Case Study

From Wood Panels to Mobile Phones: Strategic Diversification at Sonae Group

Jamie Anderson and Rob Goffee

This article tells the story of growth and diversification at Sonae, now Portugal’s largest company. Publicly quoted but still majority-controlled by its long-standing Chairman and CEO, Belmiro de Azevedo, it was founded in 1959 in the wood products business. It expanded from the 1980s to become the largest retail group in Portugal and has recently taken on the two incumbents in Portugal’s mobile telephony market. It won the third license auction in 1997 and achieved a 22% market share within three years. As the biggest part of Sonae’s technology investments, the move into mobile telephony played a big part in launching the Sonae share price on a roller-coaster path that has only recently steadied. The Sonae story illustrates the potential importance of long-term charismatic leadership and strategic vision by one person. It also provides insights into the factors that can help diversification to work.

“The analysts, the bankers, they all said we were crazy. Every third entrant to have tried to take on the established mobile network players in national markets in Europe up to that time had failed. They told us that we could only hope to have 30,000 customers at the end of the first year, and that we would never break even. But they underestimated the strength and drive of Sonae people.” – Belmiro de Azevedo, CEO and Chairman, Sonae SGPS.

Sonae was founded in 1959, in Maia, Portugal, in the wood products business and more specifically the production of high-pressure decorative laminates. During its first twenty years of existence, it developed as a small-to-medium size enterprise (SME), focussed on the area of wood derivatives. During the 1980s, it began to grow rapidly, coinciding with Portugal’s entry into the EU. During this period, Sonae diversified into retailing, launching the first hypermarkets in Portugal. The creation of Sonae Real Estate sub-holding in 1991 represented a natural progression, its main objective being the construction of shopping centres anchored on Sonae hypermarket stores. Sonae also invested in many other areas such as communication, information technology (IT), leisure and tourism.

From the early 1990s, Sonae examined other opportunities in the Portuguese market. It was involved with a failed bid for a TV station in 1989, and also failed to win the second GSM mobile telephone license in 1992. But the company remained interested in technology and telecoms, and was
committed to entering what it saw as an area of huge potential. With the third mobile license auction in Portugal in 1997, Sonae Chairman Belmiro de Azevedo, who still controls a majority of the Group’s equity, renewed his aspirations for the Group to move into this highly competitive sector.

This article tells the story of Sonae’s pursuit of diversification, with a particular focus on the Group’s move into the Portuguese mobile telephony market. The article provides lessons for any manager who is examining the challenges of strategic diversification, particularly into an industry or sector that has seemingly peripheral links to its current activities.

The Evolution of Sonae Industria
Between 1959 and the early 1980s, Sonae’s production of high-pressure decorative laminates naturally led to development in related sectors in Portugal, and to vertical integration with the production of wood-based panels and their export. The company also integrated vertically upstream in areas such as chemicals and resins. The business was aggressive in its acquisition of production technology and logistics expertise throughout the 1980s, and established itself as a high-quality low-cost producer in international markets. By the end of the 1980s, Sonae Industria had become the largest non-financial Portuguese private company. Early in the 1990s, it started production and distribution abroad, acquiring plant and other facilities in the UK, Spain and Canada.

By the mid-1990s, Sonae Industria had become the second largest producer of wood-based panels in the world (after Louisiana Pacific). By 2000, Sonae Industria had about 50 plants in 15 countries, with production capacity approaching 7.5m cubic metres per annum.

Strategic Diversification: the Birth of Sonae Distribuição
Belmiro de Azevedo, Sonae’s long-standing CEO, always passionately believed in Sonae’s destiny to become a leading European company. In a speech to 70 senior executives in May 1985 he defined a Sonae culture that would drive the Group to achieve this stretching objective (see box). But in the early 1980s, very few industries in Portugal were not under government control, and the possibility of privatisation looked remote. The retail sector, however, offered seemingly huge opportunities to a group with strong financial and management capabilities. As Belmiro de Azevedo put it:

“I was constantly looking for opportunities within Portugal during the 1970s and 1980s, recognising that there would come a point where our growth in the wood products area would naturally slow. But everywhere I looked, industries were government-owned – telecommunications and utilities for example. The one area that was relatively open to market forces was the retail sector. But until the early 1980s retailing in Portugal was highly fragmented, with thousands of small often family-owned stores selling food and household items. The modern retail concept had not yet emerged, and there were no major foreign competitors active in the market. This was an opportunity for Sonae.”

To gain the necessary expertise in the development and management of retail stores, Sonae entered a majority joint-venture arrangement with Promodes, a French hypermarket chain. Sonae Distribuição, established as a sub-holding of Sonae SGPS, opened Portugal’s first hypermarket in 1986. By 1990, in the absence of significant local or international competition, it had emerged as the market leader in food retail in Portugal.

