defence measures the spin-off of PT Multimédia, the owner of TV Cabo, the cable TV operation.

In the 28th of March 2008, PT announced a new CEO, Zeinal Bava. Zeinal Bava already worked for the PT Group, where he had been given several assignments, like CEO of the Pay-TV division from 2003 until the company's spin-off in 2007 and CFO of the PT Group between 2000 and 2006. Before joining PT, Zeinal Bava also had other important positions such as Executive Director and Relationship Manager (exhibit 8).

Zeinal Bava probably would be a face of change in PT, as he was seen as a visionary, always looking for the next innovation that could bring value to the company. The former CEO was Henrique Granadeiro, who was also the Chairman of Board of Directors since 2006, and who had thus followed all the process of the spin-off. For Granadeiro, the spin-off brought more competition to the market. He stated in the 2007 annual report, "The spin-off was the major driver for the liberalization of the telecommunications sector in Portugal".

Before the spin-off, the companies of the PT Group were independent, only connected by being part of the same Holding company. Ana Dias quoted "The companies were connected only at the level of accounts for the PT Group; companies were born and raised in parallel". After the spin-off and also with the strategy of launching MEO, all the companies would be connected, the employees working with the same objective, to make MEO a success.

After the separation of PTM, PT was left without some of its previous telecommunications services. Thus, PT had two options: keeping investing in its current services or trying to create something different. PT chose the innovative way, by aspiring to serve all consumer needs. So it created a new brand called MEO, that connected all the companies of the group PT, offering bundles of telecommunication services. In this way, it could create more value for the company and compete with PT Multimédia, that had changed the name for Zon Multimédia. Zon immediately became the leader on the Pay-TV market. This separation between PT and PTM was something that had been under consideration within PT, in order to create a competitive and healthy market.

PTM was creating some resistance in terms of innovation, since MEO was something not seen with good eyes. So the spin-off came to accelerate the process of creating

MEO. MEO was an opportunity to do something different in the telecommunications market.

With the objective to keep creative, innovative and to involve the clients more and more, PT built MEO, a concept involving television, telephone and internet, presented mainly in packs to the market, where the relation between the brand, MEO, and the final consumer would intensify and be more interactive.

Pros and Cons of the Spin-off

After the spin-off, PTM might lose access to previous agreements for financial resources that had been made by PT. This could be a “pro” for PT, because it could prevent Zon to invest a huge amount in innovation. Zon would also probably see its costs increasing in order to develop systems and business functions.

The infrastructure network from PT Comunicações to distribute Pay-Tv was ADSL (asymmetric digital subscriber line) but IPTV (internet protocol television), a more advanced technology that was supported by ADSL, would be more efficient, with MediaRoom from Microsoft being the leading software platforms. ADSL was a technology that allowed high volume data transmission (broadband) over traditional phone lines. IPTV was a digital television service available over fixed telephone line, through a broadband connection. IPTV would be complemented with Direct-to-home satellite television (DTH), which was a technology used to deliver Pay-TV services in areas that were not covered by Hybrid Fibre Coaxial (HFC) networks. The use of DTH matched the strategy of PT for MEO, that wanted to provide the same content to all customers. MediaRoom was a new platform that integrated several multimedia capabilities, such as a multimedia applications environment for the development of interactive services and advanced applications such as digital terrestrial television (DTT).

Zon had a contract with PT Comunicações to use the network from PT to deliver Pay TV, internet access and voice telephony services, since there was no other available cable network in Portugal. Zon was already a Pay-TV provider, and after the spin-off it kept its clients and know-how. Before the spin-off, PTM only provided television and

internet, but after it they could offer telephone, television and internet (triple play). So PT was almost “required” to make a better offer, in order to have a competitive advantage. And PT would need to invest in a network that could add value to its customers.

In what the employees were concerned, there were some adjustments between PT and PTM regarding the management team: Zeinal Bava who was the CEO of PTM, became CEO of PT, and Rodrigo Costa, who was a member of the Executive Board of PT, and also the CEO of PT Comunicações, became the CEO of Zon. Both men took with them other managers of their teams.

Taking MEO from an idea to a brand

Even before the spin-off, PT was working on the MEO project. PT wanted to invest in IPTV to distribute television content, although there was some resistance by PTM cable operations. While PTM was served by coaxial cables built all over the country, after the split the intent of PT with the creation of MEO was to use an IPTV network. With the spin-off, PT was placed in a position where it could keep a dominant position in fixed communications as its main business. However, the revenues of fixed communications were dropping. Or it could take the risk to innovate in something different, besides communications, like home entertainment, providing television content in a different way. As Ana Dias said, the management of PT thought that if the company did not try to reinvent or diversify its business, the overall company’s business was at risk.

The main objective of MEO was to serve clients, mainly the B2C (Business-to-consumer) segment, with triple-play bundles including fixed communications, internet and television. With this type of offer some organizational changes were required. With MEO, PT Portuguese companies would need to be 100% connected, all the operations would be linked, mainly the different areas of PT Comunicações. As Ana Dias said “more than a product, this was a huge organizational change”. The areas that would suffer major changes were operations, product management, customer care and the call center. For example “if clients spend a day without fixed phone there is no problem, if they spend a day without television, it is chaos”, said by Ana Dias. The new

mode to take MEO to the consumers would be door-to-door. This would make it easier for the clients to know the product and to be clarified about everything they wanted to know about MEO. PTM was the only company of PT with a television service and with the spin-off the television service ceased to belong to PT. Vera Pinto Pereira said that “we didn’t want to create a television service similar to PTM with fewer mistakes; we wanted to create something different”. However, the content structure needed to be the same. Vera Pinto Pereira gave some examples “A person used to watch *Sic Notícias* or *AXN*, would not want to stop watching these channels”.

MEO was launched in the end of June 2007, in a limited scale, only in some cities of Portugal, such as Lisboa, Porto and Castelo Branco, offering IPTV services. MEO included broadband up to 8 Mbps, unlimited calls between fixed phones, and Pay-TV with more than 40 channels. In the end of 2007, PT achieved 21 thousand IPTV clients. Clients also had the options to subscribe premium services, like SportTV (sport channels), cinema channels and video-on-demand services (VOD). MEO was launched in a limited scale because it was a product with a huge complexity, and PT wanted to test all the variables before the roll-out to all the country. Only in April 2008 MEO was going to be launched in full scale.

Vera Pinto Pereira explained that “everything that was done until April 2 was a test”, because PT needed to prepare teams and technology infrastructure. “All the teams were prepared to sell MEO”. In the Spring of 2007, PT also tested a pilot version of IPTV in some areas of Lisbon, with a maximum of 30.000 clients. Between September 2007 and April 2008, PT scaled all the IPTV network based in the copper ADSL 2+ (faster than ADSL) network of PT. PT needed to transform each central to increase market coverage. IPTV was a platform with return, with better interaction experiences. PT wanted to guarantee that every single client could use MEO, and in order to ensure that, PT also had a satellite operation to complement the IPTV operation. With this, PT could launch MEO being sure that everyone would have access to it.

Before launching MEO, PT analysed the market and concluded that there were some characteristics that customers valued most, like a faster zapping, live pause, the possibility to record programs and High Definition channels. Regarding the needs of the customers, MEO had the objective to create something unique that could bring

more comfort to the customers, where the interactivity between PT and the clients could be higher. So, knowing the attributes that could make the difference in the market, one of the biggest innovation of MEO would be video on demand. With MEO the customer would be able to stop the TV program whenever he wanted and it would also be possible to make recordings and to have a TV video club, which increased the value of MEO. Also, some channels would be exclusive for a certain period for MEO. Also, the content discovery would be improved with more options and PT would have High Definition for certain channels. The basic bundle offer of MEO would include 8Mbps of Internet, 30 fixed channels plus 10 optional channels and unlimited calls between PT number's, for a monthly price of 49,90€. The customer would also be able to add optional channels and premium channels. The first monthly fee and the installation would be free. At the time, Zon had a basic bundle with 80 channels, with 8Mbps of Internet, and unlimited calls during night and weekends, for a monthly price of 48,99€.

For Vera Pinto Pereira "The secret was to understand the parallelism between the evolution of technology and the evolution of customers needs". MEO was a new kind of entertainment, with the name "MEO" showing the objective of PT. Thus, the clients could control the experience. These innovations were new in the market, which could give a good image of PT as an example of a telecommunication company all around the world. Vera Pinto Pereira and Manuel Rosa da Silva (exhibit 9) were on the helm to make MEO successful, and with the help of Zeinal Bava, it was expected that MEO would grow in a fast way.

Another objective of PT was to launch DTT in Portugal. In February 2008 two contests for the attribution of frequencies for the DTT broadcasting services and for the licencing of the distributor operator were opened. The contests were the Multiplexer A (Mux A) and Multiplexer B to F (Muxes B to F), the first one was oriented to the transmission of services of open access channel (Free-To-Air) at a national level, and the other one was related to the transmission of pay-TV television programmes, being Muxes B and C at a national level and the rest at a regional level.

However, after the release of MEO some kind of retaliation by Zon was expectable. As João Menaia, a manager of PT, quoted, "typically a company could respond by product

or price differentiation. In this case, it would be difficult for Zon to differentiate in the TV platform, because Zon did not have all the functionalities that MEO would have. It was expected that Zon could retaliate only through price or internet speed". Vera Pinto Pereira said that some consequences of this intense relation between PT and Zon were expected: "Exploding the market, decreasing prices and increasing products".

In 2007 Portugal Telecom invested 147.246.817 euros in marketing and advertising. To promote MEO, PT used an attractive campaign with 'Gato Fedorento', a famous Portuguese comedy group, in order to cause great impact on the public. The idea was that 'Gato Fedorento' would continue to reproduce their comedy episodes, but now for MEO TV Commercials.

MEO was now going to be announced to the public, and it was expected to be a success. PT expected that in 2 years after the release of MEO, MEO would reach 200.000 clients. All the strategy of building MEO required a big investment. More important, it was a paradigm shift in the way of thinking of each employee from all the companies in order to make the dream come true.

Competitors

PT was the incumbent in the telecommunications market in Portugal. However there were some other important players. The major competitors were Zon Multimédia, Vodafone Portugal and Sonaecom.

Zon Multimédia

After the conclusion of the spin-off between PT and PTM in November 2007, PTM turned an independent company. Zon and PT signed a leasing contract for the use of all the cable network and infrastructures. In the end of 2007 Zon had a 715,7 million euros revenue volume. With the spin-off, Zon wanted to be a leader in the market, having TV Cabo as an advantage. In 2007 the number of TV Cabo clients grew 4,5% to 1.547.000 clients. After the spin-off Zon became the dominant player of Pay-TV, which placed PT in a difficult position (Exhibit 10). The number of clients in broadband increased 179,6%, with 38.000 new clients. Also, the monthly average revenue per user (ARPU) of Zon increased by 5,6%, to 30,8€ in the end of 2007. In spite of being a

big competitor of PT, in 2007 Zon only invested 22.896.712€ in marketing and advertising. Comparing to PT, the high volumes of investment in marketing and advertising in this industry could be an indicator of the fierce competition. Zon was separated in three different companies Zon TV Cabo Portugal (mainland), Zon TV Cabo Madeirense (Madeira Island) and Zon TV Cabo Açoreana (Azores Island). Zon was also present in the cinema business, through Lusomundo a subsidiary which main business was the exploration of cinemas. Zon offered several services to its customers:

- Public communications network
- Cable distribution network operator
- Internet service provider – ISP
- Voice over internet services (VoIP)
- Telephone service at a fixed location
- Data transmission service

Vodafone

Another competitor of PT was Vodafone Portugal, with 36% of market share of clients with mobile services, with a 1.511,3 million euros revenue volume at the end of March 2008 from 5.209.195 clients. The number of clients between April 2007 and March 2008 grew 9,7%. Vodafone was a major world telecommunication service provider. In Portugal, Vodafone entered the telecommunications market in 1992. Vodafone was more oriented towards mobile phone services, competing with TMN, that was born 1991. The ARPU between April 2007 and March 2008 was 22,72€, having decreased 2,2% compared to the previous year, mostly due to the decrease of wholesale roaming charges. In June 2007, Vodafone launched a more competitive offer of ADSL fixed broadband, implementing a network of ADSL2+, which offered Internet access with speeds up to 24 Mbps and fixed voice services. Vodafone also presented good alternatives to fixed broadband, such as a mobile broadband with faster internet access speed at competitive prices. The following services are offered by Vodafone Portugal to the public:

