GROWING FAST AND PROFITABLY IN HIGH COMPETIVE TELECOM INDUSTRY: THE GVT's CASE

PROLOGUE

It was the end of July 2014. Vincent Bolloré, chairman of Vivendi, an entertainment and telecommunication French group, was taking his summer holiday on board of his yacht at the Mediterranean Sea next to Greece. Then he was suddenly interrupted by an unexpected visit coming by motorboat. That was Cesar Alierta, CEO of Telefónica Group, a multibillion Spanish telecom company, handing over an envelope with a tempting proposal: he was offering € 6.7B (US$ 8.99B) to buy the Brazilian Global Village Telecom (GVT).

Why such an astonishing visit in such a circumstance? That is just one more episode of a turbulent and dynamic history of GVT, a telecom company from Brazil that had started from scratch 15 years before, paying US$ 54K for the license to operate in a region of that country – although assuming the commitment to subsequently invest around US$ 600M (almost all from loans). Since then, GVT have had such a fast and profitable grow in the highly competitive and dynamic Brazilian telecom industry that caught the attention of international groups and received an impressive large financial proposal for its acquisition.

However, growth and profitability in a competitive industry are not the main issues in this case, but the circumstances under which it happens. GVT arrived in Brazil at the end of the process that opened country's telecommunications sector. It started as a small and independent company with no link to any global giant in the technology or financial sector, with limited investment capacity. Their entrepreneurs did not know anything about Brazilian telecom market and did not speak a single word in Portuguese. Due to its very nature as a mirror company, or a so-called Competitive Local Exchange Carrier (CLEC) – firms who compete against incumbent telecom companies recently privatized –, it ran the risk of not surviving, just as its peers had failed on the domestic and international front. GVT's competitors were large companies owned by huge international telecom groups. In the middle of this situation, company hit turbulence, such as the bursting of the dot com bubble, September 11th, the fall of Lehman Brothers, not to mention the various Brazilian crises in the period, all with relevant impact on the sector. Notwithstanding, in 15 years, GVT maintained a record growth rate of around 30% a year, with an Ebitda margin of 40%, well over the market average around 25% to 30%.

INTRODUCTION

GVT's history (almost an adventure) started at 1999, when two Israelis entrepreneurs, Shaul Shani and Amos Genish, arrived in Brazil. They did not speak a single word in Portuguese, having virtually zero knowledge of the Brazilian market, and with limited capital. Their challenge was to take part in the public tender to operate fixed telecommunications in Region II, consisting of the South and Midwest regions and three states in the North region of Brazil.

Both entrepreneurs used to take part in GVT Latin America, a small company operating mainly in Chile. That company provided telecommunications services via satellite, in a technology called VSAT (Very Small Aperture Terminal), consisting of fixed earth stations, with small diameter antennas for communications via satellite. Even though VSAT technology presented a 1.5 second delay between talking and hearing, it was a quick to set up this technology, and was mainly used in remote regions, where physical infrastructure (i.e. copper or fiber cables) was underdeveloped or not available. However, for Chile, with many sparsely populated small villages scattered over a mountainous geography, this solution sounded perfect.

However, both Shani and Genish soon realized that was a niche market and they would need to try something bigger according to their personal plans of growing. By that time, April 1998, they were taking part in Telexpo, the largest telecommunications event in Latin America, when they met some Inepar’s executives. Inepar was a Brazilian company operating in the energy and telecommunications industries. That relationship brought an invitation for GVT to take part, together with Inepar, in an auction for Region II, to take place in August 1998. GVT’s founders accepted it and started to prepare a business plan for the initiative. However, just 48 hours before the auction, Inepar announced that would not take part in the auction. GVT decided to go on and, contrary to expectations, won it. Though GVT offered less money than other players at auction (US$ 54K against US$ 2.7M), it committed to make more investments in the following years (even with no equity at that time). According to regulator’s rule, investments were more important than money.

After winning, it was time to think thoroughly about strategy. GVT assumed the commitment with regulatory agency to launch operation in 54 target cities, 24 still in 2000, and the rest in the following years. Instead of operating in a widespread way, GVT focuses in the richest cities and neighbors, which could afford the sophisticated technology it wishes to offer. That option was different from the ones adopted by other Brazilian mirror companies, which, on this request, was literally a mirror of its incumbent player, because they had the same services of incumbent ones. Instead, GVT created a high value portfolio, focusing at broadband and video stream, in a time when voice service hardly works. For that, they develop a modern topology of network, with a different architecture of mini telephone switches, known as optic cabinets, which were interconnected by an extensive fiber optics ring. That network establishes the bases for high-speed broadband services. The neighborhoods where these networks would pass were carefully chosen through geomarketing techniques, mapping private individuals and corporate entities with higher purchase power, able to spend more for a better service.

Another challenge would be to raise money for the plan, as the entrepreneurs did not have all the money. Their original plan would be to use mainly vendor credits, a kind of operation quite common these days, in which devices providers deliver their equipment and start charging it sometime after. However, by the time GVT started, times had changed. Due to the dot com crises and failure of many CLEC all over the world, device providers were quite skeptical about vendor finance, especially to unknown shareholders of a small company in Brazil. Wind changed direction when Hewlett Packard’s CEO, Carly Fiorina, agreed to grant GVT an initial US$ 50M credit. With HP’s endorsement, many other vendors agreed to embark in the project.

The IT platform was also original by its time, as it comprised under the same system different software like billing, provisioning, managing inventory of the external network’s geographical information, customer relationship management and so on. The idea was to minimize data inconsistency. Platform was developed in 10 months, allowing GVT to receive awards all over the world due to this innovation, like a prize from Information Week magazine.