By the mid-1990s, the company operated Continente hypermarkets, Modelo mini-hypermarkets and Modelo Bonjour supermarkets. Seeing developments in some other European markets and the US, the company also moved into the area of specialised retail businesses before the entry of foreign competitors. This contrasted with long-established generalist chains in mature markets, such as Woolworths, which reacted slowly and saw their market shares erode as new retail formats captured consumer interest. New retail ventures included Worten (consumer electricals and electronics), Modalfa (clothing), Maxmat (building...
Sonae Culture, 1985

- Sonae refuses to regard itself as a conglomerate but rather as a group of small-and-medium size companies, linked together by common business strategies.

- Sonae believes in the decentralisation of decision-making through fully responsible managers as an overriding condition for efficient running of businesses, the motivation of senior managers and professional career development.

- Sonae accepts that management control, financial co-ordination and centralised auditing will be the cement which turns a group of companies into a true business and economic entity of national importance, and whose prestige will be recognised by financial institutions, official organisations and the Government.

- Sonae decides unequivocally to seek the greatest possible number of leaders, will develop professional training opportunities and will give overall management responsibilities to ever-younger managers.

- Sonae also unequivocally decides to hire employees with the best possible training, retrain those who wish to do so, in order to get as close as possible to the ideal of using the full intellectual capacity of the entire workforce.

- Sonae commits itself to following a policy of management excellence, seeking demanding objectives of quality, productivity, innovation, and competitiveness, thus accepting the challenge of market globalisation.

- Sonae refuses the comfort of a “rich” company, a comfort that softens and corrupts an organisation. Even those companies that generate substantial profits have to maintain rigorous control over costs, a critical selection of projects, a professional analysis of business decisions, and rapid action to correct variances.

- Sonae believes that diversification is the appropriate business model to follow at both a national and international level. It knows that this demands the right human resources policy to allow rapid action by versatile managers in less well-known business sectors.

- Sonae will be totally transparent with its business partners (customers, suppliers, banks etc) because it believes that an atmosphere of mutual trust brings long-term benefits that easily outweigh any short-term easy profits.

- Sonae decides to be a company for Europe, for markets, for the twentieth century. It will progress towards the concept of a modern company, open to investment opportunities, tending towards greater diversification, and looking to be an important economic and financial force which will contribute to quality, and increase the wealth of Portugal.

and DIY), Sportzone (sports equipment) and Vobis (computer equipment).

After a small initial exploration of the market undertaken from 1989, full-scale expansion to Portuguese-speaking Brazil commenced from 1997 with the acquisition of a hypermarket chain, and two smaller supermarket chains. Within two years, Sonae Distribuição had emerged as the third-largest food retailer in Brazil.

In 1998 Sonae Distribuição achieved annual gross sales of more than €2.5bn ($2.9bn). It operated more than 200 retail outlets in Portugal and over 100 in Brazil. The group was a clear leader in food retail in Portugal, with a market share of more than 40% of hypermarkets and supermarkets. At the same time Sonae Distribuição had become a leader or near-leader in the most important specialist retail areas where it was present.

From the start, Sonae Distribuição sought, under the close guidance of de Azevedo, to provide consumers with the best value for money in a market that had been dominated by local cartels and high prices. According to one senior executive:

“You should not underestimate the power of the Sonae brand here in Portugal. Yes, we have been very profitable with our retail ventures,
but we have always sought to offer value, convenience and quality to our consumers. By the mid-1990s the entry of Sonae to any retail segment was met by a customer perception that we would disrupt the status quo and provide exceptional value for money. Our CEO (Belmiro de Azevedo) has always been seen as a champion of the consumer.”

Despite being the first mover in a highly-fragmented retail market, Sonae Distribuição was not complacent. It developed a value-added strategy throughout the 1980s and 1990s based on a combination of high growth rates and major investment in the development of business processes. The business built strong competencies in the areas of retail marketing, logistics and distribution. In addition to drawing on international best practice in these areas, it also worked to develop a wide knowledge of local consumer behaviour.

In support of its retail sub-holding, Sonae headquarters became heavily involved in the professional development of managers in the retail businesses, sending executives to study on MBA, marketing and general management programmes at international business schools in the US and Europe. This process formalised an educational approach that had been part of Sonae’s culture for many years.

Over this period, another important role for the headquarters, and for de Azevedo himself, was ongoing identification of new business opportunities and facilitation of resource-sharing across Sonae businesses. The CEO was instrumental in implementing what would become known as the “Zig Zag” career process within Sonae, taking an active role in moving senior managers between different businesses within the group.

A Natural Progression: Sonae Imobiliária
Sonae’s next diversification was opportunistic. As the Group increased its hypermarket presence, it quickly realised that profitability in many areas would be limited by the need to achieve economies of scale in support infrastructure such as parking, road access, utilities and so on. Unlike many of the more developed countries in Western Europe, little infrastructure was provided by local or national authorities to promote economic development and the construction of retail locations. Says de Azevedo:

“Due to the very high fixed costs of building hypermarkets in Portugal we needed to seek ways to spread our investment and maximise the utilisation of our locations. We came up with the conclusion that this could be best achieved by locating our hypermarkets within shopping centres. Of course, we also saw another opportunity – to be the first to introduce this modern concept to Portugal.”

