A COMPETITIVE STRATEGY IN THE FACE OF LIBERALIZATION

THE LEGAL FRAMEWORK

From 1987, the year in which the Telecommunications Act was passed, right up to the present day, the legal framework for the provision of telecommunications services has undergone almost constant modification. All the modifications, including the major changes made to the Act at the end of 1992 and the recent government agreement on telecommunications policy, have tended to work towards the ending of monopoly situations. Bearing in mind that Telefónica was almost the only supplier of the whole range of telecommunications services, these changes have considerably affected its activity. At the moment the only remaining exclusive right, and not for much longer, is that for the provision of fixed network voice services, but that must be weighed against the obligation to provide a universal service.

It could be said, then, that the process of telecommunications liberalization which began in the United States in 1984, and which in the European Union dates from the 1987 Green Paper, is about to reach its peak, with not only the total liberalization of services, but of infrasructure as well, on January 1, 1998. But it would be erroneous to focus our attention solely on fixed network vocal telephony, even though it is here that the most serious problems from the point of view of liberalization are raised - those concerning the development of networks, bringing tariffs back into balance and defining the scope of the universal service and its financing. These problems account for why the liberalization process has been slower here than in the other services.

Neither would it be correct to see the different telecommunications services as watertight compartments. In fact, services which meet certain needs in the same segments of the market can always be replaced by

	EUROPEAN DIRECTIVES	SPANISH LEGISLATION
1987	• Green Paper on Telecommunications Act	• Telecommunications Act (LOT)
1988	• Liberalization of terminals	
1990	• Liberalization of services and ONP • Liberalization of voice telephony for Groups Closed User and Business Networks	
1991		• Liberalization of terminals
1992	• ONP leased circuits Directive	• Modification of LOT • Radiopaging service open to competition
1993	• Agreement for liberalization of voice services by January 1, 1998	• Data transmission, Closed Group radio telephony and local radiopaging services open to competition. • Correos and Retevisión awarded support Service for VSAT.
1994	• Agreement on liberalization of infrastructure by January 1, 1998 • Resolution on Universal Service • Infrastructure Green Paper (part I)	• Automatic Mobile Telephony open to competition • Trunking licenses granted • Second GSM license granted • Correos and Retevisión granted circuit leasing forTMA (GSM) • Public Telephony open to com petition (except public booths) • Cable Telecommunications Bill
1995	•Satellite communications open to competition • Infrastructure Green Paper (part 2)	• Resale of leased circuit capacity authorized • Liberalization of VSAT services
1996	• Automatic Mobile Telephony open to competition	
1998		• Basic Telephony and Infrastructure open to competition