Starting operation

With strategy, products, infrastructure network and IT platform, GVT started its operation in October 2000. Latest generation network and integrated IT platform allowed other innovative services to be launched for the first time in Brazil. These included Surf and Talk, which, as the name suggests, allowed the customer to use the phone without disconnecting from the network. That, at a time when Internet was generally accessed through dial-up. Also, Three Way Talk, which allowed more than two speakers to take part in the same call. Other launch was Follow me, which made it possible to direct calls from a fixed to a cellular telephone. Innovations gathered, yet, GVT’s Super Assistant, which shared a message center with a number of customers, while maintaining the privacy of each; and another service, Caller ID, that went in the opposite direction and dismayed prank callers and telemarketers by allowing the customer to know who was calling without the need for a separate Caller ID. These services are common today, but, back then, they were truly revolutionary, considering that even a simple call was frequently interrupted or not completed at all.

The initial marketing campaign marked GVT's launch. It emphasized that the objective of this new company was to improve people's lives. It was materialized by its slogan: "GVT: connecting you to a better life." To complement it, teams with salespeople and installation technicians, knocked on doors and made the sales pitch at districts provided with GVT infrastructure. Once the client agreed with the services, installation was right away, a novelty in a business in which installing a telephone line used to take up to several months. Because of these strategies, GVT revenues increased fast in its first years of operation. However, a sudden and big crisis originated abroad would threaten it all.

An overwhelming crisis

The impact from September 11, 2001's tragedy on the world economy was particularly harmful for the technology sector, which was still staggering after the burst of the dot com bubble a year and a half earlier. Situation became even worse a few months later, with the scandal of WorldCom, a company that artificially inflated its profits by US$ 4B, while increasing its debt to US$ 30B. The combined effect of the dot com crisis, September 11, and the WorldCom scandal had serious consequences for technology companies, and resulted in a lack of liquidity and scarcity for financing business. In Brazil, the global tide was further aggravated by domestic matters, including the energy crisis – the result of a drought combined with a lack of planning and investment in energy generation – that led to blackouts between July 2001 and September, 2002. Adding to that, was the rise of the dollar against the real (the Brazilian currency), which jumped from R$ 1.80 in January 2000 to R$ 3.73 in December, 2002.

The effect was even more devastating for CLEC. According to Greenstein and Mazzeo (2006), from 1999 to 2002, in 1,119 American cities 638, had a decrease in the number of CLEC. Hu and Huang (2006) confirmed the result, recalling trillions of dollars of market value that evaporated with these companies between 1999 and 2000, the loss of around half a million jobs, billions of dollars in unpaid loans and hundreds of CLEC closed. CLEC in Brazil followed the path: apart from GVT, the two other operating ones did not survive, been sold and incorporated into bigger companies.

Surviving this period was not easy for GVT. It had to pay back its vendors finance exactly under this worsening scenario. Incapable of honoring its commitments, GVT executives had to negotiate its debts, with risk of the vendors could legally remove the shareholders, assume control and take any action to recover their loans, including selling the company to a competitor for a low price. The challenge managers and owners of GVT faced was, therefore, to restructure the debt and, at the same time, maintain control of the company.

Ady Marom, an executive from GVT's investment funds, who was one of the leaders during this round of negotiations, outlined the strategy: "Decision was to play tough. On one front, led by Amos, we proved that the suppliers had not met their delivery deadlines for equipment and threatened to sue them. On the other front, which I led, we created a complicated negotiating process." Negotiations took place in New York. Marom recalls: "There were teams from different suppliers, with their financial and legal departments, as well as law firms and banks that had been hired. There were around 20 to 30 people, representing groups with a market value of more than US$ 100B. GVT's side usually consisted of Tom Abbondante, a partner of Allen & Overy, law firm in New York who accompanied us, and myself, both representing a young Brazilian startup. The imbalance was immense and, sometimes, intimidating.

However, it helped us to a certain extent as we gave a more coordinated performance, provided quicker answers and lost no time with internal policy tensions.” Hundreds of meetings and teleconferences were held during the negotiation period. Many were tense, with shouting and fists banged on the table. Thousands of e-mails were exchanged. After a year of negotiations, GVT’s team finally managed to reach an agreement at the end of 2004. “We convinced our creditors that if they worked with us and we made money, they would also make money. They might even lose some of the loan payments but they would lose much more if they ‘took over’ GVT. The final result was that GVT’s shareholders held onto 100% of the shares and the debt profile was altered to reflect the new economic situation”, Marom said.

There were also contracts with local suppliers that had to be negotiated. After many trips and roundtables, these were also addressed. But company also made a huge effort to save expenses, adopting action plans with daily meetings to reduce costs and generate cash flow. After a year, they had saved US$ 98M.Due to these initiatives and increasing revenues, GVT registered positive Ebitda for the first time in the second quarter of 2002. Company’s ability to generate cash only seven quarters after setting up business was a world record. Until then, no other telecommunications operator had managed this feat in such a short period. This did not happen by chance. Surveys showed that more than 70% of customers considered the services good or excellent. GVT ended up being elected by the Yankee Group as the company with the best business plan in fixed telecommunications. In 2003, GVT got authorizations from Anatel to expand, outside of Region II, offering local services, as well as national and international long distance services. At that time, it already had around 700 thousand fixed telephone lines in service, generating revenues of US$ 125M.

IPO

GVT’s founders always targeted the company as a publicly-traded one. Employees were being hired and encouraged to take part in a stock options program that gave them the “right to buy shares,” though few staff understood what that meant. Yet in 2006, the time was ripe, as a wave of Initial Public Offering (IPO) was sweeping across the market in various sectors of the Brazilian economy.