In 1991, Sonae Imobiliária, the newly-established shopping centre development and management business within Sonae Group, inaugurated CascaisShopping, the first regional shopping centre in Portugal. With one new shopping centre opening per year on average, Sonae Imobiliária soon became the dominant developer, owner and manager of shopping centres in Portugal. These became the natural base not only for Distribuição’s hypermarkets, but also the launch platforms for the Group’s diversification into specialised retail formats. As a first mover, Imobiliária had enjoyed many advantages including access to prime locations and low marketing costs. By late 2000, Imobiliária was the owner or co-owner of nine shopping centres, three shopping malls and a retail park in Portugal. The company’s facilities hosted more than 200 million people-visits per year, having under management 2,525 letting contracts for shops and storage space. The business also diversified into car parking management, and embarked on a series of shopping centre projects in Brazil, Germany, Greece and Spain. Total turnover of the activities of management and letting in Portugal alone was over €165m, while the net asset value (NAV) of the entire property portfolio attributable to Sonae Imobiliária (excluding the part attributable to Imobiliária’s partners) was more than €750m.

A Changing Role for Corporate Headquarters
Initially, when Sonae was limited to the stand-alone wood products business, its headquarters had functioned as an operator of its core business. As the company diversified into retail businesses, the corporate headquarters adopted a strategic planning role. This role changed again from the mid-1990s as its main industrial and retail businesses matured, and headquarters moved from strategic planning to strategic control.

In 1996, the new challenge of international expansion led to all businesses of Sonae Industria being taken
out of the holding company. Known at that time as Sonae Investimentos SGPS, this became totally dedicated to the retail business. A new holding company, Inparsa, was formed to group together all wood derivatives businesses (Sonae Industria) and all other non-strategic activities.

In September 1999, the Group decided to re-merge. Sonae SGPS (the new name for Sonae Investimentos SPGS) absorbed Inparsa and Figeste (Belmiro de Azevedo’s personal holding company). This move would allow Sonae to benefit from the systematic use of its brand name across the group as well as to gain critical mass in European terms. As a result, the new parenting role of Sonae SGPS was to manage the portfolio (in the Chairman’s own words, an “active and intervening portfolio manager”) while it would be the job of its sub-holdings to manage the businesses. According to de Azevedo:

“We are not a conglomerate but a set of focussed businesses, united by the strength of the values we share, by our ability to develop, build up and transfer knowledge and by our outstanding capacity to attract both opportunities and resources which has clearly been recognised by the financial and labour markets.”

The current business portfolio of Sonae SGPS is shown at Figure 1. Figure 2 shows the portfolio horizon approach adopted by the Group to drive growth across Sonae businesses. Table 1 provides a financial snapshot of the Group.
Figure 3 shows the share price, illustrating the steady rise until 1998. The dizzy heights of early 2001 and the even dizzier fall reflected the technology bubble common to all stock markets. A minority of the shares in SonaeCom, which included Sonae’s high-profile mobile telephony business, were floated via an independent public offering in 1999. Despite the fact that SonaeCom is only one part of the Group’s business portfolio, the market has established over time a close link between the share prices of the two. There is also a strong link with the Modelo Continente share price, that has been affected by fears about investments in Brazil.

**From Wood Products, Retail and Shopping Centres to…..**

“Success breeds success. If it is in Portugal, if it is a mass market, and if we can do it tomorrow, Sonae will grasp the opportunity to succeed in a new sector.” – Luis Reis, Board Member of Sonae Com.

Apart from small steps towards a presence in the tourism sector, Sonae’s main other area of expansion in the mid-1990s was retail finance. During 1995, Sonae identified private customer credit as an area that was underserved in Portugal. Credit was difficult to obtain, and aimed at higher net-worth individuals. Application processes were slow, and charges high. In that context Sonae launched the Visa Universo, a low-interest consumer credit card coupled with an innovative discounts scheme that reinforced loyalty.

### Table 1

**Sonae SGPS Consolidated Results**

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>3Q 00</th>
<th>3Q 01</th>
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<tbody>
<tr>
<td>Turnover</td>
<td>5,203</td>
<td>5,751</td>
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<td>Operating profit</td>
<td>135</td>
<td>204</td>
<td>140</td>
<td>126</td>
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<tr>
<td>Net financial charges</td>
<td>(97)</td>
<td>(130)</td>
<td>(105)</td>
<td>(131)</td>
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<td>Profit on ordinary activities</td>
<td>37</td>
<td>73</td>
<td>35</td>
<td>(6)</td>
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<tr>
<td>Extraordinary profit</td>
<td>111</td>
<td>258</td>
<td>267</td>
<td>38</td>
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<td>Associated companies</td>
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<td>5</td>
<td>2</td>
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<tr>
<td>Profit before tax</td>
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<td>Net profit</td>
<td>89</td>
<td>255</td>
<td>253</td>
<td>25</td>
</tr>
<tr>
<td>Operational cash-flow (EBITDA)</td>
<td>438</td>
<td>546</td>
<td>390</td>
<td>404</td>
</tr>
</tbody>
</table>