Landmarks in the Liberalization of Telecommunications

Telefónica Group Management Committee

1.- Cándido Velázquez-Gaztelu Ruiz

2.- Germán Ancochea Soto

3.- Antonio López-Barajas y García-Valdecasas

4.- Manuel A. Blanco Losada

5.- Rafael Hernández García

6.- Francisco Ros Perán

7.- Francisco Mochón Morcillo

8.- José Caballero Guerrero

9.- Heliodoro Alcaraz García de la Barrera

10.- Guillermo Fernández Vidal

11.- Ignacio Santillana del Barrio

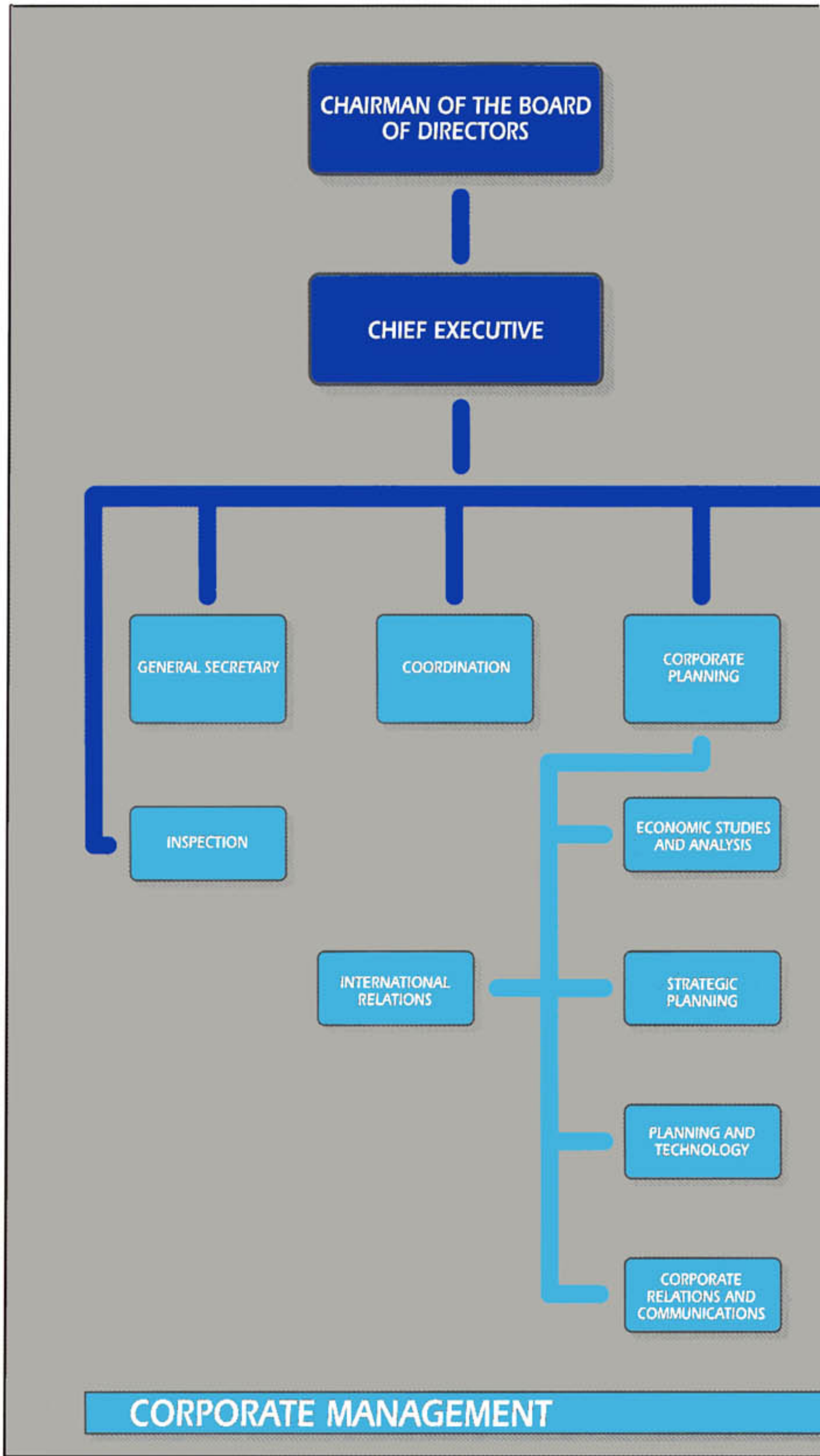
12.- Luis Lada Díaz

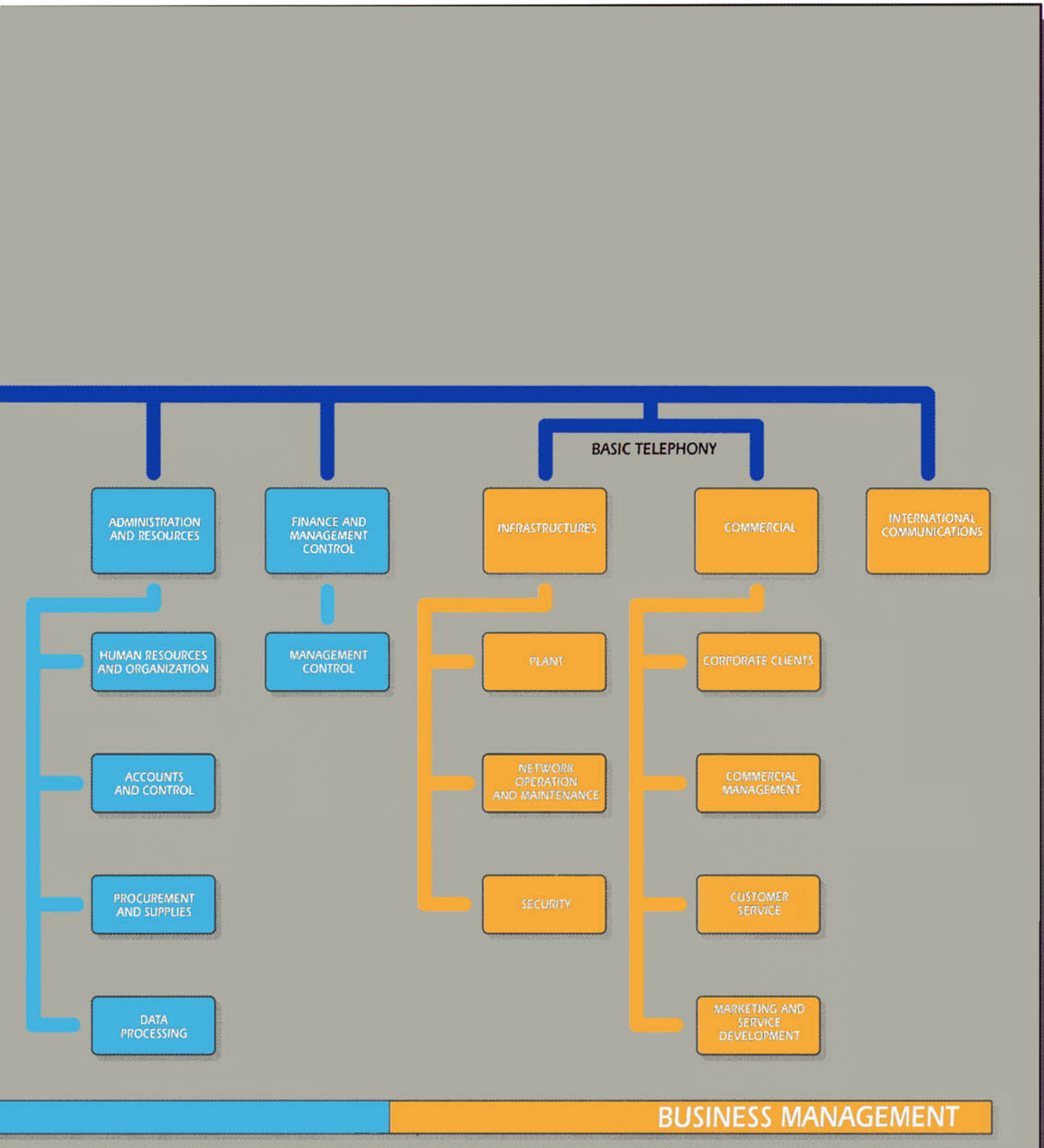
each other, and are therefore competitors, whatever technology they are based on. Many examples could be quoted here, the most obvious being that of mobile telephony, which meets the needs of voice communication in exactly the same way as a fixed line. The domination of the market which derives from the possession of exclusive rights for the provision of certain services is therefore not just a legal issue, but also technological and economical. It could thus be said that apart from the more liberal framework which has been emerging recently, competition is in fact more deeply rooted that it would seem from a simple examination of the legal situation.

REORGANIZATION AS A STRATEGIC RESPONSE

The different Strategic Plans that Telefónica has carried out in recent years have not only aimed to improve the Company's image and the quality and diversity of its services and modernize its networks, but have also inspired the necessary cultural and organizational change which the new competitive environment resulting from liberalization demanded. One of the most important aspects of the 1995-1999 Strategic Plan, which the Company's Management approved at the end of last year, was the reorganization in terms of business areas, thus culminating the process in which a business area focus had been prominent over several years.