With backing of Credit Suisse, which had helped GVT restructure its debts, preparations were made to present a prospectus to the *Comissão de Valores Mobiliários* (CVM), Brazilian agency that is equivalent to the US Securities and Exchange Commission. Once it had decided to be listed, GVT had to restructure some of the debt with the international lenders. These creditors had entered the game when some of the equipment vendors decided to sell their securities at a discount, on the market, during the 2002 crisis. Some of these securities related to GVT’s debt. Negotiations took place with the funds that held these securities in mid-2006 in New York. “We negotiated the conversion of the debts one by one into investments, paving the way to the future realization of the IPO process,” said Brazilian Credit Suisse’s CEO José Olympio Pereira, referring to dealings with the funds.

Everything was ready by the end of the first half of 2006, but GVT decided to wait for a better circumstance for its IPO. That window of opportunity came in February, 2007. GVT’s IPO was the first of all CLEC of the world, so it was difficult for the financial market to define its share price. There were simply no precedents with which to make a comparison, an uncertainty that led, interestingly, to a higher than typical estimate for the share price: the R$ 11 to R$ 16 range valuation was much higher than the typical one, of R$ 2 (R$ is symbol of Brazilian reais). With prices defined, it has started roadshows throughout Brazil, Europe and USA. The impression caused during roadshow allowed the decision of a higher price for the share (R$ 18). So, on February 14, 2007, GVT’s shares were sold at Bovespa (Brazilian Stock Market) and allowed the company to raise US$ 510M.

Expansion

With the money raised in its IPO, GVT went further into the process of geographic expansion. The first step was to buy Geodex, a backbone company with 11,000 kilometers of cables, cutting right across Brazil following (roughly) the coastal line and serving all the main cities in the North and South. Geodex was strategic to achieve GVT's expansion plans outside Region II. Considering Geodex acquisition, GVT invested in 2007 three times more than the previous year, and beat its record in expanding infrastructure by also tripling the number of accesses built. As result, company expanded its operation outside Region II, which had been marginally restricted until then to the corporate markets of Sao Paulo, Rio de Janeiro and Belo Horizonte. The new focus was retail, starting with the largest cities.

Ricardo Sanfelice, GVT's Marketing VP, said: "We had a period of austerity in terms of efficiency and financial management from the startup to the IPO process. The money from the IPO came in 2007 and we replicated the business model on a greater scale for a new cycle of geographical expansion." As a result, the earnings achieved at the end of the first year as an open capital company justified the confidence of investors, customers, team and market observers. Net revenues were almost US$ 510M, with an impressive Ebitda margin of 40.1%. The *Valor Econômico* newspaper said the GVT share had brought the best return among the investment options on the Bovespa in 2007.

The year 2008 followed the same pattern, with GVT winning prizes and, most importantly, achieving positive results. Company received the IDC Innovation Awards for the broadband project of the year. It was also regarded by JP Morgan as one of the best investment choices in telecommunications in Brazil in that year. It was further classified as the third best investment choice for shareholders in the category of companies with a market value of between US$ 2.14B and US$ 6.42B in the "Best Companies for Shareholders" ranking of *Capital Aberto* magazine. GVT was the only company in the telecommunications sector that performed well in all the items analyzed - liquidity, value creation, financial return, corporate governance, and sustainability.

GVT's culture

The values from the founders, combined with early diversified teams with people from many countries and former GVT's experiences consolidated a peculiar organizational culture. By the year of 2007, GVT decided to formalize its values in what they called Management Model. The values were listed as follows: "Efforts directed at customer satisfaction" (including aspects such as "Attends the customer promptly and sympathetically", "Identifies up to which point can he/she meet customer's expectations, and properly replies in time"); "Commitment to the organization's profitable and continuous growth" (covering items such as "Concerned with cost control in all his/her actions", "Constantly looks for new sources of revenues, new businesses, and costs optimization", "Does things correctly the first time, avoiding rework"); "Using personal initiative with accountability and integrity" (including "Complies strictly with the company's ethical standards"); "Agility in decision making" (with topics such as "Avoids putting off decisions: takes the decision at the time it needs to be taken", "Thinks carefully, but quickly, on the consequences of his/her decisions"); and "Simplicity in execution" ("Brings ideas that are easy to be implemented and improve the company's results").

Besides, company proposed its competence as a guidance to employees, leaders and performance management systems. The competences were: strategic guidance, focus on executing with results, focus on external client, and leadership and people management. For GVT, they were not management fad, but an effort to pass on to future employees what was grounded in its history and they believe to be essential for perpetuating business success.

Some company’s practices illustrate how serious those values and competence were taken. For instance, company decided to invest in its own infrastructure of call center, against common practice of other telecom operators to outsource it. There was the policy to make executives and top managers follow in person the operation of call centers, some days per year, to face the customer’s reality more directly than by executive reports. Other practice was to make this managerial team dress uniforms of phone installers and go out on the field to accompany technical staff in their daily operations, aiming the same reality perception. That was an operation internally called “Consumer Expedition”. All of them demonstrates its value “Efforts directed at customer satisfaction”.

A new player comes

By 2009, with such a good performance, shareholders of GVT were considering launching a secondary IPO. So, a new campaign started to prepare prospects and folder, when a new player came into stage. The chairman of Vivendi, Jean-René Fourtou, was sailing off Cannes, when a manager of the Crédit des Alpes investment bank brought him some news that an interesting Brazilian company, GVT, would be placing some shares on the market. Vivendi is a French telecommunications and entertainment conglomerate that owned businesses such as Universal Music (the music industry’s global leader in recording and publishing), Canal Plus (producer of television programs and leading French Pay TV company), Activision Blizzard (leader in the gaming market), along with telecommunications carriers like Maroc Telecom (leader in the Morocco market) and SFR (a French telecommunications company). In 2008, Vivendi’s revenues in 2008 amounted to €25.39B (US$ 35B).