Figure 3

**Share Price**

![Graph showing share price]

**Source:** BVLP; Sonae SGPS
to the Sonae stores, and which it promoted through them. In only six months, the number of cardholders surpassed 150,000 (14% market share), opening up a range of opportunities for data-based marketing across the Group. Today the Universo card is the largest credit card brand in Portugal, with more than 200,000 active customers. It is jointly managed with BPI bank and has become a profitable business, even if analysed on a stand-alone basis.

After the success of the credit card and in order to enlarge the range of products sold through its stores, Sonae launched a bank in 1997 with the same brand. A key focus of Sonae's banking strategy was to leverage its huge existing customer base and retail locations to offer an alternative mass market banking concept. Lacking strong knowledge of the retail financial services sector, the new business recruited heavily from other Portuguese banks and worked with consultants. After 15 months and despite having attracted more than 120,000 customers, profitability proved difficult to achieve, and Universo was sold to BPI.

Early in 1997, Sonae got its second chance to enter the mobile phone market when the Portuguese government announced a third license auction. Sonae's bid for the second mobile telephone license in 1992 had failed in the face of strong competition from Telecel, which brought together a consortium of Portuguese companies and Pactel, the large American telecoms company. Although mobile telecoms had grown more slowly than expected, de Azevedo and other senior Sonae managers were confident that the industry would become a large mass market. But beyond estimates of market size and opportunity, Sonae believed that the future success of all of its businesses would increasingly depend on building capability in the areas of technology and telecoms:

“There was a feeling that information technology, systems and telecommunications would be very important in the future. We had a team in the late 1980s that looked at IT, television, telecommunications and a lot of new areas, but these guys eventually went back to other parts of the business in response to our very rapid growth in Industria and Distribuição. Many of these guys then worked on information technology projects within our existing businesses and we built strong capabilities in internal communications and IT management. We always knew that these areas would provide significant business opportunities in the future, but would also be crucial for our own competitiveness in existing businesses.” – Angelo Pauperio, CFO, Sonae SGPS.

Many in the Portuguese business community questioned Sonae's desire to enter the mobile telecoms sector. Unlike its diversification into the retail sector, where it had significant first-mover advantages, there were already well-established incumbents in the mobile telephony market. In the other sector where it had challenged established competitors, banking, the Group had failed to build a sustainable position or to leverage its existing competencies to strongly differentiate its business. But few within Sonae itself doubted de Azevedo's belief that it could become a major telecoms player in Portugal.

Mobile Telecoms in Portugal: Space for Another Player?

By 1997 there were two incumbents in the mobile telephony sector: Telecel, which went public in 1997, and by 2000 was majority-owned by Vodafone; and TMN, the mobile division of the state-owned telecoms incumbent, Portugal Telecom (PT).

Between 1992 and 1997 mobile telephony had remained a comparatively small segment of the Portuguese telecoms market. High costs and limited coverage outside Lisbon, Oporto and the main road networks had restricted penetration beyond the corporate sector. The existing service providers had been cautious in expanding their network capacity in the face of uncertain demand. Additional capacity, in the form of transmission towers, was added by the incumbents in response to, rather than in expectation of, increasing user numbers.

Telecel and TMN distributed consumer and corporate products through extensive agent networks, a model familiar in the rest of Europe. Both players also established their own dedicated retail outlets, and also offered a limited range of products in hypermarkets. In 1997 sales of mobile phones in hypermarkets represented less than 13% of total sales, with TMN having the lion's share.

In terms of organisational structure TMN was organised by function (sales versus marketing versus advertising). Telecel was organised by segment, with
a split between mass-market and business. Neither company had a dedicated professional/SME segment, despite the large number of these firms in Portugal.

Mobile telephony was perceived by most consumers to be a high-cost luxury, and the sales, marketing and distribution strategies of the incumbents reinforced this perception. Price competition was limited with similar rates for on-network calls (calls within the operator’s own network) and off-network calls. The lowest off-peak (and on-net) tariff for both competitors was about 25 escudos per minute (about 15 US cents) for post-paid (contract) products and 35 escudos per minute for pre-paid ones.

**Could Sonae Open up This Market?**

“Success helps success. We had faced a number of difficult situations, and there had been some difficult situations, but overall we had been very successful. We believed in ourselves as a group. All people at a certain level within the Group are very close to our core values, the core values of our Chairman Mr de Azevedo.” – Angelo Pauperio, CFO Sonae SGPS.

