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The Many Faces of Social Entrepreneurship II



Terra Searches for its Identity

In May 1998, Telefónica, the largest Spanish [telecommunications] firm and one of the most important telecom firms in Europe and Latin

America, began to sketch the first outlines of Terra. Its goal was to build the largest Internet portal for the Spanish-speaking community. Two years later, that dream appeared to be fulfilled. The company had a presence in 42 countries and provided employment to more than 4,000 professionals. Moreover, it had managed to enter the U.S. and Asian markets, emphasizing Japan and China in particular, thanks to its purchase of U.S. portal giant Lycos.

In March 2003, however, Terra announced losses of 2.009 million euros. Revenues dropped by 9.98% to 622 million euros, and the operating profit continued to bleed red ink – amounting to losses of 120 million euros. To top things off, Terra's competitors appear to have found the path toward profitability.

The French portal Wanadoo, a subsidiary of France Telecom, was the first European portal to show a profit, with earnings of 30 million euros and sales of 2.075 million euros. Its German counterpart, T-Online, which is owned by Deutsche Telekom, soon announced a working profit of 103.5 million euros; it also cut its losses in half, to 459 million euros. Finally, Tiscali, the Italian portal, jumped on the bandwagon of profitability with a [positive] EBITDA of one million euros. Meanwhile, Tiscali reduced its losses from 1.664 million euros to 593 million euros.

What lesson has Terra failed to learn from its competitors? "[Terra] is a different business, because it is much more ambitious," says Enrique Dans, director of information systems and technologies at the Instituto de Empresa. "Clearly Terra has not known how to maintain a management model, while the rest of the portals have focused on clear goals that they have fulfilled little by little."

Like many other Internet projects, Terra has suffered some strong jolts since its creation. But the one factor that wound up making Terra lose its leadership was the lack of a well-defined management model. "In Terra, the strategy has kept on changing, and this has made it

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difficult for the company to evolve," notes Jordi Gual, professor at the IESE Business School. "Nevertheless, there is still time for Terra to be one of the major players because, in the end, there are only going to be four or five big portals."

The Management Shuffle

Throughout its short history, Terra has suffered from an ongoing rotation of managers. The first phase of the portal was under the direction of Juan Perea, who managed the company from 1998 until February 2000. Among his greatest achievements are the following: the purchase of Olé, the [Spanish] search engine; the launch of Terra on the stock market in November 1999; and the company's expansion into Latin America. Abel Linares took over from Perea and was responsible for unifying, under one brand, all the subsidiaries that Perea had purchased. Despite all the good feelings the company provided at the time – as it reached a high share price of 150 euros – Linares was swept aside by Joaquim Agut, who focused his efforts on cleaning up the company's accounts, even at the cost of choking off its strategic source of funding.

"Terra was the engine of the marketplace," says Dans. "It was the most innovative company and, at the beginning, it took steps with great success. For example, it was the first company to unify its sales force, and it devoted a large part of its efforts to building user loyalty because it was aware that the Internet access business was already in the middle [maturing] stages of development."

Terra's revenues come essentially from three businesses: Internet access, portals and advertising. T-Online, the German portal, has the same structure, while Wanadoo has expanded its range by offering electronic commerce and online directories. Meanwhile, Tiscali offers business services as well as [traditional] telephone service.

"When it comes to portals, Internet access is 'the meal of the past,' while online advertising is 'the meal of the present,' and electronic commerce is 'the meal of the future,'" says Dans. "Terra knew that the first step it had to take was to build the loyalty of its users through means of [Internet] access. Later, it planned to win them over with offers of online services and content. But, surprisingly, when it launched its ADSL (Asymmetric Digital Subscriber Line) broadband service in 2001, Terra did so at a higher price than [parent company] Telefónica did later on when it launched that sort of service. The logic would seem to have been the opposite."

Adds Gual: "Overall, the Telefónica group followed an appropriate strategy but Terra's management was changing so much that, in the end, Telefónica took advantage of its own network to provide Internet access and left it to Terra to act as the portal. There was a

moment when it was believed that a company could be on every front – in web access, in content preparation, in services, etc. But now, they have seen that it isn't possible. Now, Terra has to carry out this change in approach."

The case of Terra is not, however, an aberration. This entire sector has lived under an umbrella of trial and error, led forward by so many different executives. Yet for all these changes, management has wound up returning to its point of departure – banishing businesses such as online advertising, e-commerce and paid content. For example, T-Online has managed to make the Internet access game account for no less than three-quarters of its entire business with [revenues of] 1.58 billion euros. At Wanadoo, revenues from electronic commerce and portals represent barely 8% of total sales. At Wanadoo, Internet access accounts for 49% of sales and telephone directories comprise 42%. As for Tiscali, online business represents only 5.6% of total revenues.

