CORPORATE VENTURING AT TELEFÔNICA BRASIL: THE QUEST FOR STRATEGIC INNOVATION

By Carlos Arruda, Afonso Cozzi, Érika Penido and Guilherme Souza

INTRODUCTION

The Telefonica Group is a market leader in Brazil, and a benchmark in the global telecom industry. The Group develops integrated operations in fixed and mobile telephony and cable television. In 2010, the Group earned revenues to the tune of R$36 billion, accounting for approximately 15% of the Group's revenues worldwide.

Growing and yielding consistent results for the past 10 years have ensued from a series of accomplishments to correspond to the boldest expectations harbored the Group's stockholders. The company achieved its universalization goals one year before the official deadline, was a pioneer in consumer broadband provision in Brazil (with the Speedy product) in 2004, and the only large operator worldwide to enjoy growth in fixed telephony in 2010.

Such accomplishments were supported by incremental innovation in processes, product extensions and new markets. At Telefônica Brasil, incremental innovations occur within each area, encouraged by cultural change and communication actions. They yield year-to-year results and short and medium run improvements. Ricardo Kahn, innovation and new business manager at Telefônica do Brasil, highlights the importance of these innovations for the company: "In a large company, small savings or a small revenue increase that will affect a large number of customers may entail important results, involving sums that few startups can yield annually".

However, to maintain growth in the mature telephony market, reaching increasingly aggressive goals, Telefônica has also concentrated significant efforts in the quest for innovation called strategic, assuming greater risks and potential returns. "Strategic innovation helps design our dream future", stated Ricardo Kahn.

These efforts include reflections into strategic issues related to the company's businesses, such as:

- "Should we invest in VoIP or fight it?"
- "Does it make sense to invest in devices?"
- "Should we offer technology support services?"
- "What will television be like in 10 years?"
- "Who will be our next competitors? Google, Sony, Apple, HP, Microsoft?"

The quest for strategic innovation at Telefônica reflects its internal Corporate Venturing (CV)1, practices, involving investments in differentiated businesses to grow profitably.

The company's approach to promote strategic innovation is different from that used for incremental innovation. Worldwide, this approach involved the establishment of the TelefonicaDigital global business unit and the definition of seven global platforms for innovation (Annex 1). In Brazil, Telefônica's Innovation Center is

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[1]Internal Corporate Venturing (ICV) entails the creation of units within the organization that are developed and managed by company employees. Morphing R&D activities into new businesses and creating new stand-alone units that may eventually be incorporated into the company's operating system are ICV activities.

responsible for the development of innovations and new businesses. The separate structure helps the company face the existing resistance within and without the company vis-à-vis strategic innovation. Ricardo Kahn highlights the importance of this development agility: "We think ahead, but we should act quickly. The case of tablets and netbook computers shows the speed of the innovation effects. In 2009 36 million notebook computers were sold, and in 2011 tablet sales should reach 45 million."

THE INNOVATION FUNNEL AT TELEFÔNICA

"Innovation presupposes risk. To take them very well defined processes and a lot of discipline are required", explained Ricardo Kahn, innovation and new businesses manager at Telefônica Brasil.

At Telefônica, emerging businesses pass through the innovation funnel, including the following new business development cycle stages: Prospection, Assessment ("acid test"), Concept Proof, Incubation and Rollout.

By seeking strategic innovation with emerging businesses, Telefônica's objective is not short-term financial return. In this case, agility is considered of the essence and errors are acceptable, within a portfolio view. "Some initiatives in our innovation funnel will succeed, while others will fail. It is important to miss fast to miss small", noted Ricardo Kahn.

However, the company seeks to keep its "funnel" permeable. Knowledge and technologies are tapped internally and externally. Some emerging businesses are managed within and others without Telefônica (Annex 2). Funnel entry and exit decisions are made by an innovation committee, for all projects with the use of the stage-gate model. This committee enjoys strong senior management adherence (president, mobile and fixed units CEOs, unit vice-presidents and people from the corporate innovation center in Spain). Project coordination is made by the innovation area in all stages.

To define funnel projects, Telefônica promotes ideation waves. Several ideation waves have already been made in the company, each pursuing a different philosophy. In the first wave, consulting company was retained to help search for benchmarks. Other waves sought ideas from suppliers and university students. The frequency of these waves depends on the company's requirements, according to the progress achieved by its innovation funnel. In general, one or two waves are conducted per year. Besides, new ideas may come in from outside the waves, in more developed stages. Some partnering projects with other companies and mergers & acquisitions also happen in the process as well.

Following assessment and an initial test of the new business (Acid Test), Telefônica runs the new project through the concept proof, whose objective is to submit the product to customer evaluation without delay. "The concept proof is akin to a survey. It is not a pilot run. The product is developed, without seeking profit. It may cost more, but we have to do it quickly. The objective is to watch for customer reactions and seek answers to some questions, explained Ricardo Kahn. In this stage, the company seeks not to involve its main processes. The objective is to test the assumptions in practice and to identify the main commercial, operating, technical, and other risks and bottlenecks.