In 1996 Sonae SGPS undertook its first formalised research study to analyse the Group’s core tangible and intangible assets. The rationale for the study was to identify, in a more systematic way, the strengths of the Group that might facilitate its diversification into new businesses in the future. The findings are summarised in the box.

Despite its tangible and intangible strategic assets, Sonae recognised that it did not have all of the physical and human resources required to compete in the telecoms sector. To be successful in its bid to win the third license, and to build a sustainable competitive position in the market, it would have to rapidly acquire new competencies.

**Sonae’s Strategic Assets, 1996**

*Entrepreneurial culture:* Belmiro de Azevedo had worked incessantly to instil an entrepreneurial culture across the Group for more than 30 years. His definition of the “Sonae Man” in July 1986 had defined the management ethos for the Group, and had facilitated a philosophy of strategic experimentation and risk-taking coupled with a rigorous code of personal responsibility, ethics and a desire to succeed.

*Start-up experience:* Sonae’s diversification from wood-based products, to supermarkets, hypermarkets, specialised retail, shopping centres, financial services and other areas had repeatedly exposed managers and staff to start-up environments. “Zig Zag” career paths had given senior managers exposure to a range of functional and operational roles.

*Consumer knowledge:* To become the leading retailer in the Portuguese market, Sonae Distribuição had developed a deep knowledge of consumer behaviour, mass marketing and merchandising. The company believed that this deep local market knowledge provided it with a competitive advantage over potential foreign competitors.

*Sales, marketing and distribution:* Sonae had acquired extensive experience in business-to-consumer and business-to-business sales, marketing, and distribution through various retail formats, direct sales and agent networks.

*Brand:* Sonae brand awareness within Portugal was over 90%. In customer focus groups, the Sonae brand was identified with value for money, quality and superior customer service. Sonae was recognised as a Group that challenged inefficient and high-cost market sectors to provide a superior customer experience.

*Corporate relationships:* The breadth of Group involvement across the Portuguese economy, and its importance for suppliers and customers, facilitated strong corporate relationships and privileged access at the executive level.

*Financial strength:* Sonae’s growth and success in Portugal and internationally provided profits and support from financial markets to fund further expansion.

*Distribution channels and consumer access:* Sonae’s extensive retail outlets meant that it hosted over 200 million customer visits in Portugal each year.
From mid-1996 Sonae embarked on a recruitment drive to build the core project team who would compile the bid for the third license, and comprise the initial management team should it be successful. To head the team, Sonae recruited a Spanish executive who had been heavily involved with the launch of a mobile telephone company in Spain, but who had been working with Sonae Industria for several years. To develop the bid document, it recruited a consulting firm that specialised in mobile telecoms. And it employed a former member of the Portuguese telecoms regulatory authority.

The project group soon recognised that Sonae would need to partner with another mobile telecoms provider to acquire the necessary technology and network infrastructure capabilities to compete in the new sector. To develop these capabilities internally could not be achieved at acceptable cost, and the Group did not believe that it possessed the R&D capabilities to compete with its local competitors – which had partnered with established European and US telecoms companies.

It soon became apparent that competition for the third license in Portugal would be limited as most major Portuguese and international companies did not fancy market entry against two established competitors. Until 1997, third entrants to European mobile telecoms market had been wholly unsuccessful, and most analysts believed that a third entrant to the small Portuguese market would never achieve the critical mass of subscribers needed to become profitable. Sonae soon emerged as the only truly viable bidder. This put it in a strong position to negotiate with potential telecoms partners reluctant to enter the small Portuguese market alone, but who were willing to invest in a joint-venture.

After negotiations with several companies, Sonae chose as its bid partner France Telecom whose CEO, Michel Bon, had been a member of Sonae’s Advisory Board and had a close personal relationship with Belmiro de Azevedo. The French company was willing to commit financial and human resources to the success of the venture in return for a 20% stake. It was a significant commitment, with Sonae’s bid calling for the installation of more than 900 antennae in less than twelve months, the most ambitious mobile network rollout in the world to-date.

In November 1997 the Portuguese telecoms regulator announced that Sonae had won the third license. With its launch set for August 1998, Sonae had less than a year to roll out its network and IT infrastructure and devise a marketing and distribution strategy to take on the established competitors. The new business would be called Optimus.

**Changing the Rules of the Game: Sonae’s Strategy to Attack the Incumbents**

Rather than adopting the competitive strategies of the existing incumbents, Optimus management developed a strategy that would strongly differentiate it. This strategy combined three elements:

- the technical and infrastructure capabilities of its partner France Telecom;
- Sonae’s existing strategic assets; and
- new expertise to be acquired.

As with Sonae’s activities in other markets, there was a strong drive by the company to break with competitive norms.

An important element of the Sonae bid had been the rollout of an extensive mobile network across the country. Optimus worked with France Telecom to identify tower sites, and to contract with companies to construct the network of more than 900 antennae. The goal was a network that would offer much better voice quality and much wider coverage than the incumbents – which had been slow in their network rollout and had focussed on major metropolitan areas. The network infrastructure was also designed to deliver high capacity, with Optimus planning to link this capacity with its pricing plan.