- Mobile telephone service
- Data transmission services

- Internet service provider – ISP
- Public communications Network
- Telephone service at a fixed location
- Fixed wireless access
- UMTS services
- Virtual phone cards service

Sonaecom

The other important player in Portugal was Sonaecom, with a 892,7 million euros revenue volume at the end of 2007. Sonaecom belonged to the Portuguese group Sonae, created in 1994. The telecommunications services of Sonaecom were offered by three companies, Optimus for mobile communications, Novis (large companies and wholesale market) and Clix (residential market) for fixed communications. Optimus was launched in 1998 and in the end of 2007 had 2,9 millions of clients, with a market share of 20% in mobile communications. Mobile communications were responsible for 64,7% of Sonaecom revenues (exhibit 11). In 2006 Clix was the first company in Portugal that launched IPTV services, with a triple-play offer. IPTV offer was available only in limited areas where the existing cable network of PT was appropriate and where Sonaecom had central offices. This service of Sonaecom had never been a threat to PT, because Sonaecom did not have the infrastructure and the power of PT to scale IPTV. During 2006, Sonaecom also started to offer ADSL2+. With ADSL2+ Sonaecom became a more competitive company in broadband. In January 2008, Sonaecom announced the intention to merge with Zon, and in fact Sonae launched the take-over bid with the intention of separating PT and PTM. If the merger happened, the two companies together could be a dominant player in the market. Like Vodafone, Sonae was mainly oriented to mobile phone services. Sonae provided the following services:

- Mobile telephone service
- Data transmission services
- Internet service provider – ISP
- Public communications Network

- Telephone service at a fixed location
- Distribution signal of television and video service
- Fixed wireless access
- UMTS services
- Voice transport services in CUG

MEO going to the public

PT was the incumbent in the telecommunications market, and the leader until the spin-off. But, Zon became the leader in Pay-Tv and triple-play. Without any previous experience of facing a competitor in the market, PT did not know if there was space for two successful telecommunication companies.

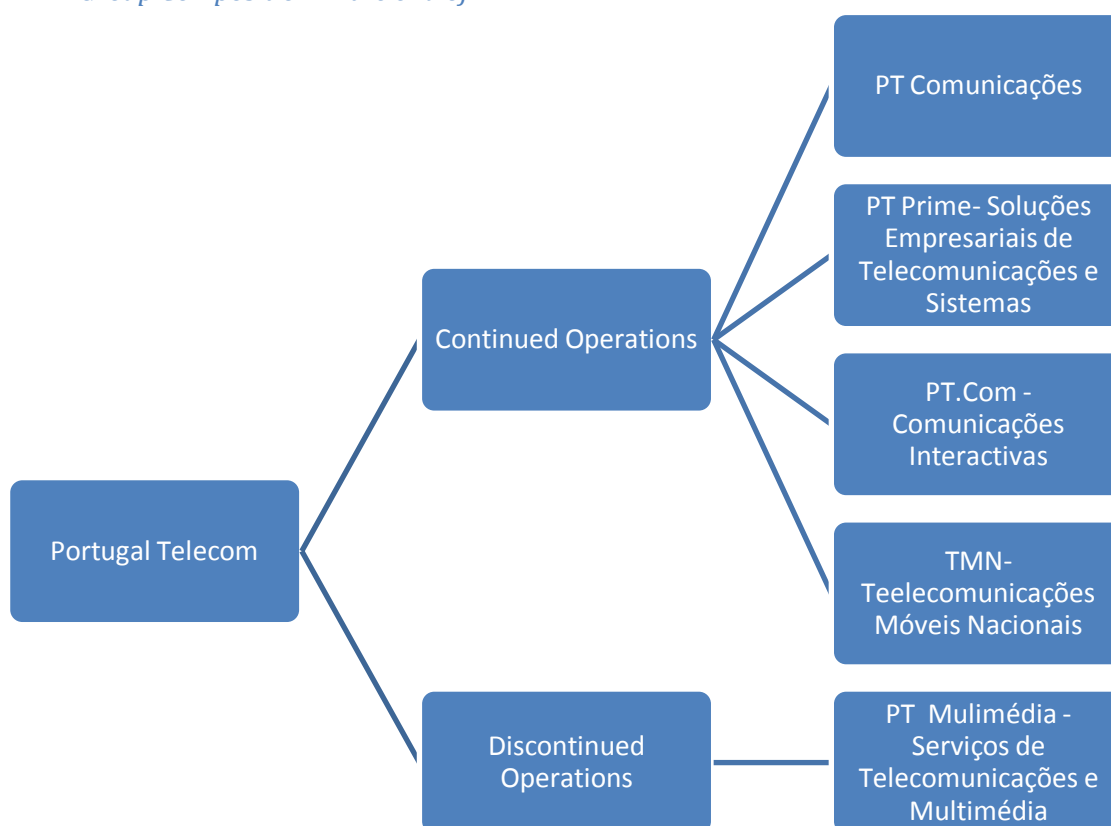
Exhibits

Exhibit 1 - Portugal Telecom EBITDA

	2004	2005	Δ 2004/2005	2006	Δ 2005/2006	2007	Δ 2006/2007
EBITDA	1.325.475.763	1.435.999.804	8,34%	1.086.825.774	-24,32%	915.711.783	-15,74%

Source: PT Annual Report 2004; PT Annual Report 2005; PT Annual Report 2006; PT Annual Report 2007 (in euros)

Exhibit 2 - PT Group Composition in the end of 2007



Source: PT Annual Report 2007

Exhibit 3 - Operating Revenues of Wireline and Mobile, Portugal Telecom 2007

	2007	2006	Δ 07/06
WIRELINE			
Operating Revenues	1962,4	2071,8	-5,28%
Retail	1023,2	1173,5	-12,81%
Voice	841,1	993,2	-15,31%
Data & others	182,1	180,3	1,00%
Wholesale	486,9	464,2	4,89%
Data & Corporate	265,6	250,5	6,03%
Other wireline revenues	186,7	183,6	1,69%
MOBILE			
Operating Revenues	1542,9	1502,4	2,70%
Services Rendered	1393,1	1363,2	2,19%
Customer	1146,2	1117	2,61%
Interconnection	246,9	246,2	0,28%
Sales	141,8	129,7	9,33%
Other operating revenues	8,1	9,4	-13,83%

Source: PT Annual Report 2007 (in millions of euros)

Exhibit 4 - Reasons for not having a fixed line Telephone

Reasons for not having a fixed line telephone	%
Use of mobile phone	43,6
Prefer not to pay subscription	19,7
It is cheaper to make calls by other ways	-
Is not needed	21,4
Other answers	1,0
New house/ rentals	3,1
Use of computer	0,4
Too expensive	9,9
Do not know/Do not answer	0,8
Total	100

Source: State of Communications 2007, Anacom; Inquired without wireline, Portugal

Exhibit 5 - Traffic Originated in the fixed Network (minutes)

	2006	2007	Var.(%) 2006/2007	2003/2007 average yearly var.(%)	2003/2007 var. (%)
Total traffic (voice+ Internet+VoIP)	9.050	8.434	-6,8	-12,0	-40,0
Voice Traffic	8.050	7.926	-1,5	-3,1	-11,9
National Traffic	7.500	7.360	-1,9	-3,6	-13,5
National fixed-to- fixed traffic	6.345	6.207	-2,2	-3,7	-13,9
National fixed-to- mobile traffic	1.155	1.153	-0,2	-3,0	-11,4
Outgoing international traffic	550	566	2,9	3,9	16,7
Internet access traffic	997	415	-58,4	-46,5	-91,8
Nomadic VoIP traffic	3	93	2.635,3		

Source: State of Communications 2007, Anacom

Unit: Million Minutes

Exhibit 6 - Distribution of voice traffic originated on fixed and mobile network



Exhibit 7 - Most Valued Attributes (excluding price)

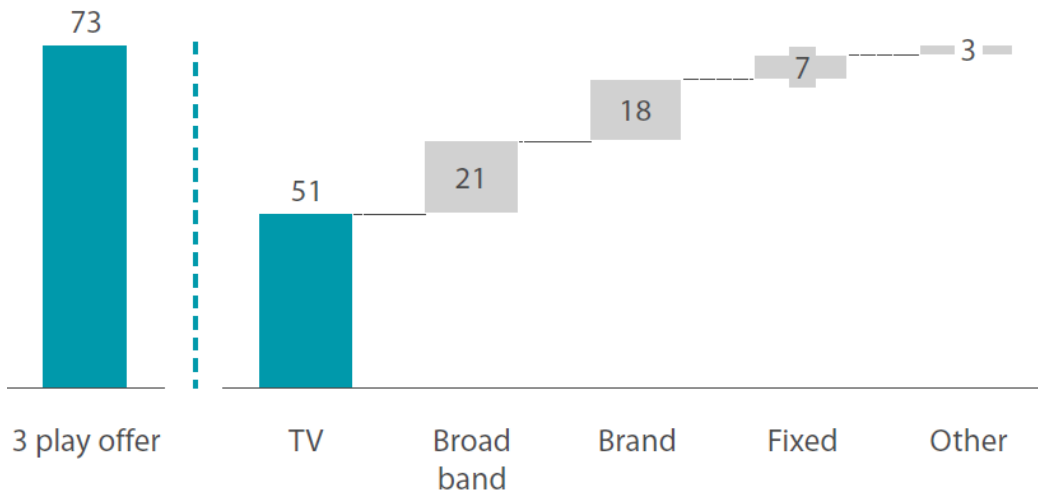


Exhibit 8 - Zeinal Bava Profile

Executive Director and Relationship Manager for Portugal of:

- Merrill Lynch International (1998-1999)
- Deutsche Morgan Grenfell (1996-1998)
- Warburg Dillon Read (1989-1996).

Zeinal Bava had a degree in Electric and Electronic Engineering from University College of London.

Exhibit 9 - Manuel Rosa da Silva and Vera Pinto Pereira Profiles

Manuel Rosa da Silva joined PT in 2000. He started working in PTM.Com (a multimedia unit of PT Multimédia- pay-TV division) as CFO, and was also part of the Board of Directors of PT-Multimédia from 2006 to 2007. Between 2001 and 2002, Manuel Rosa da Silva was Director of Investor Relations. Before starting to work in PT, he worked in London as Vice-President of Merrill Lynch, Associate Director of M&A at Morgan Grenfell, Associate in SG Warburg and Consultant at KPMG. Manuel Rosa da Silva studied Systems Engineering in Instituto Superior Técnico in Portugal (Engineering University).

Vera Pinto Pereira was the Director of MEO since 2007. Previously she had been TV service director at PT Multimédia. Before joining PT, she was founding partner of Innovagency Consulting in 2001 and a Consultant at Mercer Management Consulting (presently Oliver Wyman). Vera Pinto Pereira had a MBA from Insead and a degree in Economics at Universidade Nova de Lisboa.