This made the organization itself a key element in Telefónica's strategic

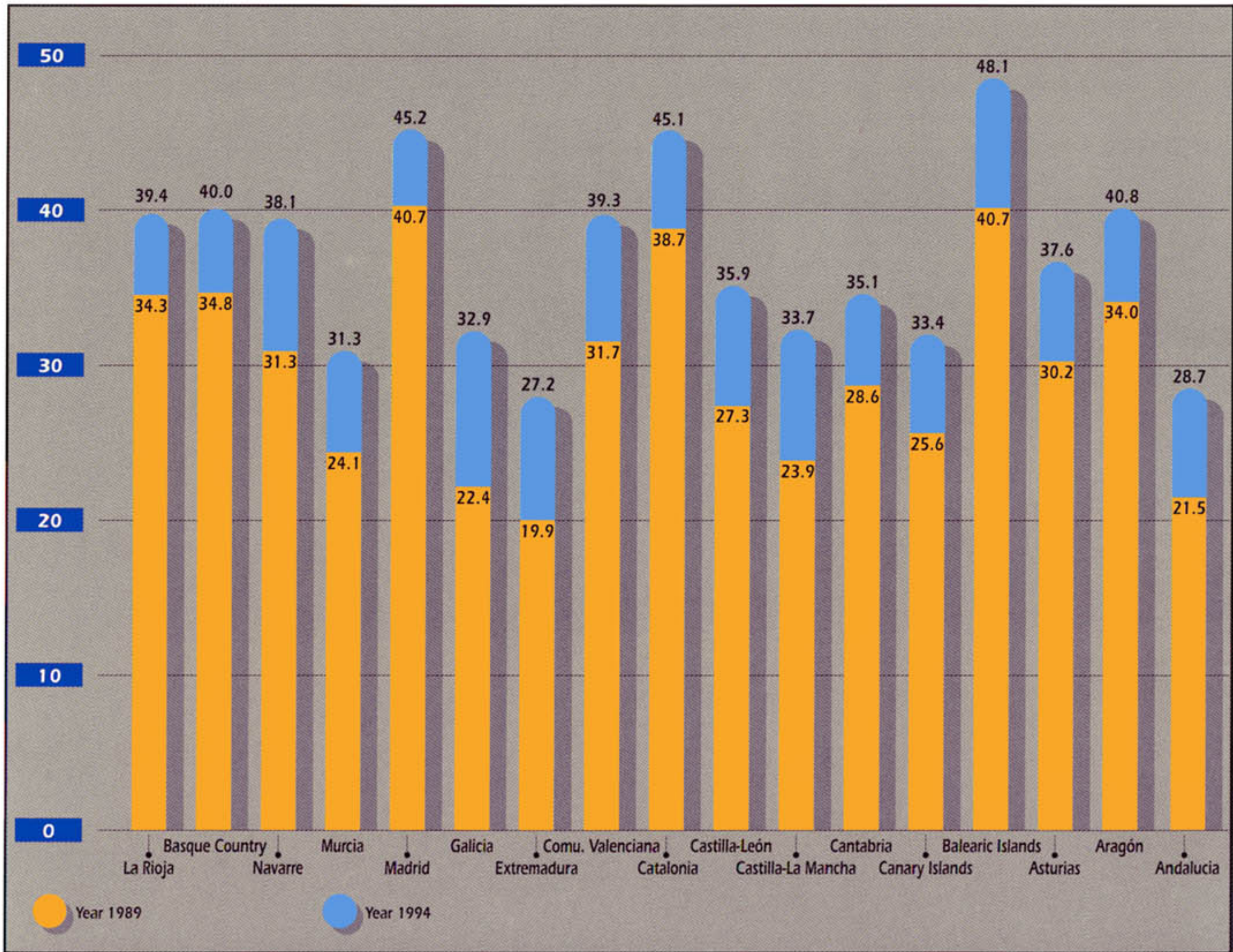



BASIC TELEPHONY
ADMINISTRATION AND RESOURCES
FINANCE AND MANAGEMENT CONTROL
INFRASTRUCTURES
COMMERCIAL
INTERNATIONAL COMMUNICATIONS
HUMAN RESOURCES AND ORGANIZATION
ACCOUNTS AND CONTROL
PROCUREMENT AND SUPPLIES
DATA PROCESSING
MANAGEMENT CONTROL
PLANT
NETWORK OPERATION AND MAINTENANCE
SECURITY
CORPORATE CLIENTS
COMMERCIAL MANAGEMENT
CUSTOMER SERVICE
MARKETING AND SERVICE DEVELOPMENT
BUSINESS MANAGEMENT