Optimus analysed the pricing policies of TMN and Telecel and decided that its high capacity and extensive network infrastructure would permit it to offer on-network calls at very discounted rates. It believed that the tariff plans of the incumbents were too complex. So Optimus decided to offer simpler tariff plans that would be easy to explain and in line with the company’s values: transparency, innovation, honesty and simplicity.
Portuguese consumers expected Optimus to combine lower prices and good quality, and the company set about matching these expectations. It offered a discounted rate of 5 escudos per minute (2 or 3 US cents) for on-network calls (even for prepaid products), at least 80% less than its competitors, and competitive rates for other connections.

Optimus had analysed its competitors’ network capacity closely and believed that Telecel and TMN would have great difficulty in meeting this offer in the short or medium term without overloading their systems. Optimus also believed that the incumbents would face another significant barrier to rapidly upgrading the quality of their networks: the expense would have a dramatic impact on revenues due to their large existing user bases.

Focus groups also led the company to believe that discounted on-network calls would not significantly reduce revenue: consumers would tend to talk longer at the lower rates providing similar average revenues per user (ARPU) to those of the incumbents. Put simply, although the 5 escudos on-net tariff was low, Optimus believed the increased minutes of usage (MOU) would compensate.

Shortly after winning the third mobile license, Optimus set about recruiting the large number of people required to manage and staff a mobile telephone company. Sonae SGPS took a role in identifying experienced marketing and general managers within other parts of the Group, and also played a major role in marshalling resources to recruit staff from outside Sonae companies. Between November 1997 and August 1998, Optimus recruited more than 450 staff.

Within Optimus’ overall management group of approximately 30, more than half were drawn from other Sonae Group businesses. In some areas, such as legal, managers came to the company as “loans” while in others, such as logistics, very senior managers from Sonae worked as “advisors” to the ones hired by Optimus. Optimus also used the human resources of France Telecom, mainly in the form of HR “loans” and temporary transfers.

A project team was established within Optimus to develop a marketing and distribution strategy to leverage Sonae Group’s existing strengths, but which would also help the company to strongly differentiate itself from the incumbents. The company was aggressive in recruiting experienced marketing managers from companies such as Procter and Gamble and Unilever, but emphasised its desire to create a new marketing approach by not recruiting within the telecoms sector. Sonae’s impressive distribution channels provided a unique opportunity and Optimus also recruited marketing managers from Sonae Distribuição to maximise synergies. Optimus also hired a significant number of Telecel people for technical, IT, sales and after-sales. For the technical and IT areas there was no time to train internally and for the sales and after-sales functions it was crucial to get people with the right experience and contacts with the dealers.

An important element of the Optimus strategy of differentiation was its approach to customer segmentation. Optimus’ entry strategy was based on three business units (BUs), addressing (a) residential, (b) professionals/SMEs and (c) bigger businesses. This organisation structure was reflected across the company as each department sought to fulfil the needs of each one of the BUs. The clear focus on a specific segment was aimed to allow every area to excel in its role along the entire value chain of the marketing and sales process (beginning with market analysis, through product design, advertising, commercial approach and finally customer care procedures). All the energy of the organisation was channelled into capturing the clients of each segment in different ways.

For the residential segment, it was decided that Optimus would replicate some of the marketing and distribution activities of its competitors by opening dedicated retail outlets and establishing an agent network. But an important break with the market would be to market mobile phones as fast moving consumer goods (fmcg) through Sonae’s hypermarkets, supermarkets and specialist retail stores. Working with merchandisers from Sonae Distribuição, Optimus experimented with packaging, point-of-sale displays, kiosks and marketing materials designed specifically for distribution through mass market channels. The concept behind the use of Sonae’s existing outlets would be to make the mobile telephone a “pick and pay” product, similar to other consumer electronics such as packaged cameras. The eventual pre-packaged product was called the “Optimus Boomerang Package”. An important element of this would be handset selection, with Optimus putting considerable
emphasis upon the “fashion” and “function” elements of the mobile telephone itself, elements that had not been fully emphasised by its competitors. The name was chosen because the Optimus logo resembled a boomerang shape.

While experimenting with marketing concepts, Optimus decided to launch a campaign to build on the consumer and media buzz surrounding the forthcoming launch. Consumer recognition of the Optimus brand was running at almost 40% by May 1998, without formal marketing. This awareness increased to 70% by August after limited media advertising.

In June, the company launched a pre-subscription “Pioneer Programme”, inviting consumers to sign up to the new network, and guaranteeing the most competitive offer ever seen by Portugal’s mobile-phone consumers: a single value proposition of 5 escudos on-net calls for one year.