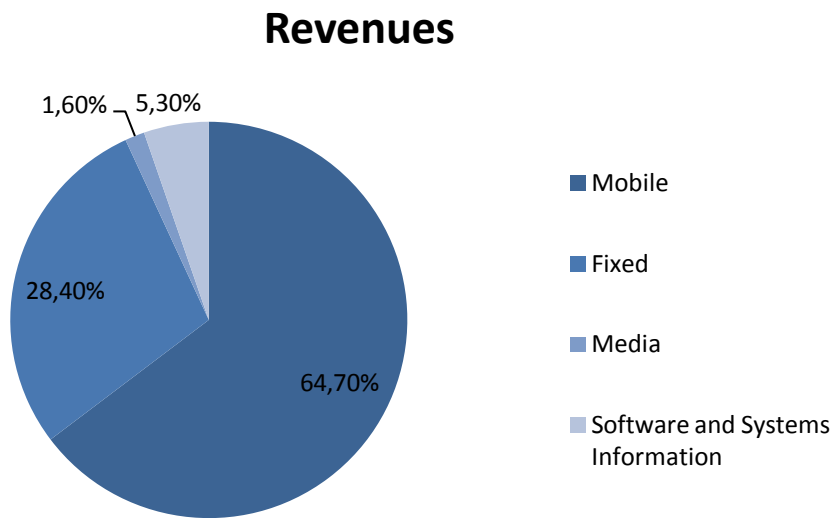
Exhibit 10 - TV Cabo/ZON Group's cable television subscriber share

2003	2004	2005	2006	2007
81	79	78	75	74

Source: State of Communications 2007, Anacom;

Unit: %

Exhibit 11- Sonaecom revenues per service in 2007, per business



Source: Sonaecom Annual Report 2007

Literature Review

Innovation

There are many definitions of innovation. For example innovation can be defined as a *'process of turning opportunity into new ideas and of putting these into widely used practice'* (Tidd, 2001). A definition of innovation related to leadership of Kuczmariski (1996) can also be used *'Innovation is best described as a pervasive attitude that allows businesses to see beyond the present and create a future vision'*, and he also stated that *'The aspect of innovation that frightens most CEOs is that it is almost always inseparable from risk'*. This perspective is important for the case study, because of the risk PT was taking. But, for Wolfe (1994) *'The problem of not specifying the type and degree of the innovation examined is a substantial obstacle to the generalizability of innovation research'*. So, Tidd, Bessant and Pavitt (2005) had separated innovation in four types: product innovation (*'changes in the products/services which an organization offers'*), process innovation (*'changes in the ways products and services are created and delivery'*), position innovation (*'changes in the contexts in which the products/services are introduced'*) and paradigm innovation (*'changes in the underlying mental models which frame what the organization does'*). For Tidd (2001), there are also degrees of novelty: disruptive, radical and incremental. In **Figure 1** it is possible to have a better understanding of these degrees.

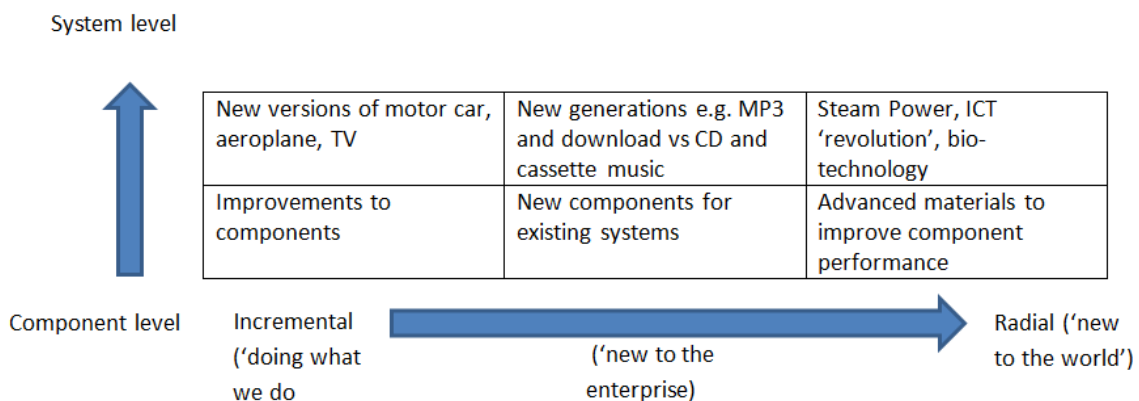


Figure 1: Dimensions of Innovation

Source: *Managing Innovation: Integrating technological, market and organizational change*; Tidd, Joe; Bessant; John; Pavitt; Keith; 2005

In **Figure 2**, it is possible to observe the innovation 'space', Tidd (2001) stated '*we can plot these two dimensions of innovation of a simple matrix that defines the space which has to be managed*'.

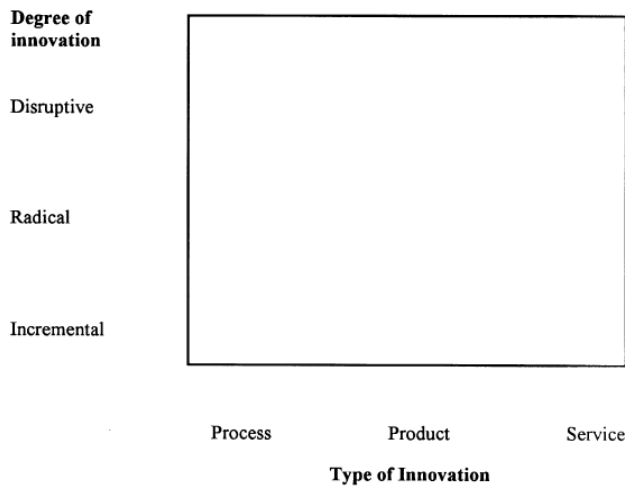


Figure 2. Innovation 'space': the type and degree of innovation

Source: Innovation Management in context: environment, organization and performance; Tidd, Joe; September 2001; IJMR

Porter (1990), Lengnick-Hall (1992) and Roberts (1998) agreed that organizations should increase their organizational innovativeness to remain competitive. Also, in **Figure 3**, it is possible to observe that all the factors in the organization are related to innovation.

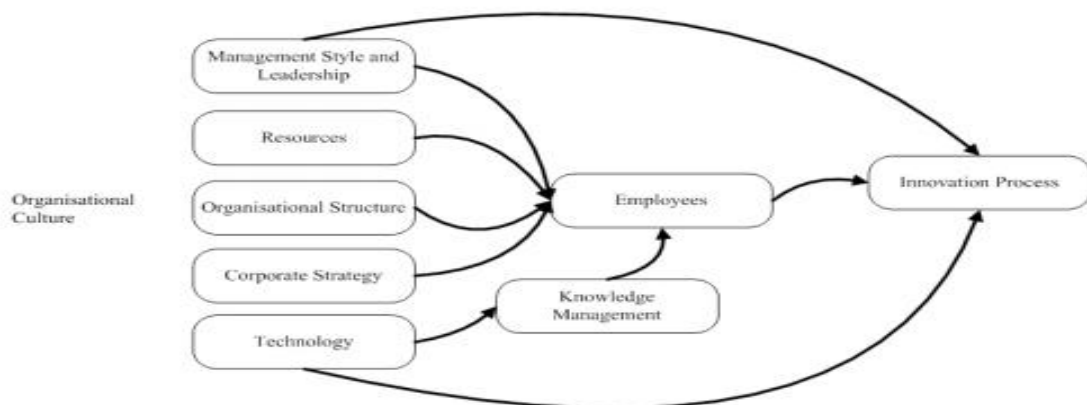


Figure 3: Relationships between factors

Source: Factors influencing an organization's ability to manage innovation: a structured literature review and conceptual model; Smith, Marisa; Busi, Marco; Ball, Peter; Van der Meer, Robert; December 2008; International Journal of Innovation Management

In this model, the innovation process is the only endogenous factor, which means that the innovation process is originated by other factors. It is directly affected by the management style and leadership, employees and technology. Watts (1998), Petroni, (1998) Loewe and Dominiquini (2006) agreed that *'technology is often used in a supportive role to alleviate various stages of the innovation process'*.

S-Curve

In 1986, Foster developed the S-curve or lifecycle model, showing that the 'basic idea is that any technology with commercial potential passes through a lifecycle' (Callahan, 2007). Callahan also stated that *'During the early stages of the commercialization process, progress is slow as fundamental technical issues are addressed. The rate of progress increases, as these issues are resolved'*. In **Figure 4** the s-curve model is presented, where the horizontal axis presents the amount of R&D effort expended, cumulative over time, and the vertical axis is a single performance measure critical to the technology's commercial performance. *'The performance improvement in technology T1 is slowing. The performance of a newer technology, T2, while inferior is actually improving at a faster rate. In fact, it does overtake T1, the old technology, in terms of performance'* Callahan (2007). Schilling (2008), also explains this fact *'This yields an s-shape curve because adoption is initially slow when an unfamiliar technology is introduced to the market, it accelerates as the technology becomes better understood and utilized by the mass market, and eventually the market is saturated so the rate of new adoptions decline'*.

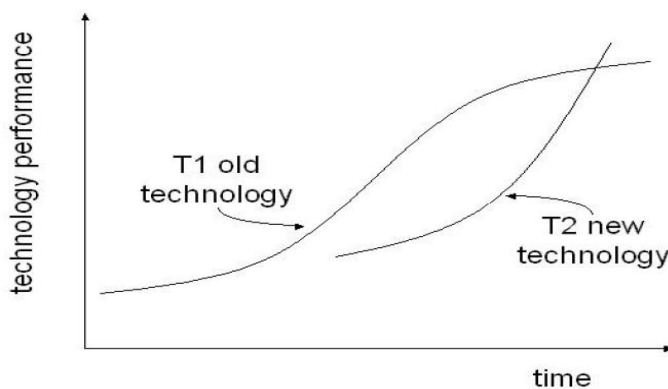


Figure 4: The technology S-Curve

Source: Patterns of Technological Innovation; Callahan, John; 2007

Sustaining Technologies and Disruptive Technologies

For Christensen (2003), there are two types of technologies: sustaining technologies and disruptive technologies. Christensen (2003) stated that sustaining technologies *'improve the performance of established products, along the dimensions of performance that mainstream customers in major markets have historically valued'*. And, disruptive technologies *'underperform established products in mainstream markets. But they have features that a few fringe (and generally new) customers value'*. In **Figure 5**, it is possible to observe Christensen's model (2003) of the impact of sustaining and disruptive technological change. Analyzing this figure he stated that *'their efforts to provide better products than their competitors and earn higher prices and margins, suppliers often overshoot their market: They give customers more than they need or ultimately are willing to pay for. And more importantly, it means that disruptive technologies that may underperform today, relative to what users in the market demand, may be fully performance-competitive in the same market tomorrow'*.

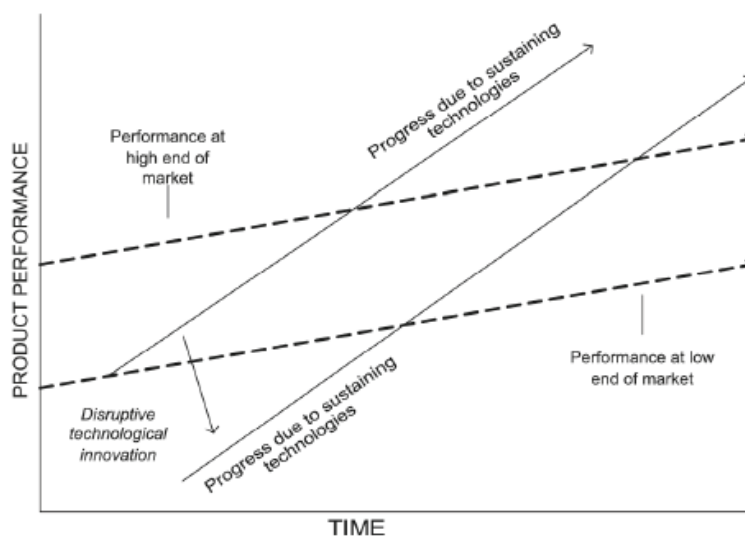


Figure 5: The Impact of sustaining and disruptive technological change, Christensen Model

Source: <http://blog.naver.com/PostView.nhn?blogId=jjangguq2&logNo=110155646689>

Christensen and Raynor (2003) add to the theory of sustaining and disruptive technologies, by interpreting disruptive innovations, *'Disruptive innovations, in*

contrast, don't attempt to bring better products to established customers in existing markets. Rather, they disrupt and redefine that trajectory by introducing products and services that are not good as currently available products. But disruptive technologies offer other benefits – typically, they are simpler, more convenient, and less expensive products that appeal to new or less-demanding customers'.

Competitive Advantage

In order to add some value to their products/services, companies need to have something different, something that can bring value to the final consumer, managers need to create competitive advantage to excel in the market. Tidd, Bessant and Pavitt (2005) quoted *'Whilst competitive advantage can come from size, or possession of assets, etc. the pattern is increasingly coming to favour those organizations which can mobilize knowledge and technological skills and experience to create novelty in their offerings (product/service) and the ways in which they create and deliver those offerings.'*

Porter (1985) identified two basic types of competitive advantage: low cost or differentiation. For him, *'The two basic types of competitive advantage combined with the scope of activities for which a firm seeks to achieve them lead to three generic strategies for achieving above-average performance in an industry: cost leadership, differentiation, and focus. The focus strategy has two variants, cost focus and differentiation focus'*.