As Vivendi was looking for opportunities in telecom business, the offering caught Fortou’s attention. After studying it and talking to GVT’s shareholder, they decided to buy its entire control. That interest led GVT to interrupt its effort for another IPO.

After due diligence, Vivendi offered R$ 42 per share, above the price of R$ 32 at which the share was traded on the market at the time. Shareholders accepted the offer, and Jean-Bernard Lévy, CEO of Vivendi at the time, flew to Brazil on September 2009, to close the deal. As soon as he arrived at the airport however, he read at the newspaper that Telefónica, the huge Spanish telecom company with solid operations in Brazil, had raised the offer to R$ 48 per share, in an almost hostile takeover as they have not communicated GVT’s executive management of their intention. Later on, Telefónica’s executives explained Genish they did so not to lose the dispute, that was why they launch the offer this way. Telefónica had always been regarded as a potential buyer of GVT, as its operational coverage was complementary to its region. Telefónica could not let that opportunity pass by and, to ensure the acquisition, raised its earlier offer on November 5 to R$ 50.50 per share.

But on November 13, 2009, Vivendi group made its final offer of R$ 56 per share. Telefónica gave up. So, on April 27, 2010, Vivendi assumed control of 99.17% of GVT’s capital. It canceled the company’s listing on the CVM 10 days after. The share price gave the company a market capitalization of over US$ 4.29B, a huge appreciation for investors who had paid R$ 18 per share at the IPO in February 2007.

As Vivendi was a holding company that had stakes in various companies and was not an operator itself with specific expertise in any area, it did not interfere to any great extent in things that worked well. Amos Genish remained as CEO, and he was given a seat on Vivendi’s Management Board in France. Genish recognized the opportunity to accelerate the expansion of GVT’s domain: “The change in control has a strategic character as we now have a majority shareholder that is active globally in fixed telecommunications, mobile telecommunications, Internet broadband, Pay TV, online games and content. This broadens our horizons and will allow us to speed up our timetable for expanding and entering new businesses." And that was what happened. With Vivendi support and capital, GVT did triple its investments in CapEx.

The French corporation not only brought new products and resources for investment, but they also made important contributions to management. Despite broad strategic guidance, in the pre-Vivendi era planning at GVT had a one year horizon. The cycle began in the middle of the previous year, with discussion of the initiatives for the following year. Then, a budget was established and a detailed business plan was drawn up. So, the plan got underway, with understanding that there would be concessions for revisions to be made during the year.

With Vivendi's arrival, the plan horizon was expanded. "We started to have more structured processes and make projections for a period of five years," said Sanfelice. "These forecasts are revised every year and this makes all the difference."

Entering Pay TV

But the main contribution of GVT was still to come. It was GVT entering into Pay TV. Though it was company's intention to enter into this business since inception, as they saw it as a convergent business, they lack opportunity to do so. Especially because Brazilian market had already huge players, dominating dominate both cable and satellite technologies, besides a legislation that allowed cable TV to enter telecom market but not vice-versa, and the fact that margins at pay TV were lower, 22% against the 40% Ebitda margins GVT was used to achieve. However, things changed around 2011, because legislation was modified, Vivendi arrived with experience on Pay TV and a new technology emerged. Visiting the IPTV (Internet Protocol Television) World Forum held in London, Genish, Sanfelice, and Celso Valério, GVT's Innovation Manager, were walking through the stands when one in particular caught their attention. It was from the Swedish telecommunications technology supplier Ericsson, which developed a hybrid TV that combined satellite for the transmission of channels while using broadband for interactive services. This solution allowed the customer to receive the standard TV programming through a satellite dish while browsing Internet. That created the possibility of offering something different: as Genish said, "GVT always looks for a way of innovating when it enters new businesses".

GVT started negotiations with Ericsson in order to implement that new technology. After one year working together, GVT had a pre-launch of its Pay TV service in September 2011. By January 2012, the service was launched into market. et the decision to offer a revolutionary hybrid platform, and in record time, came at a price. GVT faced quality problems it had never experienced before. The broadband Internet was good, as was the fixed telecommunications service, but the Pay TV element within the package did not work properly, and sometimes even interfered with the functioning of the other platforms. The entry into the TV sector brought record levels of complaints and the company lost clients as outcome. GVT was used to providing a top line service and being perceived as a premium service provider. To hear so many complaints from clients dented its self-confidence, even leading to an identity crisis.

Company did not stand idly as client dissatisfaction was on the rise. It mounted a war operation to reverse that situation. First, it created the role of Vice President of Quality. The hybrid technology was adjusted, and the Pay TV product was modified to allow the possibility of selling it in a simpler, satellite-only version, without the interactivity provided by the combination with the Internet. After a huge effort, problems could be fixed.

Despite the initial problems with Pay TV, the view at the end of the day was that GVT had to enter TV at that time or it would run the risk of losing the triple play wave; besides, the net effect of TV is positive. "TV contributes a lot to the company's growth today, thanks to the development of the products and its new functions," reflected Fabiano Ferreira, Sales VP. Vincent Bolloré, Chairman of Vivendi, shared this opinion: "GVT has been able to diversify its activities in Pay TV, which has been experiencing steady growth since it was launched in 2012." At the end of 2014, the company reached more than 860K registered TV subscribers. Furthermore, even with TV, a business with lower margins, GVT's Ebitda margin remained in the 40% range.

For sale, again

Despite its good results, on October 2012, Vivendi announced its intention to sell GVT. The news took GVT executives by surprise. The company had received large investments shortly beforehand and had met expectations by presenting high levels of growth and enviable financial results. "We were one of the darlings of the Vivendi group, the one that had grown the most and added more value. Despite this, we received the news that we were going to be sold," said Genish.