The Pioneer Programme was advertised heavily in the media, with consumers asked to visit Sonae retail outlets to complete application forms. The close involvement of Belmiro de Azevedo and other senior Group executives facilitated interaction between Optimus and Sonae Distribuição. Optimus paid for space within Continente stores, installing kiosks where visiting customers could find information on the August launch and subscribe to the Pioneer Programme. A critical aspect of the programme was the enthusiastic involvement of Sonae Distribuição managers and staff.

The outcome of the Pioneer Programme was unprecedented in the mobile telephone sector, for Europe and the world. Between June and August 1998 Optimus signed more than 270,000 individual mass-market customers (410,000 including SME and corporate subscribers) to its future network. The analysts who had predicted customer numbers of 30,000 or less for Optimus by the end of the first year quickly revised their predictions. In 1999, Sonae’s Pioneer Programme would be awarded “Best Marketing Success of 1998” by the world-wide association of all GSM mobile operators at its annual international conference in Cannes, France.

The intermediate or “Professional Small Companies” segment was identified as an important target by Optimus, and at the time of launch the company was the only competitor to have a division dedicated to servicing this customer group. As Optimus entered the market a new sales channel and new products were introduced reflecting this focus on the professional/SME segment. First, an indirect sales force was developed which allowed Optimus to multiply the number of visits to potential clients; the idea was to establish SME dealers which would have their own sales force, but completely following Optimus guidelines provided by the company’s internal account managers. Second, a new product concept was introduced which allowed small companies to share the same bundle of minutes among different users (employees), under the same account. Both the commercial and the marketing approaches were new to the Portuguese market.

Optimus also used Sonae’s corporate connections within Portugal to begin its “Corporate Business” segment marketing campaign prior to the network launch. The second market entrant, Telecel, had struggled to penetrate many sectors of the B2B market due to strong competition from the incumbent, TMN. For example, TMN had a 100% penetration rate for the financial services sector in Portugal. The personal involvement of Belmiro de Azevedo and other Sonae executives and Board members opened doors to major corporate clients across the country. All Sonae Group companies agreed to migrate to Optimus, representing more than 2,000 individual corporate customers.

**The Network Launch**

The excitement in the weeks preceding the August 1998 network launch was palpable. Said Luis Reis:

“In the weeks before the launch we were inundated with calls. Not calls from customers, but calls from Sonae Distribuição store managers and staff asking when they were going to receive stock! It is hard to explain – almost two years later – how important these people were to the success of our launch, and this kind of enthusiasm had never been captured by external companies using our distribution
channels. It was about culture, about the respect for our Chairman, and challenging the duopoly of the market. Optimus was the sword, but our people in the stores were the crusaders.”

From launch until Christmas 1998, the demand from the public remained strong, with customers waiting for hours inside and outside retail outlets just to get an Optimus package. The production capacity of Optimus’ packaged telephones had to be increased fivefold to cope with the demand.

According to Paulo de Azevedo who was CEO of Optimus during the start-up and launch phase, the huge demand for Optimus’ services was the result of a combination of several key factors:

“The reasons for the huge demand had to do with a combination of the Pioneer Programme, the experience people had about Sonae being the consumers’ champion, the quality of the handsets sold, the quality of the network, the advertisement focused on values rather than on prices and the appealing format of the ‘boomerang’ package.”

The Optimus strategy of differentiating the company from its competitors in terms of both network quality and marketing methods had gained immediate results. From a market share of only 1.6% in the third quarter of 1998, Optimus had acquired a 16.2% a year later and 22.2% by late 2001 (Figure 4).

While some of this market share growth was taken directly from the incumbents, organic growth through Optimus’ targeting of the mass market added large numbers of new subscribers. Optimus’ early lead in the marketing of mobiles through Sonae Group’s existing retail channels provided previously untapped access to Portuguese consumers. By 2000 mass-market channels represented more than 27% of Optimus’ new residential subscriber sales (Figure 5). In 2000 alone Optimus increased its subscriber base by 73% (Figure 6). This was well above the 43% growth of total mobile penetration, and the company added a further 3.7 percentage points to its market share.
Profitability
In late 2001, Optimus was still delivering strong growth in customers and revenues. In the third quarter of 2001, Optimus’ subscriber base grew by 141,000 (Figure 6), of which 28% were contract customers. Only about 10% of its nearly 1.8m subscribers were inactive. Over 80% were prepaid. Market share was also still rising, though slowly. Service revenues in 3Q01 increased by 14% to €149m up from €131m in the second quarter (Table 3). Monthly average revenue per user (ARPU) in the third quarter was €29.4, up from €28.2 in second quarter and €27.8 in the first half. Average revenues per minute of billed airtime (MOU) rose to €0.24 from 0.23. Revenues from data (non-voice traffic) were €9.7m in the third quarter, or 9.8% of customer revenues, slightly down from €9.8m. Along with the gain in market share and customers, Optimus’ profitability also improved. Earnings after interest, tax and depreciation (EBITDA) and after eliminating the deferred costs margin, grew by 1.2 percentage points to 12.9% of assets, up from 11.7% in the second quarter. Cash operating margin per user – the difference between ARPU and CCPU (monthly cash cost per user) – grew to €2.2, up from €1.3 in the second quarter.