In **Figure 6** the three generic strategies of Porter are presented. The notion underlying this model is that competitive advantage is the basis of any strategy.

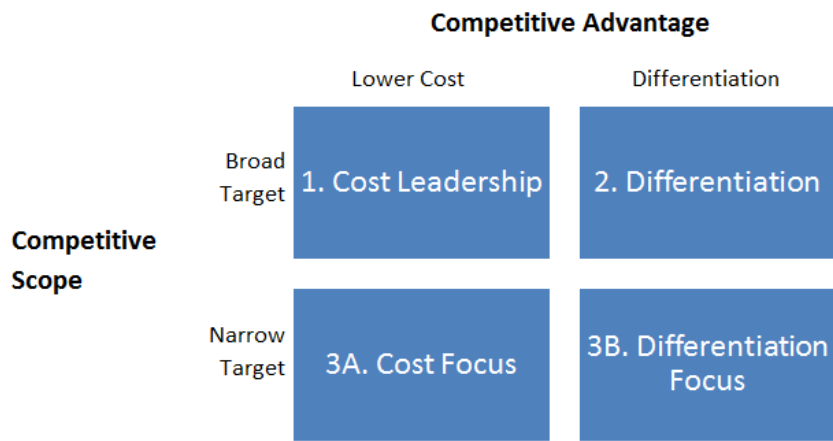


Figure 6: Three Generic Strategies

Source: Competitive Advantage: Creating and sustaining superior performance; Porter, Michael; 1985

Competitive Advantage and Innovation/ Technology

Tidd, Bessant and Pavitt (2005) quoted ‘*Innovation contributes in several ways. For example, research evidence suggests a strong correlation between market performance and new products. New products help capture and retain market shares, and increase profitability in those markets*’. Innovation can bring some competitive advantage for companies, as companies are able to improve their products/ services with the help of innovation. In **Table 1**, it is possible to identify the contribution that innovation can make to competitiveness.

Type of Innovation	Competitive Advantage
Disruptive	Re-writing the rules of the competitive game , creating a new ‘value proposition’
Radical	Offering a highly novel or unique product or service, premium pricing
Complex	Difficulty of learning about the technology keeps entry barriers high
Continuous Incremental Innovation	Continuous movement of the cost/ performance frontier

Table 1: Innovation and Competitive Advantage

Source: Innovation Management in context: environment, organization and performance; Tidd, Joe; 2001

Technology is related to innovation and improvements in technology can bring more value for the company. Porter (1985) stated that *'Technological change is one of the principal drivers of competition'*, but he also stated that *'A technology is important for competition if it significantly affects a firm's competitive advantage or industry structure'*. In the value chain framework of Porter (1985), it is possible to observe the role of technology in competitive advantage in the value chain. In **Figure 7**, technology is represented across all the phases of the value chain. Technology is mainly present in primary activities, it is also embodied in support activities, for example a new computer for some department with new programs, like Human Resource Management.

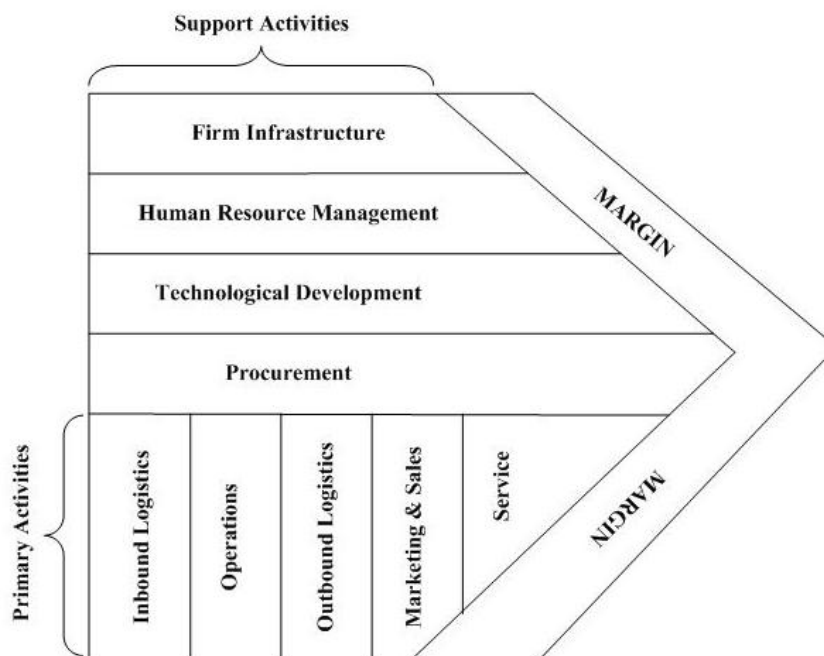


Figure 7: Porter's Value Chain Framework

Source: <http://strategy-models.blogspot.pt/2011/06/use-of-porters-1985-value-chain.html>

Supporting Porter's theory of competitive advantage, *'Technology will affect cost or differentiation if it influences the cost drivers or drivers of uniqueness of value activities'* and *'Technological development can raise or lower scale economies, make interrelationships possible were they were not before, create the opportunity for advantages in timing, and influence nearly any of the other drivers of cost or uniqueness'*, Porter (1985).

Also, Lutz and Caldwell (1987) agreed with Porter, saying that *'technology increases personal productivity, raises product and service quality, spur the space of innovation, and changes the structure of organizations and society'*.

Porter (1985) emphasizes that technology strategy must address three broad issues:

- What technologies to develop
- Whether to seek technological leadership in those technologies
- The role of technology licensing

Supporting these three broad issues, for Porter (1985) *'Choices in each area must be based on how technology strategy can best enhance a firm's sustainable competitive advantage'*.

The Strategic Benefits of Competitors

The existence of competitors sometimes can turn market more interesting. Porter wrote (1985) *'The presence of the right competitors can yield a variety of strategic benefits that fall into four general categories: increasing competitive advantage, improving current industry structure, aiding market development and deterring entry'*. Of course, the benefits will differ by industry and the strategy a firm is following. In the following topics some mechanisms that can be used for each category, according to Porter (1985) will be listed:

Increasing Competitive Advantage

- **Absorb Demand Fluctuations** – *'Competitors gain share when the leader's capacity is short during an upturn because the leader cannot or chooses not to meet all the demand. In a downturn, the leader gains share because it is the preferred source and now has capacity available'*
- **Enhance the Ability to Differentiate** – *'Competitors can enhance a firm's ability to differentiate itself by serving as a standard of comparison'*
- **Serve Unattractive Segments** – *'A firm's competitors can be happy to serve industry segments that it finds unattractive, but that would otherwise be forced to serve in order to get access to desirable segments of for defensive reasons'*

- **Provide a Cost Umbrella** – *'A high-cost competitor can sometimes provide a cost umbrella that boosts the profitability of a low-cost firm'*
- **Improve Bargaining Position with Labor or Regulators** – *'Having competitors can greatly facilitate bargaining with labor and government regulators, where negotiations are partly or wholly industrywide'*
- **Lower Antitrust risk** – *'The presence of viable competitors may be necessary to reduce the risk of antitrust scrutiny and prosecution, in both government and private suits'*
- **Increase Motivation** – *'A viable competitor can be an important motivating force for reducing cost, improving products, and keeping up with technological change'*

Improving current Industry Structure

- **Increase Industry demand** – *'The presence of competitors can increase overall industry demand and, in the process, a firm's sales'*
- **Provide a second or a third source** – *'In many industries, particularly those involving important raw materials or other important inputs, buyers want a second or a third source in order to mitigate the risk of supply disruptions and/or to hedge against the bargaining power of suppliers'*
- **Reinforce Elements of Industry Structure** – *'A good competitor can reinforce desirable aspects of industry structure or promote structural change that improves the attractiveness of the industry'*

Aiding Market Development

- **Share the Costs of Market Development** – *'Competitors can share the costs of market development for new products or technologies. Market development often involves costs of inducing buyer trial, battling substitutes, legal compliance, and promoting the development of infrastructure'*
- **Reduce Buyer's Risk** – *'Competitors may be necessary in a new market (or a new technology) in order to provide an alternate source for buyers, even if buyers would not normally require another source later on'*

- **Help to Standardize or Legitimize a Technology** – *‘Having competitors that employ the same technology as a firm can accelerate the process by which the technology is legitimized or becomes the standard’*
- **Promote the image of the industry** – *‘The right competitors can enhance the image of an industry. Established companies with reputations in other businesses can lend credibility to an industry by signaling that the industry is legitimate and that promises by firms will be met’*

Deterring Entry

- **Increase the Likelihood and Intensity of Retaliation** – *‘Competitors can increase the likelihood and severity of retaliation perceived by potential entrants’*
- **Symbolize the Difficulty of Successful Entry** – *‘A competitor can bear witness to the difficulty of successfully competing against firm, and demonstrate the unspectacular profitability of a follower position’*
- **Block Logical Entry Avenues** – *‘Competitors can occupy positions that represent logical entry paths into an industry, blocking them from potential entrants’*
- **Crowd Distribution Channels** – *‘Having a competitor gives distributors and/or retailers multiple brands, and may make it more difficult for a new entrant to gain access to distribution’*

Company Analysis

Management Style and Leadership

Management differs from company to company, always depending on several factors, like managers, employees, the business... There are also different views of what is the role of managers and the best way to perform that role. Sayles (1989) quoted that *‘thus good managers are supposedly those who: trust and have confidence in both the capabilities and the motivation of subordinates and believe that they want to accept responsibility and work hard; believe that shared authority (participation) is both desirable and useful; seek achievement and legitimate power; are reasonably self-confident, assures, optimistic, sensitive and alert’*. Sayles (1989) also stated *‘In other*

words, *“good” managers make “good” decisions that work out to be sensible plans, embodying reasonable delegations and yielding desirable results’*. Schermerhorn, Hunt and Osborn (2005) presented a theory more related to leadership, they stated that *‘The successful leadership team of today must operate out of 360° paradigm of interest and involvement, vertically up and down, as well as horizontally across, the organizational compass’*.

Heifetz and Laurie (2001) have a more practical view of what a leader should be *‘Leaders who truly care for their followers expose them to painful reality of their condition and demand that they fashion a response. Instead of giving people false assurance that their best is good enough, leaders insist that people surpass themselves. And rather than smoothing over conflicts, leaders force disputes to the surface’*. They also suggest some points of leadership tasks:

- **Get on the balcony** – *‘Business leaders have to be able to view patterns as if they were on a balcony’; ‘Leaders must be able to identify struggles over values and power, recognize patterns of work avoidance, and watch for the many other functional or dysfunctional reaction to change’*
- **Identify your adaptive challenge** - *‘For the strategy to succeed, the company’s leaders needed to understand themselves, their people, and the potential sources of conflict’*
- **Regulate distress** – *‘To inspire change – without disabling people – pace adaptive work:*
 - *First, let employees debate issues and clarify assumptions behind competing views – safety*
 - *Then provide direction. Define key issues and values. Control the rate of change: Don’t start too many initiatives simultaneously without stopping others*
 - *Maintain just enough tension, resisting pressure to restore the status quo. Raise tough questions without succumbing to anxiety yourself. Communicate presence and poise’*
- **Maintain discipline attention** – *‘Encourage managers to grapple with divisive issues, rather than indulging in scapegoating or denial. Deepen the debate to*

unlock polarized, superficial conflict. Demonstrate collaboration to solve problems'

- **Give the work back to employees** – *'To instill collective self-confidence—versus dependence on you—support rather than control people. Encourage risk-taking and responsibility—then back people up if they err. Help them recognize they contain the solutions'*
- **Protect leadership voices from below** – *'Don't silence whistle-blowers, creative deviants, and others exposing contradictions within your company. Their perspectives can provoke fresh thinking. Ask, "What is this guy really talking about? Have we missed something?"'*

Key/Critical Success Factors

Boyton and Zmud (1984) defined critical success factors as *'those few things that must go well to ensure success for a manager or an organization, and therefore, they represent those managerial or enterprise areas that must be given special and continual attention to bring about high performance'*. In Table 2, there are some strengths and weaknesses, established by Boyton and Zmud (1984), of the critical success factors:

Strengths	Weaknesses
1. Provide effective support to planning processes	1. Farther removed managers are from senior position within the organization, the more difficult it is for them to identify meaningful organizational CSFs
2. Develop insights into information services that can impact firm's competitive position	2. Managers not involved with strategic & tactical planning can experience difficulty in dealing with conceptual nature of CSFs
3. Are received enthusiastically by senior management who identify with trust of CSF ³ concept	3. It is difficult for certain managers to ascertain their information needs using only CSFs
4. Serve as top level of structured analysis & promote structured analysis process	

Table 2: The strengths and weaknesses of CSFs

Source: An Assessment of Critical Success Factors; Boyton, Andrew C.; Zmud, Robert W.; 1984

³ CSF: Critical Success Factors

The concept of critical success factors was introduced by Ronald Daniel, in 1961, and later developed and defined by John Rockart as a *'mechanism for defining a chief executive officer's information needs'* (Boyton and Zmut, 1984).