The decision emerged because of a bad investment Vivendi had done a year before at SFR, a large telecom mobile company. Just after investing € 7.95B (US$ 11.3B) to buy a stake of 44% of SFR shares from the British company Vodafone (Vivendi had already 56% of its share, so achieved total control), a new French competitor, Free, would launch an aggressive quadruple play combo (bundling 4G mobile service with broadband Internet access, Pay TV service and fixed telephony service) a few months later, for half the market price. The result was a plummeting of the sales and market value of the other telecom operators in the French market. Less than a year after buying SFR, Vivendi's share price had tumbled from around € 23 to € 12.

As such, it increased pressure over the board of Vivendi to leave all investment in telecom and concentrate its business in content and entertainment business. As result, former CEO Lévy resigned and Fourtou, the chairman, took his position. And his first decision was to sell off all investments in telecommunication, GVT included.

As GVT was put to sale, some interested investor shows up, but none offered the price Vivendi expected. Meanwhile, Fourtou visited Brazil and got to know GVT better. He liked what he saw and decided not to sell it in March 2013. "GVT could be integrated to Vivendi's new strategy," he said. But now, who was not confident of remaining inside Vivendi's conglomerate was Genish. As he saw it, "Vivendi's focus remained on content and media. Projects for Pay TV were welcome, but heavy investments, such as expanding the fiber optic network, would be harder to approve". To make things worse, being able to offer quadruple play combos (bundling fixed broadband, fixed telephony, mobile telecommunications and Pay TV) was expected to become increasingly important. In this way, one piece was missing for GVT: mobile telecommunications. And it would be expensive to get it.

With all these questions in mind, Genish suggested to Vivendi, in February 2014, that GVT should look for another partner or find the resources for the necessary investments. Perhaps it was time for a fresh opening of capital in Brazil. "Considering Vivendi's strategy, I told them it was time to let us find another partner, so we could ensure our ability to compete". He was told that GVT would not be put up for sale but that he could look for sources of financing or arrange local partnerships, and then submit the results to the board for its consideration.

With that approval, Genish started chats with Marcos Patuano, CEO of Telecom Italia, owner of TIM, one of Brazilian leaders in mobile industry. As Patuano put it, "the future of mobile telecommunications will be mobile connectivity. This will demand great investments to be able to offer all the services the customer wants, regardless of whether it has a fixed or a mobile network. To do so, we needed to have a fiber network that was very well developed in the large urban areas of the country.” GVT fit like a glove on this project. “GVT had an incredible history, great coverage, latest generation technology and an executive team that we felt very comfortable with. There was a possibility of joining two companies with a very similar DNA in innovation”, he added.

After some meetings, both Genish and Patuano agreed on the possibility of a merger, capturing the synergy existing between the companies. They agreed that the next step would be a visit to Paris to present their plans to Vivendi’s Chairman, Bolloré. On June 25, 2014, Genish and Patuano met Bolloré. They present him their plans and Bolloré agreed with the thinking behind the merger between GVT and TIM, and authorized the due diligence.

It was then that Telefónica heard about this approach between TIM and GVT and, fearing losing GVT again, literally embarked in the game, first announcing its interest and then catching the motorboat to show in person a proposal to Bolloré in the Mediterranean Sea.

Telefónica’s acquisition

Although GVT was not actually up for sale, the sheer scale of the interest meant its controllers had no other choice but to examine the proposals. They issued a market notice, announcing that other companies wanted to acquire GVT, and stressing that, if there were any other candidates, Vivendi would receive their offers until August 27, 2014, on the eve of the board meeting. On the deadline’s last day, both Telefónica and Telecom Italia presented their proposals. Both were analyzed at the board meeting the day after. Telefónica’s proposal of US$ 9.29 B was considered the best. So, Vivendi, which had spent US$ 4.44Bto buy GVT 5 years earlier, had nothing to complain about.

With GVT, Telefónica Brasil consolidated its leadership position as an integrated telecommunications operator in Brazil, leader in the mobile industry and in the high-speed broadband market, with national coverage, and with a solid lead on high value segments. It was an ideal combination in structural and operating terms, and it was recognized also by the market.

On March of the following year, regulatory agencies in Brazil approved the acquisition. In the same day, Telefónica announced its new structure in Brazil, with Amos Genish as the president of the company. As such, Genish would have some challenges: how to inseminate GVT’s culture and innovation into Telefónica, a much larger operation?

PEDAGOGICAL NOTE

This case is one of the outcomes of a larger research project on business models (BM) in dynamic industries. Particularly in this case of GVT, authors collected data predominantly through semi-structured interviews combined with focus group debate, observation and gathering of secondary data. This research involved 35 semi-structured interviews (recorded and transcribed) with GVT top management team, besides stakeholders, competitors, regulatory and financial representatives. We used snowball sampling, starting “with a small group of people relevant to the research questions, and these sampled participants proposed other participants who have had the experience or characteristics relevant to the research” (Bryman, 2012, p. 424). We started with GVT C-Level team and used theoretical saturation, “carrying on sampling theoretically until a category has been saturated with data” (Bryman, 2012, p. 421): in our case, proposed (BM) components. Secondary data and documental analysis were drawn on the following GVT’s data sources: cash flow and cost reduction action plan (GVT, 2002); marketing strategy plan to enter the Brazilian Region II market (McKinsey, 1999); marketing strategy and business plan from vendor financing information memorandum (McKinsey, 2000).

This teaching note is useful for academic discussions about business models in dynamic environment, such as the sector that GVT represents (telecom industry).

Summary of the case

GVT entered Brazil as the opening of the telecommunications sector was drawing to a close. It took part in the last of the fixed telecommunications auctions. It entered with no experience as a telecommunications carrier on a large scale and paying US$ 54K for the license (although it committed itself to subsequently investing around US$ 600M).