Competing with Yahoo, Google

In the end, says Gual, "the big portals are going to convert themselves into 'aggregators' – that is to say, they will pick up various kinds of content [from elsewhere] and present them to users in an attractive way." He believes that this model will favor those companies that form part of a telephone company "because the [larger] group offers them great potential – above all, [access to] a large number of [telephone] customers. Moreover, they must be able to compete with other companies that have a very strong brand, such as Yahoo, or with businesses like Google, which began in a very specific niche and, little by little, have been widening their markets and gobbling up market share from traditional portals."

Dans suggests that [product] quality and customer relationships will be the factors that determine the future for the portals. "The straightforward portal, which doesn't think about relationships with users or about market share, doesn't have a future. These days, few people directly enter a portal; they prefer to move about through search engines. The more that people educate themselves about the culture of the Internet, the less they miss the portals."

Terra's strategy is precisely along those lines – to gain market share by building the loyalty of users and by giving them content with added value.

Given Terra's innovative approach, and the fact that it had a much stronger market presence than its competitors, why then are Terra's financial results so poor? Observers point to several reasons: On the one hand, Terra gave into the euphoria of spending millions buying out other companies, and that created a high level of indebtedness. On the other hand, Terra wound up turning its back on some agreements that it signed.

Finally, there is the strategy of the Telefónica group which, after the last change in its senior management, destroyed the autonomy of Terra's executive leadership.

The Question of Terra's Independence

To expand its network, Terra carried out an ambitious growth plan, branching into many new operations that wound up costing more than 75 billion euros. The most important of these was Terra's purchase of Lycos for 17 billion euros in June 2000. All these steps were taken during the days of total euphoria about the Internet. The agreement that sealed the Terra-Lycos merger came when Bertelsmann, the German giant, became a business associate of the Spanish company. That same fiscal year, Bertelsmann signed a contract to purchase services valued at one billion euros from Terra-Lycos over the course of five years. However, Bertelsmann only fulfilled the first 325 million euros of the contract. Then it refused to continue paying.

Another black mark on the Terra record concerns Integrated Device Technology, Inc. (IDT). At first, that American company was a partner of Terra's, but it became Terra's most determined enemy after the Spanish company broke its affiliate agreement. IDT then reacted by demanding millions of dollars in return.

The entire process of aggressive expansion took place during the period when Juan Villalonga headed Telefónica; he resigned his position in July 2000. Under his mandate, the Telefónica group, which had just become privatized, achieved higher levels of investment as well as new strategic alliances and agreements. Cesar Alierta, who took over for Villalonga, then revolutionized management by setting out to clean up its financial accounts. Did Telefónica, in general, or Terra in particular, give in to an excessive fondness for acquisitions?

"You can't say that it was a specific mistake of the Spanish company," says Wharton management professor Mauro Guillen. "In the Internet age, every company jumped into making acquisitions, something that was later shown to be a big mistake. I always say that it is easy to invest, but that the challenge is to make money with those investments."

Shortly after Alierta arrived, the technology bubble burst and Internet businesses began to acknowledge their strategic errors. "They created too many Internet companies and their margins were very low," Guillen states. "Moreover, they didn't control spending and, as a result, the companies were generating losses for the groups that they belonged to and for the funds that were financing them." Guillen now believes that Telefónica is on the right track with its current management turnaround. "Terra had to do something to contain its costs. Its new managers realized that margins were very low and that the only way they had to make money was to reduce costs. Until now, Telefónica has functioned as

if it were Terra's bank."

In order to carry out these cuts, Telefónica put an end to the independent management of Terra, its Internet subsidiary. In addition, to keep its Internet business afloat, Telefónica took responsibility for Terra's agreement with Bertelsmann. In practical terms, this new arrangement presumed the end of Terra's independence. The parent company was given control over strategy regarding commercialization of ADSL technology, and Terra now works exclusively for Telefónica on the design of all its portals. Analysts believe that, while this agreement means lower revenues for Terra, it will also maintain a fixed margin for Terra over a period of six years and lead to potentially larger revenues. "The organizational structure of Terra was too decentralized; this change can be a positive for the company," says Guillén.