response to the new environment in which it has to carry out its activity.

The thinking behind this reorganization is that it was felt desirable to move towards a decentralization in which the people responsible for the different areas have a higher profile and take more initiative. We also expected this to lead to improvements in terms of more efficient management.

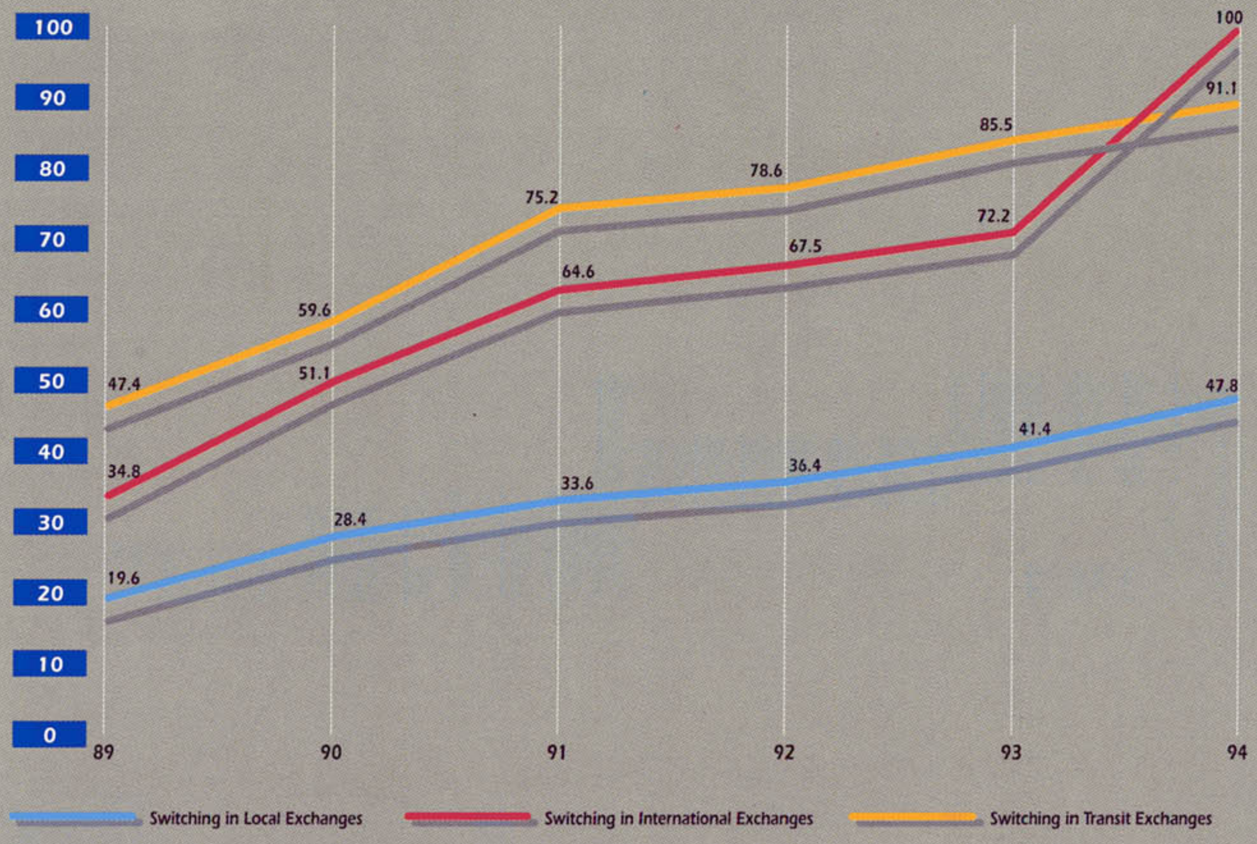
Thus emerges a new Telefónica, a Group made up of the parent company Telefónica de España and a group of companies which take on the name of the type of service provision which is transferred to them. This business concept has been reinforced by the fact that, along with this decentralization of the business areas, the management of the Group as a whole revolves around a Group Management Committee and several corporate General Directorates which support it. These, although they form part of the organizational structure of the parent company, have an area of responsibility which covers the whole business conglomerate. This "corporate core" has then as its main missions those of defining the Group strategy and coordinating and controlling at an op-