GVT's history can be understood in cycles. First of all, its "pre-history" coincides with previous experience of its founders in operations in Latin America up to winning the authorization to operate in Brazil's Region II. The second cycle corresponds to the efforts to launch to the market. The third cycle, the operational one, is marked by a large number of externally driven crises and by lean times within the company itself. IPO process was the start of its fourth cycle, characterized by heavy investments and by the expansion outside its original area of activity, replicating the highly successful strategy of differentiated products and services for selected clients and regions, still in the same business – fixed telecommunications and Internet broadband. A fifth cycle got underway when the company was acquired by Vivendi and investments in infrastructure tripled – as did the growth rates and results – and GVT entered a new business, Pay TV. Finally, a new cycle has begun with Telefónica's integration.

Subject

Business models in dynamic environment.

Target public

Students from Master and Doctorate programs in Administration.

Learning objectives

To make participants able to comprehend features and limitations of traditional concepts of business models, guiding to the discussion of an alternative framework suitable to dynamic environment context.

Theoretical framework

Telecommunications industry

Organizations of all sectors and sizes operate in a constant-changing business environment, fenced by uncertainty and with continuous need to respond, rapidly, changes that go beyond local boundaries. Particularly, in telecommunications industry, discontinuities and disruptive innovation that affect consumer demand are examples of challenges that organizations in this sector face (Fransman, 2001; Van der Boor, Oliveira & Veloso, 2014). Besides, increased convergence movement (telecommunications technological convergence, software, internet, electronic devices) has caused a paradigmatic shift in traditional telecom organizations (Fransman, 2001). It is also observed that this industry has shifted to an Information and Communication Technology (ICT) converged market (Birudavolu, Nag & Wali, 2016). Therefore, technology innovation is constant; in regarding, organizations need to invest more and more to provide robust yet scalable infrastructure to accommodate innovation and industry trends (Birudavolu, Nag & Wali, 2016).

Nevertheless industry innovation and consumer demand changes, other external elements such as broader market competitors and key players' strategy, stakeholders and regulatory aspects are vital elements that cannot be ignored when building strategy (Zhang & Liang, 2011; Ghezzi, Cortimiglia & Frank, 2015). Specialization, financial markets, competition, consumer demand and the porous limits of this industry are important forces of its development (Fransman, 2001). In this fierce competition, technology-driven, multifaceted and volatile contexts, telecommunications service providers need to focus on quality, value-added services, and corporate competences to keep up with the challenging task for setting successful business (Birudavolu, Nag & Wali, 2016).

To manage such dynamic environment conditions, BM that include pricing strategy and value network relationship are required (Fernández & Usero, 2009). In fact, BM is key to drive organizations to a success path and a sustained competitive advantage (Teece, 2010; Johnson, Christensen & Kagermann, 2008). Facing these industry features with complexities typical of telecommunications market in Brazil and its recent privatization process, brings even more challenges, such as regulatory policies, hand labor costs, infrastructure, population's purchasing power and tax burden. By pondering all these challenges, we postulate that traditional BM are insufficient when assessing external elements, notwithstanding dynamic business context and fast-paced evolution of telecom industry.

Business Model

The implementation of an efficient BM design can explain an organization success. Critical decisions regarding market niche and related investments are processed at the design stage. Therefore, BM might potentially become a cause of sustained competitive advantage if strongly well-structured and innovative (Teece, 2010). Casadesus-Masanell and Ricart (2010) define BM as the logic of the company, how it operates and creates value for its stakeholders. The choice of a BM entails a careful alignment of organizational components. The authors agree with that and defend that strategy, consequently, is the BM choice a given company decides to develop and tactics, the possible residual (and consistent) decisions to be taken within a given BM.

Zott, Amit and Massa (2011) organized BM body of knowledge in 4 major areas: (a) as unit analysis; (b) as framework to potentially explain how organizations do business; (c) as framework to analyze proposed commercial models; and (d) as framework to explain value creation by companies. In organizations, value creation is linked to processes, resources and financial structure articulated by companies to provide their customers value added products and services. This is critical to sustain competitive advantage, likewise identifying customer needs and implementation viability (Johnson, Christensen & Kagermann, 2008; Teece, 2010; Ghezzi, Cortimiglia & Frank, 2015).

So, organizations are able to create value to their customers by providing solutions to a problem or offers a product or service that better matches their needs. Organization's profit is result of customer value creation; thus, it represents an important business success marker (Johnson, Christensen & Kagermann, 2008). According to it, Teece (2010) argues that not only innovative portfolio but also robust and well-designed BM are fundamental to obtain competitive advantage. When a company offers solution to a problem or innovates (no matter if in terms of products or services) to better fit customer needs, this is an outcome of a well-structured and articulated BM that drives organization to success (Johnson, Christensen & Kagermann, 2008).

Game-changing opportunities bring new and radical customer value propositions: they fulfill a job-to-be-done in dramatically better ways, solve a problem that has never been solved before, or serve a whole unaddressed customer base. Capitalizing on such opportunities does not always require a new BM, but one that offers that flexibility to leverage its strength to develop innovations: after all, it neither addresses an entirely new group of customers nor it represents a major disruptor element (Johnson, Christensen & Kagermann, 2008).

Lambert and Davidson (2013) use the perspective of BM as unit of analysis and state that it can be used to assess organization performance. As per Johnson, Christensen and Kagermann (2008), successful organizations operate according to a BM that can be broken down into fours elements: (1) customer value proposition, that fulfills an important job for the customer in a better way than competitors' offerings do; (2) profit formula, that lays out how the company makes money delivering the value propositions; (3) key resources and (4) key processes needed to deliver that proposition. Indeed, the model of Johnson, Christensen and Kagermann (2008) integrates these 4 organizational components, been one of the most relevant in literature regarding the value creation process understanding.