THE INCUBATOR

To accelerate project development, Telefônica established an incubator, which seeks to simulate a startup environment with venture capital funds. The incubator was established such as to ensure certain independence vis-à-vis the parent company and some of its processes are facilitated compared to other company units.

It is interesting to note that the incubator's projects are part of Telefônica (they do not have a separate CNPJ Finance Ministry registration number) but are not linked to the Telefônica brand. For example, the business cards of the executives from atHome, a newly incepted company from the incubator, did not follow Telefônica's pattern, but showed only the name and the logo of the incubated company.

Projects report to an "Incubator Council", comprised of the company's CEO and main VPs. This council is responsible for project approval, for which bimonthly goals and a burn rate are defined[2]. (Annex 3).

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[2]The burn rate is the rate at which a business spends the funds provided to finance its general expenses before yielding a positive cash flow from operations. It is a measure of negative cash flow.

Following approval of a project to be incubated, the business team (incubation team) is defined and relocated to another physical site. This promotes a deeper startup feeling. Responsibility for the incubation is defined to five individuals who begin to manage the business conducting activities such as contract drafting, service promotion, hiring people, service and maintenance.

"The incubator provides a segregated, less hierarchical environment, for the projects that seek strategic innovation for Telefônica. This stimulates creativity and allows projects to take on a startup pace", noted Ricardo Kahn.

The incubator is also given support by the "Incubator Workshop", consisting in an administrative office reporting to the innovation directorate. The support is provided to issues such as budget, umbrella contracts and reports.

ROLL-OUT

Projects remain in the incubator for one or two years, tops. The exit strategy is devised along the project development process. The exit definitions take approximately one year. In some cases, a spinoff is done, with the incorporation of a new company. In other cases, the new business is incorporated to Telefônica's process, which may occur in its traditional market or in untapped markets or in other industries.

"Telefônica's measure of success is to be able to 'climb up and down the mountain, and arrive alive'. Exiting the incubator is challenging, especially at the time of incorporating the projects into Telefônicas processes", noted Ricardo Kahn.

PROJECT EXAMPLES

One of the projects coordinated by Telefônicas innovation area was the "Popular Broadband" program, created by the government of the State of São Paulo. Launched in the neighborhood Cidade Tiradentes, the service offers prepaid broadband at the price of R$29.80 for 31 days, in low-income neighborhoods areas, using Wi mesh / Wifi technology.

This project was developed at Telefônica's business incubator and recently exited via incorporation to the company.

The Popular Broadband service differs from Telefônica's traditional business. The service is prepaid and the purchase is made at the company's on-line store or at points-of-sale. Marketing is by word of mouth, and community dwellers – in the eastern zone of São Paulo – are the sales people. The popular broadband installation process is different from Telefônica's traditional process. There is an access link, extended to myriad apartments.

The project was commercially successful reaching 9,000 recharges by June 2011. The pilot project, with five promoters only, 10,000 registrations were made. From June 2010 to June 2011, the number of Cohab-type apartments connected with Telefônica's Popular Broadband jumped from 2,000 to 60,000. The number of users reached 100,000. The social benefits achieved are also significant, since they encourage the provision of services over the Internet and encourage children to remain at home. "The system is taking the kids off the streets. With the Popular Broadband service, kids stay at home and avoid LAN Houses, where we never know what kind of company the kids will find", explained Eduardo Koki Iha, the manager responsible for the Popular Broadband project incubation.

Ricardo Kahn highlighted that strategic innovation projects such as Popular Broadband propose new manners of working to Telefônica. "How can we tell Speedy installers that 10 out of 40,000 installations will be made differently? This means breaking rules, which is bothersome and laborious".

Other projects coordinated by Telefônica Brasil's strategic innovation area are atHome, TecTotal and Talky.

At home supplies environment, equipment and security for high-standard residences. The company is now leaving the incubator successfully. In 2010 alone, sales reached 2,000 projects.

TecTotal was created 2007 to provide IT, audio and video support. In 2011, it sold 50,000 packages per month. The company sprouted outof Telefônica's first ideation wave. This happened internally, with Telefônica's employees. After incubation, it was incorporated as a separate company collaborating with other investors, such as Intel Capital.

Talky offers telephony services over the Internet for use in any connected device (computers, tablets, cell phones, orby, etc.) and recently completed its concept proof and made its software available to all browsers and for Apple, Android and Nokia cell phones. "Talky consists in breaking Telefônica's paradigm, where VoIP is a sensitive issue. Even though there may not be a rollout to the market, it brought substantial learning for the company", highlights Ricardo Kahn.

RECENT INITIATIVES

TThree new Telefônica initiatives in 2011 aim at driving even further the development of strategic innovations in Brazil: the Innovation Center, the Wayra Project and the Innovation Investment Fund.