Dans sees it differently. "In losing its independence, Terra is going to lose the true source of its inventiveness," he predicts. "I wonder if now is the right time to integrate Terra into [Telefónica,] the parent company. When Telefónica succeeded in its launch of Terra, it did that as an independent venture, so that Telefónica could navigate the new online world. Telefónica had a much less dynamic culture. It wasn't ready to adapt itself to the speed of change and innovation demanded by the Internet. Moreover, Terra's debut on the stock exchange was a big operation that led to important new revenues. The initial idea was to keep the subsidiary separate and let it mature – and then bring it back into the parent company. However, I believe that the process has been accelerated."

Wanadoo and T-Online also belong to telecommunications groups – that is, to France Telecom and Deutsche Telekom, respectively. "The German company will wind up absorbing its subsidiary, but the French company is not going to do that," Dans predicts.

Different Strategies, Different Successes

At first glance, Terra's history doesn't appear to be very different from that of its European competitors. Most of the companies have a telecommunications group standing behind them. Most were taken in by the euphoria of their corporate acquisitions, and most were unable to control their spending. Nevertheless, Terra is the only company in which the numbers in red ink continue to grow larger. Why is that? "The Spanish company's business plan was on a much larger scale, and manifested in many more services [than the competitors' plans]," notes Gual. "Moreover, it involved continually trying to innovate new products. In contrast, the rest of the companies followed a path that Terra marked."

However, the road hasn't been easy for either one of the other European [telecommunications] groups. Wanadoo has put into operation a plan to sell off subsidiaries.

Tiscali is barely managing to expand its revenues and, during the last quarter, T-Online doubled its losses, reaching 271 million euros.

Before achieving profitability, Wanadoo also suffered the consequences of its own high-priced investments. In December 2000, Wanadoo acquired Freeserve, the United Kingdom's main provider of Internet access, for 2.7 billion euros. During the same month Wanadoo landed in Spain, purchasing a telephone directory firm, Indice Multimedia, for 360 million euros. Wanadoo's final move took place last June, when the company bought the Spanish portal, eresMas, for 255 million euros. That operation marked the end of Nicolas Dufourcq's reign as president of the company and the arrival of Olivier Sichel. He has decided to focus on the French, British and Spanish markets while dismissing dreams of expanding throughout Europe.

The history of T-Online has also been written with a series of purchases and management changes. During the mandate of Wolfgang Keuntje, the company jumped into France with its purchase of Club Internet. Months later, in February 2000, it arrived in Spain with the purchase of ya.com for 550 million euros. But in December of that same year, Thomas Holtrop became president, following the brief stay of Detlev Buchal. Under Holtrop, T-Online has implemented a determined program of cost controls that is now beginning to bear fruit.

Tiscali is a special case. Born as the initiative of Italian entrepreneur Renato Soru, Tiscali's mission was to convert itself into one of the most important companies in Europe, so it launched a plan to buy companies throughout the region. Between 2000 and 2001, Tiscali acquired more than 25 companies at a price of 7.7 billion euros. One of the most outstanding was World Online, the German Internet service provider. After the resignation of managing director James Kinsella, Soru assumed control of Tiscali in February 2001 and implemented a cost-reduction strategy.

Despite the fact that the histories of these companies have features in common with Terra's tale, their size and goals make for some important differences, experts agree. These two factors – size and goals – may provide the key to understanding why Terra, the Spanish portal, has lost its advantage. "While T-Online has established itself as the foremost portal of the German-speaking world, Terra's ambition involves a much broader market – the entire Spanish-speaking community," notes Dans. "Moreover, in acquiring Lycos, Terra extended its tentacles to include the United States. You can't compare one situation with the other. Terra's situation is much more complicated. Tiscali and Wanadoo have focused all their efforts on Europe, so they also aren't comparable [with Terra]."

"Not every group is going to have a niche in the future.

Only four or five players will remain, among which the American companies will have to be counted," says Gual. "One of Terra's big mistakes was that it stripped away the potential of Lycos, which had a broad knowledge of managing [online] communities – one of the businesses with the most future on the Internet, in my view. The dismissal of its top management was a mistake because it lost all the know-how they had developed, as well as their line managers." Nevertheless, Dans is convinced that the Spanish company will be one of the survivors. "Telefónica will have to manage things very badly for it *not* to turn out that way."

The big groups that own these businesses will have an impact on the way they develop. "It is an advantage to be part of telecommunications firm because the parent company can provide a financial boost and can open doors to new customers," concludes Gual. "But the groups will have to redefine their focus when it comes to what place these [Internet] businesses wind up occupying in the overall strategy of their [telecommunications] groups."

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