Network Externalities

Considering the network formation, Buechel and Hellmann (2012) stated that *'As in non-cooperative game theory, a central issue in the theory of network formation is the analysis of equilibrium or stability, i.e. a situation where no player wants to change his links'*, but Jackson and Wolinsky (1996) pointed a central problem in strategic network: *'There is a tension between stability and efficiency, meaning that individual interest can be at odds with societal welfare'*. Church, Gandal and Krause (2008) stated that *'network effect exists if consumption benefits depend positively on the total number of consumers who purchase compatible products'*. They also presented the theory of Katz and Shapiro (1985) when they differentiate direct and indirect network effects:

- Direct network effect – *'direct physical effect of the number of purchasers on the quality of the product'*
- Indirect network effect – *'individuals care about the decisions of the others because of the effect that has on the incentive for the provision of complementary products'*

Buechel and Hellmann also referred that there are two types of network situations, efficient and inefficient. For them, the externalities help to distinguish the situations, *'positive externalities define situations where agents can profit (at least do not suffer) from others who form a relationship; while negative externalities mean that they do not benefit from that action. We argue that both types of externalities correspond to natural settings. Network formation games where direct and indirect connections are the source of benefits represent examples for positive externalities. On the other hand, in a context of competition or rival goods, negative externalities occur'*. Wang, Liang and Lin (2012) summarize the definition of positive and negative network externality: *'The network externality is positive if the value of the product increases with the number of users, but becomes negative if the value of the product decreases as the number of users increase'*.

Eisenmann, Parker and Alstyne (2006) developed a theory where there are two-sided networks, *'If you listed the blockbuster products and services that have redefined the global business landscape, you'd find that many of them tie together two distinct groups of users in a network'*, and they gave the example of credit card that links consumers and merchants. They called *platforms* the products and services that bring together groups of users in two-sided networks. Another example of two-sided networks, given in the article, is the PC operating system, where one side is consumers and the other application developers, and platform providers are Windows or Macintosh. And they pointed that *'With two-sided network effects, the platform's value to any given user largely depends on the number of users on the network's other side'* and *'Because of network effects, successful platforms enjoy increasing returns to scale. Users will pay more for access to a bigger network, so margins improve as user bases grow'*.

Teaching Note

Case Summary

Portugal Telecom is a Portuguese company that provides telecommunication services, being the leader in the Portuguese telecommunication market for many years. In 2007, with the spin-off of the TV services provider, PT Multimédia, PT was no longer a TV service provider. PT Multimédia turned into an independent company, changing the name to Zon Multimédia.

Zon Multimédia was a threat for PT because the most valued service for consumers was television services. And now, Zon Multimédia not only offered television services but also fixed telephone and broadband services. This made Zon a dominant player in the market, offering triple-play to its customers.

The Portuguese telecommunications market was suffering some big changes, because the fixed phone service was no longer a valued service by consumers and several companies were offering broadband services, so internet wasn't something that only PT could offer. In spite of offering mobile phone services, PT was losing revenues in fixed lines, because with mobile phone this service became a secondary need. PT was "required" to do something to face the market. Without TV services, with fixed phone services revenues declining, with a variety of broadband providers in the market, and moreover with a strong competitor, Zon, which offered triple-play, something needed to be done.

Analyzing all the changes of the market, all the needs of the consumers and all the internal changes of PT, PT created MEO which combined three services: television, fixed phone and broadband services, the so called triple-play. MEO was a brand that provided telecommunications services in bundles but not in the traditional way. PT concluded that television was the service which customers most valued. So, the television service would have several different characteristics which were adapted to the consumer needs and to the consumer lifestyle. Being one of the largest companies in Portugal, PT had a large network infrastructure in Portugal. With all its knowledge and strength, PT was sure that MEO was the only option.

In spite of not being in the best moments of its history, PT made the decision to take the risk of creating MEO to face the market and its competitors, and more importantly to create something unique for the customers.

Learning Objectives

The objective of this case study is to provide an example of a large company that completely changed to face not only its new competitor, Zon, but also the market and the customers' needs. It could be a big company with recognition in the market, but if needed to adapt to the new changes of the market. In the case the decision of creating a new brand, MEO is presented, and the strategy behind that decision.

Therefore, during the analysis of the case, the following points should be understood by the students:

- The current situation of PT and advantages and disadvantages of PT
- The structure of PT and how it was changed
- The drivers for the spin-off and its impact in the market
- The advantages of PT competitors
- The protagonists of MEO
- The changes in the telecommunications market and the needs of the consumers
- The reasons for the creation of MEO and its characteristics and the consequences of not launching MEO
- The consequences of an intense competition in the telecommunications market
- The importance of the role of technology

Other possible ways to analyze the case study can be added, depending on the instructor's intent during the course.

Suggested Assignment Questions

The objective of the assignment questions is to give a guideline for the students to prepare the case study analysis before the class, in order to improve in class the discussion.

Assignment Question 1: What was the market situation before the spin-off in November 2007?

Assignment Question 2: What is the importance of Zon in the market?

Assignment Question 3: What are the reasons for the creation of MEO? What are the characteristics of MEO and how will it change the strategy of PT?

Assignment Question 4: How will the market respond to this fierce competition?

Class Plan

The class plan intends to organize the class in terms of time and which topics to be discussed in each Assignment Question, during a 90 minute class. This plan is mainly focused on strategic issues, when big changes have to be faced with the support of technology.

Market Analysis (40 minutes)

Assignment Question 1: What was the market situation before the spin-off in November 2007?

- a) What were the main problems of the telecommunications business in 2007? (7 minutes)
- b) What was the position and the key success factors of PT in the market before the spin-off? What was the connection between PT companies? (7 minutes)
- c) Who were the main competitors of PT? Were they interfering with PT 's role in the telecommunications market? (6 minutes)

Assignment Question 2: What was the importance of Zon Multimédia in the market?

- a) What were the drivers for the spin-off? What was the impact of the spin-off in the market? (6 minutes)

- b) What are the advantages of Zon that could be analyzed as a threat for PT? (7 minutes)
- c) Not being a leader in the Pay-TV market, what kind of path should PT take? (7 minutes)

Strategy Analysis (35 minutes)

Assignment Question 3: What are the reasons for the creation of MEO? What are the characteristics of MEO and how will it change the strategy of PT?

- a) What were the reasons for the creation of MEO? (7 minutes)
- b) Who were the protagonists of the creation of MEO? In terms of organization, what changes did PT suffer? (5 minutes)
- c) In face of a competitor that leads the Pay-TV market, what were the advantages of PT to create MEO, comparing with its competitors? (6 minutes)
- d) What were the main characteristics of MEO to attract customers? Should we consider innovation as priority for PT? (7 minutes)
- e) What kind of benefits could PT take from network effects and bundle offers? (5 minutes)
- f) What kind of technology was PT using? Can it be seen as an advantage? (5 minutes)

Predicting the future (15 minutes)

Assignment Question 4: How will the market respond to this fierce competition?

- a) Are the expectations for MEO going to be consistent with reality? What could be improved in MEO? (5 minutes)
- b) What kind of retaliation will Zon have, and what were the consequences in the future? (5 minutes)
- c) Is MEO the best option for PT? What is the strategy that PT and ZON are following? (5 minutes)

Analysis

Market Analysis (40 minutes)

Assignment Question 1: What was the market situation before the spin-off in November 2007?

**a) What were the main problems of the telecommunications business in 2007?
(7 minutes)**

In 2007 the telecommunications industry was suffering big changes, because customers' needs were changing and also the evolution of technology was higher every day, and companies needed to follow the market progress to keep their recognition in the market. With the appearance of mobile phones and the massive use of them, fixed telephone was not a primary need anymore. Being the fixed telecommunications the main business of telecoms, these companies had to adapt to the market. In exhibit 3, it is possible to observe that the major reason to stop using fixed telephones is the use of mobile phone (43,6%).

In exhibit 4 the traffic originated in the fixed Network (in minutes) in Portugal is presented. The total voice traffic in 2006 was 8.050 millions of minutes and in 2007 was 7.926 millions of minutes, a decrease of -1,5%. However this reduction can be analyzed more generally, as between 2003 and 2007 the total voice traffic decreased 11,9%. These numbers confirmed the bad situation of the market, and they also convey the idea of the easily adaptation of Portuguese consumers to new technologies. In fact, the mobile phones had the same functionality of fixed telephones, but they also provided other functions with better prices. Also, the competition in mobile communications was more varied, and companies had better conditions for their clients, because the pressure was higher.

The importance of the television service was increasing, as the Pay-TV service was improving each day, with a higher number of channels with higher variety and quality. There was no a direct substitute for television, as for example the mobile phone was

for the fixed phone, with even more functions. But for television this did not happen. It was a unique service, which did not have a direct substitute with the same features.

Also broadband was not a service with high revenues. There were several offers in the market, the competition was intense, because competitors decreased the price and increased the speed of internet, so this service was not a guarantee, in terms of revenues, for big companies, like Portugal Telecom.

Telecommunications companies will need to adapt to the situation of the market, because what was a big business yesterday, is no longer today. In order to do that, companies should study the market to know what is valued by customers and what could be a possible competitive advantage in the market.

Another problem of the telecommunications market before the spin-off, was the lack of competitors in telecommunications. PT was the only significant player in the market that had fixed communications and Pay-TV business.

b) What was the position and the key success factors of PT in the market before the spin-off? What was the connection between PT companies? (7 minutes)

Before the spin-off, PT was the leader in the telecommunications industry, being one of the largest companies in Portugal. PT was always recognized as a company that is always looking for the next innovation. With the entire infrastructure and its power in the market, PT was a difficult company to fight. In spite of this leading position, the business itself was not in the best moments, not only for PT, but also for other companies. In table 1, it is possible to observe the decline of the total traffic in wireline. In 2003 the total traffic was 18.255.000.000 minutes and in 2006 was 13.442.000.000 minutes, a total decrease of 26,37%. PT was always the first mover in the market, like in the mobile communications when PT launched TMN, without any competitor in the market, before Vodafone Portugal and Optimus appeared in the market. Optimus only appeared six years after the launch of Vodafone in 1991, and seven years after the launch of TMN.

In terms of the organization of the Group, PT was composed by several companies, as referred in the Case Study. But before the spin-off, these companies were completely

independent. The only common factor between the companies was the fact that they belonged to the same holding. As the director of Innovation, Ana Dias, said, “The companies were connected only at the level of accounts for the PT Group; companies were born and raised in parallel” (Case Study – page 6). The mind of PT employees was only prepared to work for the company they worked for, as the objectives of each company were different. As a Group, PT was present in different areas of telecommunications, but these areas worked independently, and the employees were prepared to sell their telecommunications business, not all the businesses of PT. However, the different companies of the group had the advantage of being supported by the PT Group, and also, by being recognized by the name PT.