Customer value proposition expresses the way in which an organization creates value to its customer, including an effectively delivery of what it was proposed. Profit formula is the way in which a company creates value for itself, at same time that it delivers value to the customer; it includes methods for creating revenue streams, working capital, profit margin and cost structure. Key resources encompass people (involved in the processes), technology, equipment, distribution channels and brand itself; they are supposed to be aligned to customer value delivery and to generate competitive advantage. Finally, key processes include training, designing, budgeting, planning, sales, services, metrics, rules and norms (Johnson, Christensen & Kagermann, 2008).

All in all, the model of Johnson, Christensen and Kagermann (2008) permits the understanding of all components of the organizational processes, enabling the description and analysis of any company's BM. Particularly, this model provides the association between process and key resources, helping the understanding of company's value proposition.

Business model in a dynamic environment

Although the model of Johnson, Christensen and Kagermann (2008) manages many elements required for this research, it does not account for the impact of business and technology disruptions, which are common elements within the dynamic environment many businesses face today. Ghezzi, Cortimiglia and Frank (2015) and Cortimiglia, Ghezzi and Frank (2016) emphasize on this respect. According to those authors, it is important and necessary not only to analyze the BM itself, but the elements that nurture and sustain BM along the time, mainly disruptive change factors. Ghezzi, Cortimiglia and Frank (2015) classifies disruptions as environment or enterprise-driven. Environment-driven changes are exogenous to the firm and can happen at micro (like strategy making in a single company) or macro-level (i.e. industry) analysis. The authors further distinguished environment-driven changes as (i) external innovation, (ii) regulatory change, (iii) customer change and (iv) competitor strategy change.

On the other hand, enterprise-driven changes refer to disruptions to the competitive *status quo* generated by the firm itself. Its origin can be (i) research and development (R&D) efforts and (ii) emerging resources and competences. From these concepts, Ghezzi, Cortimiglia and Frank (2015) propose to analyze how disruptive change impacts BM dimensions. In their framework, it is considered each disruptive factor due its impact on each BM dimension. Figure 1 illustrates their framework.

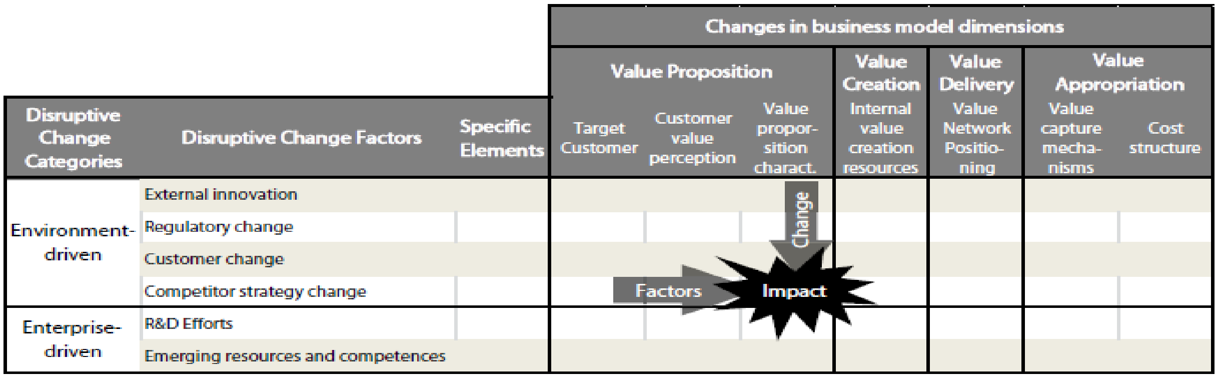


Figure 1 - Ghezzi, Cortimiglia and Frank (2015) framework

However, the model of Johnson, Christensen and Kagermann (2008) fails to provide the nurturing process that sustain the BM: in other words, the relationship between external components influences on BM dimensions. Under this perspective, the model of Ghezzi, Cortimiglia and Frank (2015) manages these relevant external elements by crossing disruptive change factors and BM dimensions. By doing that, it allows to estimate different impact degrees (i.e., strong, median or weak, or any other adequate scale, in a quantitative approach). But the tool, itself, can be evaluated as not enough if used alone, because of the lack of other qualitative elements of analysis.

Thus, as a way to employ BM as a valid method to explain organization’s performance, providing insights for the strategy process included in the nurture of its BM over time, we extended Johnson, Christensen and Kagermann (2008)’s model, by including elements of Ghezzi, Cortimiglia and Frank (2015)’s tool. Outcome is a more suitable framework for this assessment, as shown in Figure 2.

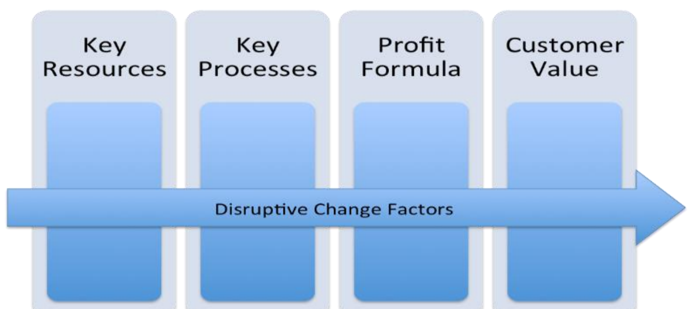


Figure 2 - Proposed adjusted model from Johnson, Christensen and Kagermann (2008) and Ghezzi, Cortimiglia and Frank (2015)

As well as in Johnson, Christensen and Kagermann (2008)’s model, key resources encompass: people; technology / products; equipment; information; channels; partnerships / alliances and brand. Key processes encompass processes, rules & metrics, and norms. Profit Formula: revenue model, cost structure, margin model and resource velocity. All these elements lead to a customer value proposition that encompasses target customer; offering, and job-to-be-done to solve an important problem related to an important need for the target customer. In addition to these dimensions, we included 2 disruptive change factors (adapted from Ghezzi, Cortimiglia & Frank, 2015): environment-driven (external innovation, regulatory change, customer change and competitor strategy change) and enterprise-driven (R&D efforts, and emerging resources & competences).