In terms of financial and operating performance, Optimus management believed that the company would achieve ongoing growth in revenues for 2002, with further improvements in operational profitability.

The Future for Optimus
By the end of 2001, Optimus faced several challenges. Its strategy of differentiation through network quality and marketing innovation had allowed the company to grow rapidly, with market share growth outstripping its major competitors. The company had also undoubtedly benefited from the rapid organic growth of mobile subscribers which had occurred across all Western European markets between 1998 and early 2001.

But by 2000 some of the advantages which Optimus enjoyed at the start had decreased in significance. In contrast to the retail and shopping centre sectors where Sonae had been able to build substantial barriers to entry through its first mover advantages, Telecel (Vodafone) and TMN eventually responded to Optimus’ network infrastructure strengths by embarking on major network expansion projects. Both competitors were also quick to attempt to replicate Optimus marketing innovations such as the distribution of handsets through mass merchants. This provided an interesting outcome for Sonae Distribuição which benefited from intense competition for shelf space within its retail outlets. Responsive to its shareholders’ commercial interests, Distribuição opened its distribution channel to other mobile network providers.

Another issue was market saturation. At the end of third quarter 2001, mobile penetration in Portugal had reached over 80%. The focus of Optimus and its competitors had shifted from customer acquisition to retention and maximising average revenue per user (ARPU). “Network effects” also affected Optimus. Given that on-network calls (that is, calls between subscribers on the same network) were cheaper than calls to different networks, the company’s smaller market share had the potential of deterring prospective customers.

Despite these challenges, Optimus executives remained bullish:

“As we see the focus moving from acquisition to customer retention and maximising ARPU, Optimus is in a very strong position to continue capturing market share from our competitors. We have proven that our market and customer service capabilities are second to none, and this will only help us strengthen our competitive position in the future. We won’t be number three in this market forever.” – Antonio Casanova, CEO Optimus.

Learning from Diversification
An interesting outcome of Sonae’s diversification into mobile telecoms sector has been the opportunity for...
many Sonae managers to acquire experience in a new industry. In the words of one senior executive who was involved with the Optimus launch:

“I am now a different person from when I was in Industria. The strategic and tactical thinking needed in that new industry was very demanding and sophisticated. For example, getting knowledge from the market, developing products tailored to market needs or managing distributors with more sophisticated training and communication methods, these are things that we could take back to Sonae Industria, for instance, in the same way that we brought knowledge from Industria that was needed by Optimus.” – Joao Paulo Pinto, Novis Board Member.

This view was shared by many of the Sonae executives interviewed as part of the research for this article. While it is difficult to measure the impact of this experience upon the wider Sonae Group, the “Zig Zag” career policy encouraged by Belmiro de Azevedo will inevitably facilitate these managers transferring knowledge to other businesses. Indeed, since the launch of Optimus, the Group has diversified further in the area of telecoms and technology, transferring its expertise to launch an internet service provider and online content company (Matrix) a fixed-line telecoms company (Novis) and a systems integration consultancy company for the telecoms sector (WeDo). These various businesses have been brought together with Optimus and Publico (a newspaper owned by Sonae), to form a new, separate strategic sub-holding company, Sonae Com.

Lessons from the Sonae Experience

The diversification initiatives of Sonae Group provide some valuable lessons for any company considering diversification into a new industry or business sector:

- Any company considering strategic diversification should first make a measured assessment of its core strategic assets, and how these assets might provide a launching platform to move into new businesses.

- Next, a company must identify the strategic assets that it is lacking for success in the new market, and identify if these assets can be acquired at reasonable cost. In some cases this might be achieved through strategic partnerships, alliances or joint ventures, but effective recruitment from both within and outside the organisation is also crucial.

- Diversification in the face of established competition is never easy. A company must not only identify the core strategic assets (existing and those which it must acquire) which will enable it to move into a new market, but how it might use these assets to differentiate itself from the incumbents.

- Another important question for managers considering diversification is whether the differentiated or new strategic assets that it brings to a market are unique. If they can be easily acquired, replicated or made redundant by competitors, any competitive advantage might be short-lived.

- A related aspect, not discussed at depth in this article, is the degree to which diversification can broaden learning within the larger organisation. Diversification provides an opportunity for individual and organisational learning that might be transferred to existing or new businesses.

In the case of Optimus, by identifying and leveraging its core Group strengths in areas such as marketing and access to distribution channels, and pursuing a strategy to acquire those additional strategic assets required to compete in a new market, Sonae enabled a new business to acquire a substantial share of the Portuguese mobile telecoms market in the face of entrenched competitors. The challenge for Optimus in moving forward will be to see if the company can continue to innovate and differentiate itself from its competitors, and of course to improve profitability. It will also be interesting to observe whether Sonae can create value by migrating its learning from the telecoms sector to other parts of the Sonae Group.