Regarding the key success factors of PT, it is possible to underline some of the drivers that made PT a success in the Portuguese telecommunications market:



Figure 1: Key Success Factors

c) Who were the main competitors of PT? Were they interfering with PT's role in the telecommunications market? (6 minutes)

Before the spin-off, PT did not have a competitor that provided all the services that PT provided, although it had competitors in some business units. The competition in the market was more intense in mobile communications, since there were three big players: TMN, Optimus and Vodafone Portugal. The fixed communications and television services were mainly provided by PT. This means that, for PT, there were only important competitors in mobile communications and broadband, which leads to a conclusion: the valuable assets of PT were fixed communications and TV services, although the utilization of a fixed telephone was decreasing, because of its substitute, the mobile phone. Consequently, the main service of PT was Pay-TV, a service without an important competitor, and a service that was valued by the consumer, without a direct substitute. The next table had the objective to simplify what were the main competitors and in which services PT could distinguish from its competitors.









Company/ Service	Fixed Communications	Mobile Communications	Broadband	Television
Portugal Telecom				
Vodafone Portugal				
Sonaecom				

Table 1: Companies - Services provided

This analysis of the services can be confirmed, by the companies description in the Case Study. For Portugal Telecom the services are presented in page 4; for Vodafone Portugal, in page 12; and for Sonaecom, page 13. Among these three companies, PT is the only one that is a cable distribution network operator, which reflects the power of PT, being the only telecom company in Portugal with a cable network.

PT competitors were interfering with PT's role in the market in some business units. In spite of being the main provider of fixed network, mobile communications were growing, consequently destroying fixed communications. In fact, PT had important competitors in mobile and fixed communications, because Sonaecom and Vodafone may not offer fixed communications, but the mobile phones provide the same functionalities that fixed telephones provide and even more. In this way, PT had relevant competitors in fixed communications, even bigger than in mobile communications, because fixed communications business was losing importance, as a business itself, not a specific problem of a company, but a problem of the business.

Assignment Question 2: What was the importance of Zon Multimédia in the market?

a) What were the drivers for the spin-off? What was the impact of the spin-off in the market? (6 minutes)

Following the interpretation made in the previous answers, before the spin-off the market was mainly composed by three companies, Portugal Telecom, Vodafone Portugal and Optimus (from Sonaecom). However, Vodafone and Optimus were mainly focused in mobile connections, which lead us to conclude that the fixed network was mostly concentrated in Portugal Telecom.

With this, it is possible to analyze some drivers for the spin-off:

- PT owns the cable network
- PT was the major provider of fixed communications and Pay-TV services
- PT was present in every telecommunications business
- The power of PT in the telecommunications market turned PT a monopolist
- Lack of alternatives for the consumers
- Difficult to enter the telecommunications market
- To stimulate the market
- Growth of innovation
- Price competition and product competition

- Hostile take-over bid from Sonaecom
- PT Multimédia was making some resistance for the creation of MEO

All these drivers turned into good reasons for the separation of Portugal Telecom and PT Multimédia, with the hostile take-over bid launched by Sonae being the big step to start all the process for the spin-off. As it is mentioned in the Case Study, Henrique Granadeiro, the former CEO of PT, agreed that the spin-off brought more competition to the market, moreover in the annual report of 2007 he quoted “The spin-off was the major driver for the liberalization of the telecommunications sector in Portugal” (Case Study – page 6).

With the spin-off, Portugal Telecom and PT Multimédia turned into two independent companies. PT Multimédia was now TV Cabo, the main provider of television services, with Pay-TV services being most valued asset. However, with the spin-off there was a huge impact in the market. Not only good things came, but also bad things. Of course, it was good for the market because the competition increased. With two big companies in the market, there are more alternatives for the consumers to choose. In fixed network services, they are no longer restricted to Portugal Telecom.

But, as it was analysed before, before the spin-off, the most valued asset for PT was television services, because internet and mobile communications were provided by other companies besides TMN, and fixed communications were no longer a valued service by the customer, as mobile phone was indirectly substituting the fixed telephone. Without PT Multimédia, PT will be at a disadvantage, because saying that PT Multimédia does not belong to PT anymore, is the same to say that PT does not have television services, the services that are the most important for the consumers. In this way, the impact of the spin-off was negative for PT, because without television it lost its clients in TV services. And probably if Zon extended its services to fixed communications, PT would lose a big part of its clients, decreasing the size and the revenues of the company. PT would lose importance in the communications sector, unless it figure out a new strategy to prevent that effect. On the short run the market kept the characteristics, with PT being the big provider with some services, but in the long run the competition will increase in one market segment, TV.

b) What are the advantages of Zon that could be analyzed as a threat for PT? (7 minutes)

With the separation between PT and PT Multimédia, PT multimedia changed the name for ZON. With this, Zon is identified as a new company, independent from PT. Now, Zon has the principle asset of PT, TV. And this is the biggest advantage of Zon, because not only Zon has television services, but also Zon left PT without television services, the most valued service by the consumers. In exhibit 6 it is possible to analyze the most valued attributes by the consumers. The attributes that were identified as the most important were TV, broadband, brand, fixed (excluding price), more than a half of the interviewers referred TV as most valued attribute. It is also important to mention that only 7% valued fixed network more than the other attributes. Regarding the type of offer to the consumers, 73% of the clients prefer to have telecommunications services in bundle, more specific, triple-play, the offer that provides internet, television and fixed communications in one bundle.

In spite of the power, the history and the size of Portugal Telecom, at the moment that Zon appeared in the telecommunications market, Zon was identified as the biggest competitor of PT. If PT stayed with its current services, probably the power of Zon would destroyed PT. Zon had several advantages comparing to PT. Zon had a contract with PT to use its cable network. Obviously that PT is the owner and that is a huge strength of PT, but once Zon is using it, it is a threat for PT. In 2008, Zon launched its triple-play offer, being able to provide in the same bundle internet, fixed telephone and TV services to its clients. As it was referred before, triple-play offer was considered a valued attribute for the consumer. Being the old PT Multimédia, Zon has the advantage about the knowledge of the market and its clients. Zon knows what kind of programs clients like, what kind of services customers adhere more, how to provide a television service. Zon could also have some bargaining power with new channels, because it has presence in the market and is recognized as the television provider.

Another advantage of Zon is the benefit of network effects. After the spin-off, Zon was automatically the leader in the Pay-TV market, being in a favorable position, because Zon had the monopoly in the Pay-TV market. If customers give more value to TV services, with the triple-play offer it is supposed that clients that had fixed network

services in other companies, like PT, will change to Zon. Because with Zon, clients could have a complete bundle, where Pay-TV belongs. So, Zon could benefit from this network effect, with clients being more oriented to its complete offer, not only to TV. This network effect could also be observed by the fact that Zon could benefit from its number of TV consumers, since the switching costs to change from Zon to other companies could be higher. For example, the cost of the new installation could be interpreted as a direct cost, and an indirect cost could be the fact that the customer would need to change its telephone number.

c) Not being a leader in the Pay-TV market, what kind of path should PT take? (7 minutes)

Mainly, since 2004, the profits from PT started to decrease. That could be interpreted as a signal of less use of fixed telephones, as it was referred before. In exhibit 1 it is possible to observe the differences in the EBITDA: in 2004 the EBITDA was 1.325.475.763€ and in 2007 this operational result was 915.711.783€, decreasing from year to year. This means that between 2004 and 2007 the EBITDA decreased 30,91%, with the highest decrease between 2005 and 2006, 24,32%. As it can be observed in exhibit 3, the operating revenues from wireline had significant decreases in voice services, declining 15,31% between 2006 and 2007. Another option that can be raised in the class to justify this bad moment of PT, is the number of big competitors that provided mobile phone services, TMN (from PT), Vodafone Portugal and Sonaecom. If there are several dominant players, probably the revenues of each one will decrease.

In the classroom, two main options for Portugal Telecom could be discussed: stay with the current services or go ahead with something different. For the first option, PT could have benefits:

- Big company
- Principle owner of the cable network
- The structure worked, because of the previous experience
- Present in three principle services: internet, fixed and mobile communications

- International presence
- Zon was already the leader in TV services, so PT would not have the risk to make a huge investment in TV services that was not worth it
- Could improve its current services, do what it knows best
- Zon had all the clients from PT Multimédia

Basically PT could benefit from its current situation of a big company already established and recognized in the market. But, staying in the same situation could be a serious problem for PT, because PT could not predict that customers would keep some services with PT. In case of no response from PT, the company with no Pay-TV services would put itself in a very dangerous position, highly unlikely to survive in future. Even if PT survives to this strong position of Zon in the market, perhaps the dimension of PT as a whole would have a serious decline. It is supposed that students in the class could conclude that this option was not the best, because PT probably would face serious problems to keep the company alive, and also students should understand that PT is one of the largest companies in Portugal, and the incumbent in telecommunications. So PT has the possibility to do something better, in a different business even if in the first years the results were not the expected.

Regarding the second option, go ahead with something different, it should be considered as the best option for PT. Moreover, this “something different” should be identified as an investment in Pay-TV services. In this way there are several options for PT that could be also mixed with each other: PT could retaliate with a similar Pay-TV service with lower prices; provide Pay-TV as a complementary service to its existing services, forming a bundle; create a unique service, that includes Pay-TV, that stands out through its quality and innovation. Other options could be presented by the students, but the main point is that Pay-TV must be included, because it is something that consumers need. As it was mention in the Case Study, “PT rapidly understood that customers were consumers of TV contents” (Case Study-page 5). Whatever the option of PT, this should include Pay-TV and could bring several benefits:

- Television is the attribute most valued by the clients
- Pay-TV is the major asset of Zon, that should be fought

- PT has the capacity to innovate in order to provide television services
- The management team of PT was from PT Multimédia, so they know what were the mistakes, what should be improved and what are the needs of the consumers
- If PT connects all its Portuguese companies, the power would be higher, because the employees would be working for PT as a whole
- Before the spin-off, PT was already testing MEO, a unique service of PT that would involve the PT companies and its services, that included a Pay-TV service
- The pressure in the market to innovate and to be better than the leader would be higher

With a Pay-TV service included, PT would be stronger to face Zon, the leader in Pay-TV services. Doing something different, PT has the opportunity to avoid the expected incontestable leading position of Zon in the telecommunications market.

Strategy Analysis (35 minutes)

Assignment Question 3: What are the reasons for the creation of MEO? What are the characteristics of MEO and how will it change the strategy of PT?

a) What were the reasons for the creation of MEO? (7 minutes)

The telecommunications market in the end of 2007 was very fierce, and the challenges for PT were significant. In this phase there was a restrictive regulatory environment for the incumbent, in this case PT, because the spin-off had the objective to liberalize the market, consequently to diminish PT influence in the market. There was also the problem of the fixed-mobile substitution and strong cable competition. The wireline revenue was decreasing, and there were three big players in mobile communications, TMN, Vodafone and Sonaecom, so the clients were distributed by these three.

Although the idea of creating MEO was before the spin-off, so PT probably was expecting to run out of TV services. But analyzing the period after the spin-off, the creation of MEO could be interpreted as a reaction for the triple-play offer by Zon. With MEO, PT provides to their customers a bundle of telephone, internet and TV.

MEO had the objective to be a unique service of PT, where innovation plays the main role. Besides fighting Zon and also fighting for the survival of PT in the market, MEO wants to go deeper, adhering the needs of the customers and improving television services. The brand MEO is created as an innovative interactive brand within PT. Its image is shaped around the very own feature of the service itself, mainly TV contents.

TV contents have an imperative place in the telecommunications market. Without a direct substitute, with the lack of offer by communications companies and with the importance for the consumers, there was no doubt that Pay-TV was the more attractive attribute in the market, not only for the customers, but also for the companies. The TV contents were so important because it was widespread through the population, highly valued by the consumer and with plenty of room to improve the service, contrary to the fixed telephone.

To build MEO, organizational changes would be required. The companies that worked in parallel until now would be more connected than ever. The creation of MEO would link PT companies, because with a bundle offer, companies would need to have the same objectives, since now its services are together. This could also be interpreted as a reason for creating MEO. Without PT Multimédia, PT was weaker and more vulnerable, and the union of the companies would give more strength to PT.

b) Who were the protagonists of the creation of MEO? In terms of organization, what changes did PT suffer? (5 minutes)

The main protagonists for the creation of MEO can be easily identified in the Case Study. They were Vera Pinto Pereira and Manuel Rosa da Silva. Vera Pinto Pereira was the Director of MEO, and she was from PT Multimédia, where she had occupied the position of TV service director. So working with TV services once again, it would be supposed to be easier than the first time. Manuel Rosa da Silva also worked for PT Multimédia, and now belongs to the Executive Committee of Portugal Telecom. Both of them were highly involved in launching MEO. Also, the CEO of Portugal Telecom can be interpreted as a protagonist because he was the CEO of PT Multimédia and in 2008 was announced as the new CEO of Portugal Telecom. He brought with him a big part of the management team, which is a benefit for the creation of MEO. Zeinal Bava was

described as a visionary, always concerned with innovation and what was the best for the company and its employees.