In summary, based on the research literature, we highlight the following aspects of this case (intercession elements of both environment / business models to sustain and organize analysis): a) Customer Value Proposition (CVP); b) Key Resources (KR); c) Key Process (KP); d) Profit Formula (PF) and e) Disruptive Change Factors (DCF).

Recommendations

In class, it might be revisited striking facts of GVT history, from its foundation until its acquisition by Telefónica. This can be supported by the previous reading of the book "Of fiber and people", from Fernandes and Barbosa (2016). It is important, also, previous read of papers from Johnson, Christensen and Kagermann (2008) and Ghezzi, Cortimiglia and Frank (2015).

In discussion strategy, students must analyze gathered information under business model elements, aiming to understand the magnitude of business dynamism in telecom sector.

Possible questions & expected answers

Key question: considering GVT's history, proceed an analysis of its business model, bearing in mind not only its components but disruptive factors affecting company and its environment.

Customer value proposition: GVT demonstrated that innovation on value proposition may be the only alternative for new entrants in highly competitive markets, such as telecom industry. The decision to become a differentiated telecommunications company, serving a demanding segment, is seen in factors such as state-of-the-art technology, directed at customers who were carefully and geographically selected, with an offer of sophisticated products, directed communications and a differentiated service, among others. Company's tactical decision, sustained throughout its existence, maintaining an updated portfolio of products and technologies directed at its target public, complemented the BM. GVT's ability to execute in a disciplined, consistent way was part of its corporate philosophy.

Key resources: One of GVT's key resources was its culture. It is possible to identify how the founders' characteristics and experiences blended in to consolidate a particular culture, expressed in its Management Model. The emphasis on planning and execution is a feature and corresponds to listed firm's competences. The company's approach into a new product was preceded by detailed feasibility studies. The fact that the process was carried out in such a meticulous way does not mean that there is no rhythm. This was how decisions on which technology to bet on, which markets and cities to enter, and which products to launch were made. Technological infrastructure was another critical resource for GVT. Even during the crisis times, whatever had to be spent in these areas was spent.

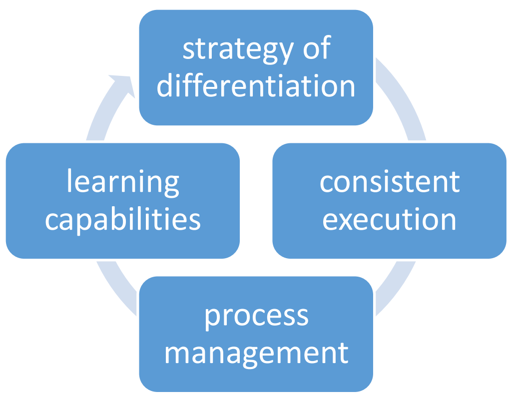
Partnership / alliances: Technology suppliers (or vendors, in the jargon of telecom industry) were decisive to GVT starts its operations, in such way that partnership and alliances are key pieces of company's BM. Most of GVT's innovation, like its IT platform, network infrastructure or pay TV technology was original in world level and obtained through joint development with its partner as a sort of pilot test.

Key processes: The detailed planning process was a trademark of GVT. It established projections five years in advance and defined targets for the following year, with budgets and key performance indicators. Then they were closely monitored, with quarter reviews. Customer care was a GVT key process. Practices like "Consumer Expedition" and executive dedicating time to attend on call center prove it. Training process was another key process, with a permanent and intensive agenda of internal and external events throughout the year, to train workers, recycling old knowledge and opening new ones, especially in the case of new technologies. Another process was the performance of management system, focused on consistent execution and on company's values and competence. Financial processes were also meticulously design and monitored. Every investment was conducted under a perspective of return of investment, control of expenses and sense of urgency. In summary, well-designed and managed processes were one of the features of GVT's BM.

Profit formula: Regarding GVT's profit formula, revenue was originally sourced from double play (fixed phone and internet), moving later to triple play (fixed phone, internet and pay TV). Throughout the years, remained the firm decision for not exploring mobile communications, market already taken by giants of telecom sector. Such decision allowed the necessary focus to develop products and services with higher performance, in technical and financial perspectives. This was one of the reasons of the Ebitda above the sector average.

Disruptive change factors: As other operators, GVT always had to deal with external breakthroughs, like VOIP services, Skype and WhatsApp – some of them turn into new business for the company, case of Vono (VOIP service). In telecom industry, new technologies often lead changes in regulatory, customer, competitor and market fields. But GVT not only suffered influences from outside, but also inflicted them on competitors with its R&D efforts, emerging resources and competences (some of those acquired from Vivendi, as the case of pay TV). Its new IT platform and infrastructure network allowed products and prices competitors could not cope with.

Blackboard plan



- **strategy of differentiation:** the distinct strategy to deliver to high-income consumers (class A and B, and corporate), i.e. customers willing to pay more for a differentiated service.
- **consistent execution:** coherent strategy execution, in operations, finance (selective investments and control), customer care (communication, customer service and products), people care through strong leadership with a sense of mission (revolutionize telecommunications), an overview (starred in several countries before arriving in Brazil) and closely following the deal. Besides the cultural mix, there were also the human resources policies to stimulate uptake, retention and motivation of people.
- **process management:** company also worked well its processes, making care planning, setting budgets and monitoring results through indicators; and knew how to work well the regulation of the sector, respecting it but exploring its limits.
- **learning capabilities:** company has shown great ability to learn quickly on opportunities, knowing how to adapt and innovate.

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