Basic Telephone Service Density
in autonomous regions
Lines per 100 in habitants

erational level all the Group's business activity, with the aim of capitalizing on all the possible synergies and avoiding dispersal of effort.

The reorganization distinguishes between the Basic Telephone Service, which is the core of the Company's activity, and other services such as Data Transmission, Mobiles, Public Telephony, Information and Advertising and Multimedia, which can be transferred to different specialized companies, some of which have been in existence for some time. International Communications is also seen as a separate business area from the Basic Telephone Service, and for the moment remains within the structure of Telefónica de España. International Business, an essential part of which are the holdings in foreign operators, will continue to be managed by Telefónica Internacional. Nevertheless, except in the case of the data transmission and international communications businesses, whose globalization demand integration at at least the European level, the Group companies are affiliates over whom it is always desirable for Telefónica de España to exercise a high degree of control.



Network digitization levels

SERVICE PRICE REDUCTIONS

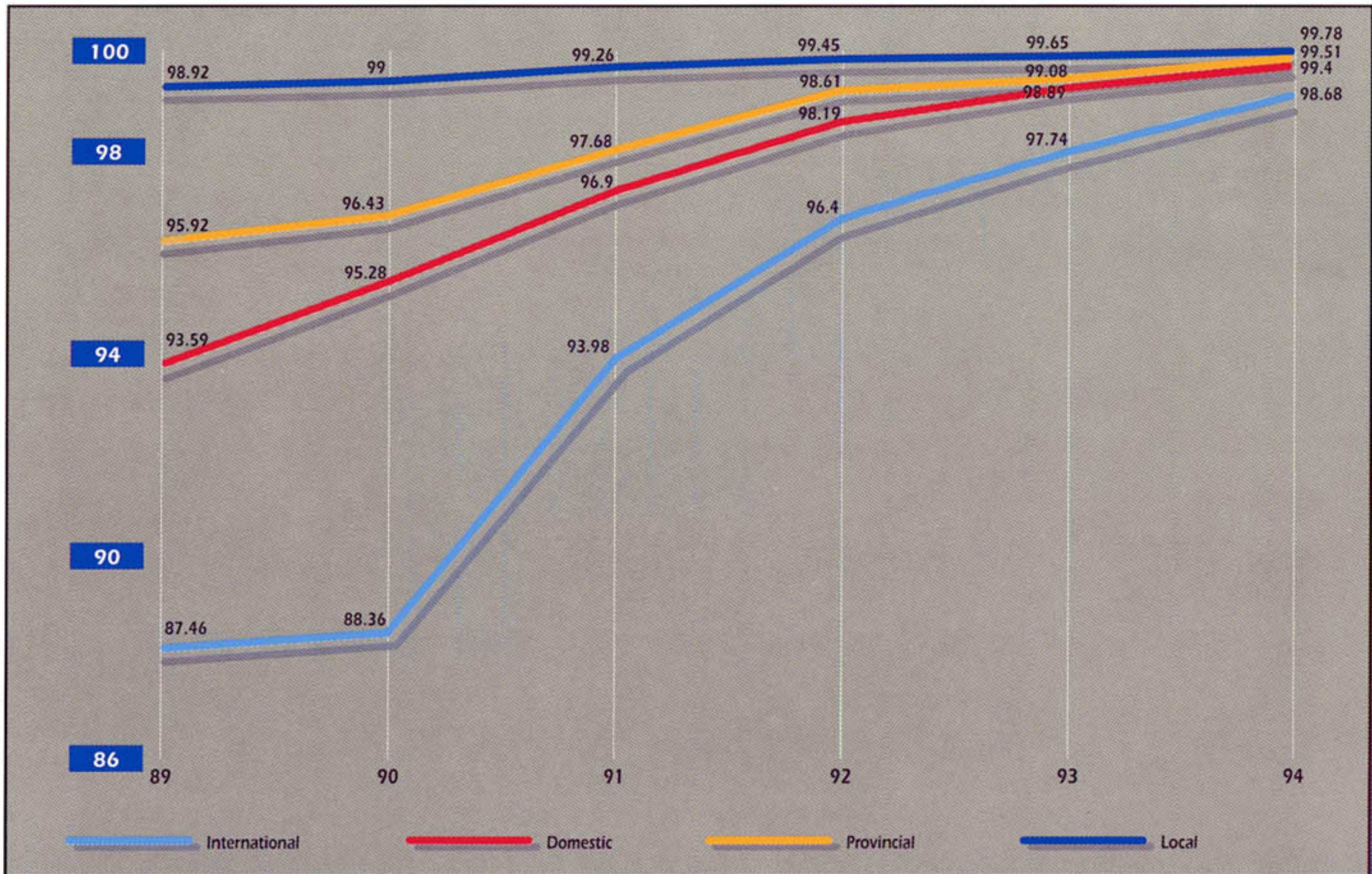
As has been repeatedly pointed out in many forums, the restructuring of telephone tariffs is of great importance as it is a condition for the total liberalization of voice services under conditions of fair competition which is planned to take place on January 1, 1998. However, this competition will be impaired if tariffs are not brought into line with the real cost of services, and this was the understanding of the Council of Telecommunications Ministers of the European Union in their historic agreement of June 1993.