In terms of what was their opinion about the path that PT should follow, the opinion of Vera Pinto Pereira was clearer, but is also presented the opinion of the PT management team. For Vera Pinto Pereira it was clear that PT had the capacity to build MEO, adding that “We didn’t want to create a television service similar to PTM with fewer mistakes; we wanted to create something different” (Case Study – page 9). In spite of having the know-how, PT rapidly understood that it was not a simple television service that was going to make the difference. This service needed to be unique to compete with Zon, and also with telecommunications globally. PT wanted to go further and make the difference in the telecommunications market. For PT the future was home entertainment, because the consumer valued television services, and something different above the normal TV service must be created.

At an organizational level, PT suffered several changes. PT was composed by four main companies, PT Comunicações, PT Prime, PT.Com and TMN (exhibit 2). These companies used to work in parallel, only linked by the fact that these companies belonged to the same holding. But with MEO, all these companies would have to make efforts to turn MEO into an enormous success, as it was referred by Vera Pinto Pereira “All the teams were prepared to sell MEO” (Case Study – page 9). The management team changed and also the organization of the company changed. In this way, it was fundamental the role of Zeinal Bava, a visionary CEO, concerned with all the problems of the company and also with what is the best way to link the companies to create an incredible force in the telecommunications market. Ana Dias mentioned “More than a product, this was a huge organizational change” (Case Study – page 8). The areas that suffered more challenges when creating MEO were operations, product management, customer care and the call center. The big concern of MEO was the quality of the product, whether the product would be the correct for the consumers and how to spread the word, in order to be clear for the consumers, what were the characteristics, the conditions, and the fact that PT would be present if the consumer had any problem.

c) In face of a competitor that leads the Pay-TV market, what were the advantages of PT to create MEO, comparing with its competitors? (6 minutes)

With the spin-off, Zon immediately acquired the leading position in the TV market, being the provider of Pay-TV. In exhibit 10, it is possible to observe that over the years TV Cabo/ Zon had been the leader with more than a half of the cable television subscriber market. For instance, in 2007 the share was 74%. PT was facing a big challenge, without a big competitor in the market for many years. Now Zon rapidly turned into a dominant player, and consequently, a threat for the survival of PT. But, with the strategy of creating MEO, it might be possible for PT to have success, because MEO is not a simple product where the consumers watch television. MEO is a new product that involves a new organizational change, where the need of the consumers is the priority, which creates room for an innovative product. In the following list some competitive advantages that PT could have for the creation of MEO are presented:

- Trustworthy company, with many years of good service in telecommunications
- Huge number of clients in fixed network that could migrate to MEO
- Cable network from PT
- Pressure of the market to create a new product with television services
- Know-how of the management team
- Interactivity of MEO
- Innovation
- Dimension of the company
- Pilot version of MEO – everything was tested before the official announcement of MEO
- The possibility to integrate TMN services in the bundle, “quadruple-play”
- Capacity to launch triple-play
- Marketing and advertising power of PT
- Incumbent in telecommunications in Portugal

Another competitive advantages could be presented in the class, but the main point is that the students should understand that PT should do something better than a simple

television service as it was presented by TV Cabo and what are the competitive advantages of PT that could lead PT to this main point. Launching MEO is a risk for PT, because as it was previously referred, Zon was already the leader in the Pay-TV market, forcing MEO to have characteristics that added real value. Something that could improve telecommunications services as a whole.

d) What were the main characteristics of MEO to attract customers? Should we consider innovation as priority for PT? (7 minutes)

MEO will offer to the consumers a triple-play offer, where they will have the opportunity to have fixed telephone, internet and TV in the same bundle. This kind of offer was already launched by Zon. With the contract with Portugal Telecom to use the cable network, Zon was able to launch fixed network and TV. In spite of being without television services, PT had the capacity and infrastructure to create a TV service. The major challenges in MEO would be in the television component. TV is the most valued attribute by the consumer and is also the service where significant changes could make the difference in service. For example, companies could increase the internet speed, provide free calls between fixed telephones, but these changes are not relevant for some consumers. The fixed telephone could be substituted by the mobile phone, and some consumers did not care about the internet speed; if the internet works, everything is ok. But for the television services, there are some characteristics that PT noticed that are important for consumers, which could improve their way to watch television, or even improve their lifestyle. The needs of the consumers can be identified through the characteristics of MEO:

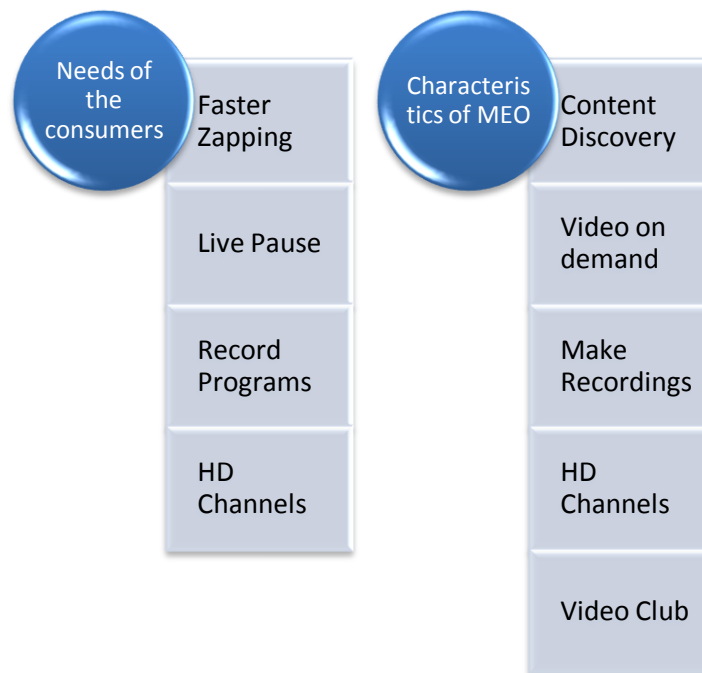


Figure 2: Characteristics of MEO

With these characteristics MEO has the objective to satisfy the needs of the consumers, in an innovative and interactive way. Basically MEO provides an opportunity for the consumer to choose what he wants to see without “damaging” his routine and lifestyle. The innovation for TV services provides the possibility for the consumer to control what, when and how to watch TV. The free installation and first monthly fee could be an attraction for the consumer, because the switching costs are minor. It is important to point out that the High Definition would be only for some channels where PT thinks that is appropriate to have better quality in order to improve the experience of the consumer.

There is also another attractive point for MEO: the campaign to launch MEO would be with a famous humorist Portuguese group, Gato Fedorento, a regular presence in the TV because of their episodes of comedy. To better understand this campaign to attract clients, the instructor could use in class, the video of the first episode for MEO, launched in the 2nd of April, the launching of MEO:

<http://videos.sapo.pt/vitor>

The role of innovation for PT could be considered a priority, because PT is always concerned to address what are the needs of the consumers, what are the trends. We

can consider that PT is always one step ahead from the other telecommunications companies. With MEO, PT is able to provide the four main services: internet, television, fixed telephone and mobile phone. The effort that PT put in its services is amazing: between September 2007 and April 2008, PT scaled up all the technology around the country to have the conditions to provide MEO to every single person. Also, the management team had the capacity not to make the mistake to create a television service with less features than TV Cabo television, but had the courage to reinvent the experience of watching television, the so called home entertainment.

e) What kind of benefits could PT take from network effects and bundle offers? (5 minutes)

PT is a telecommunications company that provides services to improve the connection of the consumer to the world. There are some network effects that PT could benefit from. For example, regarding the television service, there are some channels that would be only transmitted for clients that subscribed to MEO; thus if it is a sport channel from a football club, probably the fans of the club would prefer to adhere to MEO. It is also possible to find network effects in the Video club, in the way that if the films/series/TV shows provided increase, the value of this platform will increase, and the consumers would find more value in the Video club, because they will be able to pay for a bigger network.

Another option that could be presented in the class is the 'quadruple-play', with MEO. PT would be able to deliver internet, mobile phone, fixed telephone and television in a bundle. At the moment PT is only launching triple-play, but TMN is a company from PT, so PT has the conditions for one day to launch the four big services in the telecommunications market. However, this did not happen yet. It is important to interpret this fact, because MEO could be a strategy to be the most complete telecommunication company in the Portuguese market. And, here the network externalities will play an important role, because if the number of users of this 'quadruple-play' increases, the company will benefit from this increase, because the communications between each client would be easier.

f) What kind of technology was PT using? Can it be seen as an advantage? (5 minutes)

In terms of technology PT had a big advantage from being the owner of the cable network. Consequently for PT it is easier to innovate. PT was the owner of the cable network for many years, so it is easier for them to adapt to new technologies, because they are in the market since 1994. The network that PT used to distribute Pay-TV was ADSL (asymmetric digital subscriber line), that transmits high volume data over traditional phone lines. But PT wanted to provide its services over a better technology, IPTV (internet protocol television). IPTV was first tested in June 2007, because PT was trying to create MEO and test everything in order to choose what could fit better its higher-quality services. IPTV was first tested in Lisboa, Porto e Castelo Branco, in a pilot version of MEO, offering the triple-play. At the end of 2007, 21 thousand clients had MEO.

IPTV was a technology defined as a 'digital television service available over fixed telephone line, through a broadband connection' (Case Study – page 7). PT scaled up all the IPTV technology around the country between September 2007 and April 2008. To be sure that MEO could be present in every single Portuguese house, PT complement its IPTV technology with satellite, more specifically Direct-to-home satellite television (DTH), that was used to provide Pay-TV services in areas that were not covered by Hybrid Fibre Coaxial networks (HFC). With the utilization of these two technologies, it was possible to complete each other, and in 2 of April, PT could launch MEO with the guarantee that everyone could access it. IPTV was served over a platform named MediaRoom, that is described in the Case Study as a "new platform that integrated several multimedia capabilities, such as a multimedia applications environment for the development of interactive services and advanced applications such as digital terrestrial television (DTT)" (Case Study – page 7).

The utilizations of these technologies must be seen as an advantage, because PT is concerned to deliver MEO to everyone. It is something that should be valued, because PT is not concerned to launch rapidly a TV service, but is worried to provide a different product with all the conditions to be launched in the market.

In order to improve the quality of its technology, PT is participating in a contest to launch DTT in Portugal. More specifically, the contests were Multiplexer A (Mux A) and Multiplexer B to F (Mux B to F), to transmit open access channels and Pay-TV channels.

Predicting the future (15 minutes)

Assignment Question 4: How will the market respond to this fierce competition?

a) Are the expectations for MEO going to be consistent with reality? What could be improved in MEO? (5 minutes)

For PT, MEO is the strategy to face the problems of its businesses and is also an opportunity to create something unique, because with the situation that PT was living, PT needed to adapt, needed to take the risk to take a step forward.

PT believed that in 2 years after the launch of MEO, MEO would reach 200.000 clients. Students can analyze 4,5% the growth rate of TV Cabo clients from Zon: in the end of 2007 Zon had 1.547.000 clients. Being the main provider of TV services, students can assume that the growth rate of MEO would be similar to 4,5%. Assuming this hypothesis the number of new TV Cabo clients is 66.617 a year.

