With a client base of about 90 million subscribers, China Netcom Group Corporation (CNC) is the second fixed line telecommunications operator in China, behind China Telecom. This makes Telefónica’s new stake in China Netcom something to keep in mind, although for now the stake is just under 3%. The fact is that 70% of the shares of the company are still in the hands of the state through the public office of industrial shares (the Chinese equivalent to the Spanish SEPI); another 10% is in treasury stock; only 20% are listed on the stock market, which means that Telefónica becomes the second largest shareholder in the company.

The underlying strategy of the operation is not obvious. Given that Telefónica cannot exercise any significant control over China Netcom for now, the acquisition is in response to the determination of having a partner that allows the Spanish operator to undertake certain actions it cannot do alone, given the idiosyncrasy of the succulent, albeit complex Chinese market. One example of this could be to prepare the ground to offer integrated telecommunications services in the future to Latin American and Spanish enterprises that intend to operate in China.

If Telefónica wants a foothold in China – the most dynamic economy in the world, with annual growth rates of 9% - and wishes to make room for itself in a market of 1,300 million potential customers (only 30% have mobile phones), then why not do so with the second fixed line operator that more than likely is about to get a new 3G mobile licence.

In spite of Telefónica’s insistence that it will raise its stake to 5% and place a representative on China Netcom’s board, it still seems rather a small slice of the pie for the Spanish operator to be able to influence, in any real sense, the decisions of the Chinese telecom. But if Telefónica does achieve a certain share of power, the alliance with China Netcom may provide other interesting synergies. The greatest one would undoubtedly be its enormous capacity to negotiate prices and purchases with common suppliers. Therefore, Telefónica could, for example, negotiate with

**Highlights**

1. Telefónica’s purchase of shares in the Chinese Netcom Group Corporation (CNC) spells out an alliance between between the second fixed line operator in China, after the huge China Telecom, and the third largest telecommunications group in the world in market value.

2. CNC manages more than 150 million fixed line phones. It has 15% of the market and its stronghold lies in the north of the country and includes Peking. Moreover, it boasts 6.2 million broadband customers, 50% more than Telefónica. This blend gives the alliance enormous possibilities, among which is the power of negotiation in the joint acquisition of technology.

3. Although China Netcom does not provide voice and data mobile services, it is well placed to get a 3G licence, which would mean competing against China Mobile (220 million clients) and China Unicom (120 million clients). However, the low rate of penetration of the mobile, which stands at 30% of a population of some 1,300 million people, clearly shows that this sector has enormous growth potential.

4. The Asian market is attracting the attention of European operators. Vodafone, for example, has a 3.3% stake in China Mobile, the main mobile operator in China. On the other hand, Chinese telecoms are very interested in Latin America, where Telefónica has a lot of experience.
infrastructure suppliers cheaper prices in Spain in exchange for providing contracts in China.

Telefónica has some interesting things to offer China Netcom as well. These boil down to two: capital and experience. Capital, because China Netcom’s objective is to attract foreign investors. In spite of the fact that their income increased by 8.4% last year to 6,484 million euros, and that they also managed to turn 1,108 millions in losses into a small profit, the company is still burdened by heavy debt. Telefónica can contribute its experience because it efficiently manages more than 122 million customers worldwide. There are not many reliable indicators available, but with those there are it is reckoned that CNC has about 600 customers per employee while Telefónica has an average of 700, so it is 15% more efficient. Telefónica, the third largest telecommunications operator in the world in market value, can provide China Netcom with knowledge in operations, marketing and management. However, it is still too soon to speculate on how the Chinese dragon will react to the timid approach of the Spanish telecommunications giant.