In the case of Spanish telephone tariffs, where the imbalance between local and long distance tariffs was particularly significant, this restructuring was even more necessary, despite advances made in this regard since 1990.

Last year another step in the right direction was taken when the Government authorized a substantial increase in local tariffs, which was almost totally made up for by reductions in provincial, domestic and international tariffs.

However, it should not be forgotten that Telefónica supplies quite a lot more than conventional fixed network telephone services.

The circuit leasing service, which is essential for the development of information technology and data



Call efficiency levels
December

transmission networks all over the country, had its tariffs reduced by over 20%. The ever more popular mobile services had their tariffs reduced by 15%.

The result of the above is that the price index of Telefónica's services taken as a whole and weighted according to their monetary values in the base year 1993 fell in 1994 in nominal terms. Or to put it another way, the fall in prices in real terms was greater than the inflation rate.

This meant that Telefónica was able to pass on to its customers savings of at least 50,000 million pesetas, thanks to the improvement in productivity and the reduction of unit costs in 1994.

Such a price reduction is virtually without precedent in the Company's history, and clearly shows the extent to which the improvements in efficiency in its internal management procedures are already allowing Telefónica to respond competitively in price terms, in the way it has already been in terms of service quality.

TYPES OF SERVICE	RATE OF CHANGE
Monthly standing charge	+ 3,2
Connection fee	- 10,3
Local service and fixed-rate special services	+ 30,7
Provincial service	- 29,8
Domestic service	+0,2
Fixed-mobile service	- 0,8
Public service telephone	- 3,4
Automatic service to E.U.	- 6,3
Automatic service to rest of W. Europe	- 22,3
Automatic service to rest of Europe	0
Automatic service to USA and Canada	- 9,5
Automatic service to rest of America	- 0,1
Automatic service to Japan	- 12,9
Automatic service to rest of the world	- 4,7
Circuit leasing service	- 23,6
Automatic mobile service	- 15,0
Other non-regulated services	-3,3

Percentage change in prices of main Telefónica de España services in 1994