Number of clients 2006 Zon= $1.547.000/1,045=1.480.383$

Number of new clients in 2007 Zon= $1.547.000-1.480.383= 66.617$

So in 2 years it is possible to expect $66617+66617$ clients for MEO, 133.234 clients. This number is below the expectations of PT. However, it is important to understand that MEO is a new product in the market with attractive characteristics. Using the growth rate of TV Cabo clients, the minimum number of reached clients in two years would be 133.234. But, probably the number would be higher than the expected by PT, because MEO would have attributes that would attract more clients than Zon. The rate used was from TV Cabo because TV is the main attraction. Triple-play is an offer that satisfies the consumer, but TV services are the big advantage of PT, which makes a different product. In the following list some features are presented that could be added to MEO, in order to increase its value for the users:

- Join mobile communications to the triple-play
- Share records with other users of MEO
- Increase internet speed
- Unlimited calls for any number during the night
- Connect the box with the computer, in order to be able to watch the records and to have access to the Video Club
- Create a platform with games, where it is possible to play with other MEO users

b) What kind of retaliation will Zon have, and what were the consequences in the future? (5 minutes)

Being an intense market with two dominant companies, with the official announcement of MEO in the market, some retaliation was expected. For PT, there are two main possibilities for the retaliation of Zon:

- Product differentiation
- Price decreasing

For Zon it will be difficult to differentiate the product, because the TV platform of PT is more developed and Zon TV platform did not have all the functionalities that MEO had. So to follow the first hypothesis, the internet speed might be a way for Zon to retaliate. Of course Zon could improve its platform TV, but MEO would be one step ahead, so the more realistic threat could be the internet speed.

In terms of price, Zon could decrease its bundle price, and this would originate a fierce competition in the market, because when delivering similar services, the price would be an important component with an impact on the consumer choice. This price versus product competition probably will increase the product offer for the same price. As Vera Pinto Pereira stated: "Exploding the market, decreasing prices and increasing products" (Case Study – page 11).

c) Is MEO the best option for PT? What is the strategy that PT and ZON are following? (5 minutes)

As it was referred earlier in the teaching note, MEO is the best option for PT. If PT stayed with its current services, probably a big part of its clients would move to Zon. And without the most valued service by the consumers, PT could decrease its size and power in the market, facing the risk of disappearing.

MEO would also be a risk for PT, but it is important to notice that PT had the capacity to innovate and go big. PT is not prepared to be the second choice or to disappear. MEO is the best option for PT because it is an innovative and interactive product, which will stand out in the telecommunications market. MEO also implies an organizational change that will join all the companies and the employees, which gives more strength for PT, since now all the PT companies are concerned with each other.

Regarding the strategy that PT and Zon are following, the instructor should present the table below, in order to give a better understanding of the strategy that this companies are following. PT and Zon are similar companies offering triple-play to its clients and the competition between these two companies will increase for sure in the future. If PT had something to its offer, Zon will do the same or if Zon decrease prices, PT will do the same. Both companies want to satisfy a broad target, every single house in Portugal, but following some differentiation. Zon advanced in the triple-play, and something could have been done by PT before the spin-off. And PT is trying to launch a product, MEO, with different characteristics, which is adapted to the needs of the consumers. According to the three generic strategies, it could be considered that PT and Zon are following the Differentiation Strategy.

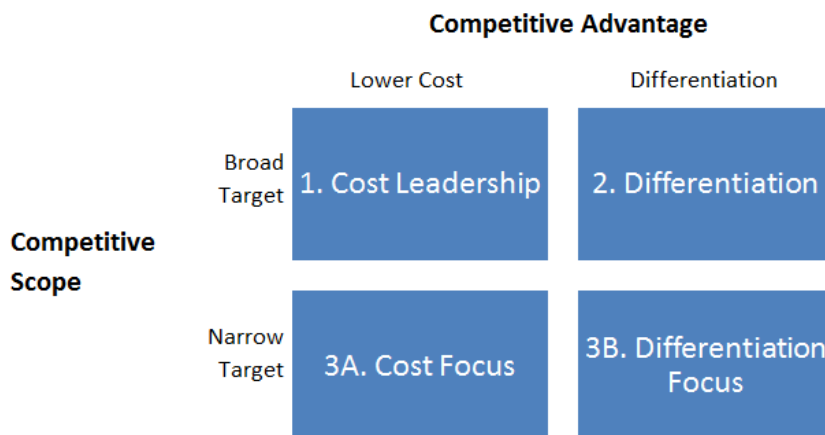


Figure 3: Three Generic Strategies

Source: Competitive Advantage: Creating and sustaining superior performance; Porter, Michael; 1985

Recommendations

The main recommendation for MEO is to continue to invest in innovation, because MEO presents different features that cause impact in the consumers' choice. Innovation played an important role in the creation of MEO, so it is important that PT keep this focus on innovation, on what can bring more value for the consumer. With a competitor like Zon, PT should not be only focused on price and or having the same bundle of Zon. Of course, the type of bundle that Zon is offering is essential, studying the market is always a relevant task, but what gives value to MEO is that PT took the risk in doing something different, and that is what attracts consumers because they see their needs satisfied.

PT should follow this path, because PT is a big company with the capacity to invest in new products and in innovation. Although, PT should be aware that the market is different, the competition is more intense and more obstacles will appear. PT should understand that the history is not everything, the present should be faced, and MEO is an important step to fight the weaknesses of PT.

In what the product is concerned, my recommendation for MEO is that the exclusive channels for MEO, should be important channels, not only 'one more channel'. MEO should look for channels that could make the difference for the consumer. For example, a football channel in Portugal is crucial, because football is the most important sport in Portugal. On contrary, exclusive channels with TV series might not be so relevant, because it is easy to watch them on the internet, so it will not make the difference on MEO.

Regarding the VideoClub, it could be improved. For example, MEO could offer some promotions to its clients, for example if you rent 5 movies for month you get one for free. This kind of promotions could engage the consumer with the product, because they would feel rewarded in some way.

What happened next?

In April 2008, PT launched MEO to the public, and since then MEO has become a success. The success of MEO was better than what was expected. In the following table the number of clients acquired, after 2 of April is presented. It is important to

remember that PT expected 200.000 clients in two years, and PT reached 200.000 clients in 6 months.

Time after the launch	Number of clients
6 months	200.000
12 months	315.000
2 years	600.000
3 years	800.000
4 years	1.000.000

Table 2: Number of MEO clients

In spite of all the risk that PT suffered, MEO was very successful, and the public received MEO better than what was expected. Reaching 600.000 clients in two years, is a huge achievement for PT. Between 2006 and 2007 the number of new clients of Zon was 66.617, and PT achieved 315.000 clients in 12 months, which represents the enormous success of MEO and what MEO could achieve in the future.

MEO had developed several things that turned MEO into more than a TV service. In August 2008 MEO signed with the Portuguese football club, Benfica, to launch the sport channel Benfica TV. MEO would be the only operator to transmit its channel. This is the first football channel in Portugal, while other football clubs had already launched their channels, like Chelsea, Barcelona, Inter Milan, Manchester United and Real Madrid. Benfica is the biggest football club in Portugal, and all the football fans were waiting for this channel. Benfica TV will be broadcast through IPTV and Satellite. Benfica TV can be considered as another factor of differentiation of PT.

In April 2009 MEO launched MEO Kids, which is an interactive service. MEO Kids has exclusive contents which are adapted for kids. MEO Kids is available for free in the main menu of MEO, to every clients of PT television service. MEO Kids is mainly oriented for two publics, children between 4-6 and between 7-10, the contents adapted are mainly in these areas: television, VideoClub, Music, Sports, Discovery and Play.

Regarding the technology used, PT launched the Digital Terrestrial Television (DTT) in April 2009. PT committed to launch DTT, and gave the guarantee that 40% of the

Portuguese population would have access to DTT. Besides having DTT at home, on the television, it will be possible to have DTT out of home, in the computer, in places that are covered by DTT, with a new TMN mobile broadband. This mobile broadband allows to watch the national channels by DTT, even if not connected to the Internet.

In June 2009, MEO offered some new functionalities in the mobile phone. MEO clients that were also TMN clients, could have access, in the mobile phone, to television programming. This new feature allows a faster zapping for the consumer and is also an opportunity for PT to converge its platforms. In December 2009, PT launched a new channel, SIC K, this channel is mainly oriented to kids between 6 and 11 years. SIC K results from an agreement with SIC (main channel), a national channel. This new channel contains several national projects and all the programs are translated in Portuguese until 9:30 pm. SIC K would be exclusive for MEO and supported by IPTV and Satellite.

MEO also was distinguished by 'Meios e Publicidade Magazine Awards', as the best brand in 2008 and 2009. In December 2010, it launched an application to have the 'MEO remote' through mobile phones and tablets, which is available in the Apple Store and Android Marketplace. With the connection with the Wi-Fi network of the MeoBox, it is possible to control the TV programs. In November 2011, MEO launched a multi-screen MEO experience, MEO GO. With MEO GO clients were able to have MEO in several screens inside and outside the home, with this innovation costumers have the possibility to watch and control their TV programs, with all the functionalities of MeoBox. The MEO experience could be extended to smartphones, tablets and computers through a broadband connection. This new service is only available for MEO clients and had the cost of 8€ per month.

In February 2012, MEO had a new feature that would increase its value MEO Kanal. This new feature enables customers to create their own channel in the green button of MEO remote. This new application allows consumers to edit, produce and share their MEO contents. This new feature was distinguished by The International Business Awards, in August 2012, in the category of the Best New Product or Service of the Year.

In January 2013 MEO launched M4O, which is an 'upgrade' of MEO. In addition to the normal bundle with internet, TV and telephone, with M4O mobile phone services will also be part of this offer. The cost of this new offer includes free mobile communications for all Portuguese operators.

MEO has developed several features in order to create value for the consumer. It has been a success since the announcement of MEO. The growth rate of clients increased more than it was expected. MEO was certainly the right path for PT.

In terms of market share, PT had a huge growth in the telecommunications market. As it can be observed in 2011 the total market share of Zon was 42% and the market share of PT was 38,3%, very close to Zon. In spite of the spin-off, with MEO PT attracted clients and also gained a huge market share in triple-play, 39,7%.

2011	Multiple-play (total)	Double Play	Triple Play
Zon	42,0%	32,2%	46,1%
PT Comunicações	38,3%	34,8%	39,7%
Vodafone	4,3%	9,5%	2,1%
Optimus/ Sonaecom	3,9%	8,3%	2,0%
Other operators	11,5%	15,2%	10,1%

Table 3: Subscribers market share of services provided in bundle in the end of 2011

Source: State of Communications 2011, Anacom

In table 2 it is possible to observe that PT is the leader in 2012 in double-play and triple-play, with 42,9% of total market share, gaining the leading position. Also the market shares of Vodafone and Sonaecom decreased, due to the position of PT in the market.

2012	Multiple-play (total)	Double Play	Triple Play/ Quadruple Play
Zon	40,4%	32,6%	43,2%
PT Comunicações	42,9%	39,4%	44,1%
Vodafone	3,8%	7,3%	2,5%
Optimus/ Sonaecom	2,9%	5,6%	1,9%
Other operators	10,0%	15,1%	8,3%

Table 4: Subscribers market share of services provided in bundle in the end of 2012

Source: State of Communications 2012, Anacom

Conclusion

During this period of the development of the Master Thesis, it was important to me to work with a company like Portugal Telecom, one of the largest companies in Portugal with many years of history and learning. It was a “lesson” to me to understand that Portugal Telecom adapted to the needs of the market. PT could be comfortable with its position as an incumbent operator, but that did not happen. PT was aware of its problems and did not just try to solve them. PT went further and created something different, MEO, which would improve the consumer experience. It was also important to know the passion that PT workers have for MEO. It is perceptible that MEO was a huge risk in the beginning and the expectations were really low comparing to what happened. When I was talking to them it was easy to understand that they created the project from the beginning and even with the huge success that PT had they do not want to stop innovating. Innovation is one of the key concerns of Portugal Telecom and not only to outperform the competitor, but also to be better in understanding the needs of the consumer.

Nowadays, the telecommunications market is a very competitive market. It already was at the time, but this competition increased with the existence of Zon Multimédia in the market. Operators are able to do everything to attract more clients and to be the number one. This competition is important to stimulate the market. However the willingness to do more and more is also dangerous, because operators will copy or try to improve the products of each other's. Consequently, by intensifying the competition the price of the bundle will decrease, so each consumer will pay less. This could be reflected in the investment in innovation. If each consumer will pay less, the profit will decrease, so the budget for investment will decrease.

It is a very interesting market because of its dynamics and its capacity to innovate. Nowadays we have features in the television service that some years ago we did not even think of. But companies should be careful with the fierce competition; companies should not lose the focus: the consumers' needs.

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