INNOVATION CENTER

In February 2011, Telefônica installed one of the Group's Innovation Centers in São Paulo. This is Telefônicas second innovation center outside Spain, whose focus is upon new business, more so than the other centers, which concentrate on R&D activities. This innovation center will focus upon the initial stages of new solutions (incubators, concept proof and accelerators) and also upon technological video, mobile networks and service initiatives via fiber-to-the-home optics. "The Innovation Center will provide us with a broad frontline in the "innovation funnel", from R&D through business growth, highlighted Antonio Carlos Valente, president of Telefônica do Brasil (Annex 4)

According to the president, video fiber optics and broadband TV will be a priority in the Innovation Center because of the country's advanced stage in these areas. "Brazil is in the forefront in these areas, exactly the areas that the company decided to bet on recently."

Telefonica do Brasil's Innovation Center consists in a separate unit, reporting to an innovation center council, comprised of senior executives in Spain and by Telefônica's R&D company in Spain.

"We enjoy greater autonomy, because we report to the innovation center council, as though we were another, stand-alone business unit within the Telefônica Group", noted Ricardo Kahn.

INNOVATION INVESTMENT FUND

Telefônica do Brasil's new initiatives to promote strategic innovation will include External Corporate Venturing activities. "We know that major opportunities for the company do not sprout only within Telefônica." (Ricardo Kahn)

Telefônica plans to establish an innovation investments fund to support financially innovative businesses developed externally to the company. Several Latin American countries will have their own fund allocations for this purpose, the funds will be veered both to venture capital (a manner of investing in the initial stage of new ventures or services) and in growth capital (small and medium companies having the potential to become big). This fund will contemplate, besides Telefônica, the participation of other public and private partners. Prior to this initiative, Telefônica made ad hoc direct investments in external companies out of Telefônica's own funds.

"We have a few investment funds in Brazil, but this will be different. Telefônica will be an investor who may create conditions to consume the products within its own business", explained Antônio Carlos Valente, president of Telefônica do Brasil. According to the president, the funds will be invested in projects and technology in seven specific areas: electronic health, cloud computing, mobile applications, security services, financial services, traffic & machines and video platform applications.

PROJETO WAYRA

"Wayra seeks innovation in the embryonic stages, trying to awaken the Latin American innovation potential." (Ricardo Kahn)

The Wayra project (meaning "wind" in Quechua, the ancient family of South American indigenous languages), launched by Telefônica in

March 2011, proposes to leverage the talent of small Latin American entrepreneurs through project accelerators in seven Latin American countries and Spain. Ten projects will be selected per country, which will be given between 50,000 and 100,000 dollars in the first stage

José Maria Alvarez-Pallete, former president of Telefônica LatinoAmerica and currently president of Telefônica Europe, feels that with the Wayra Project Telefônica will exert a different role than that of a traditional incubator, adding an Ibero-American hub to financial support. Through this hub, companies will have their workspace and support in their marketing, product and legal needs.

According to Ricardo Kahn, innovation and new business manager at Telefônica do Brasil, Wayra will be strong incubation model, but Telefônica will not pursue the objective of acquiring the company from its entrepreneur. As a counterpart to the investments, Telefônica will request an equity interest in the company through a call and a preferred right over products and services.

The Brazilian projects will be funded by the Brazilian operation, within the scope of the Telefônica do Brasil Innovation Center, but also count on the sponsorship of the Telefônica Latin America president.

Wayra has a well-defined project selection and evaluation process, involving the possibility of a two-round financing and an eventual entry in the investment fund to be launched by Telefônica (Annex 5).

To select 10 projects in Colombia, 10 in Spain and 10 in Mexico, 1,500 business plans were evaluated. In Brazil, in excess of 500 projects were evaluated, 30 taken to the Wayra Week, where the business plans will be developed under mentoring support; 18 out of these 30 were selected to receive accelerator support.

The chosen projects will share a common space for six months, to develop their ideas. This will enable interaction among them. This common space will be equipped with cutting-edge technology infrastructure and Telefônica's Innovation Center will provide support. They will also be given training, monitoring and marketing education from establishing a company through drafting contracts. Selection will be semestral or annual for project replenishment.

Internal selection criteria were defined by Telefônica, but the company counts on partners to help in the selection. The partnerships developed within the scope of this project may yield co-investments into projects developed in Wayra.

The Wayra Project's Call for Ideas was launched in social media focused upon the communities of entrepreneurs. The investment areas include 10 fronts in the "IT and Communications" and "Social Innovation" areas (new ideas that respond to unattended needs and improve people's lives).

José Maria Alvarez-Pallete, the objective is the creation of a Silicon Valley replica in Latin America, promoting the sprouting of startups in the region and retaining the best talents in the ICT area (Information and Communication Technologies).

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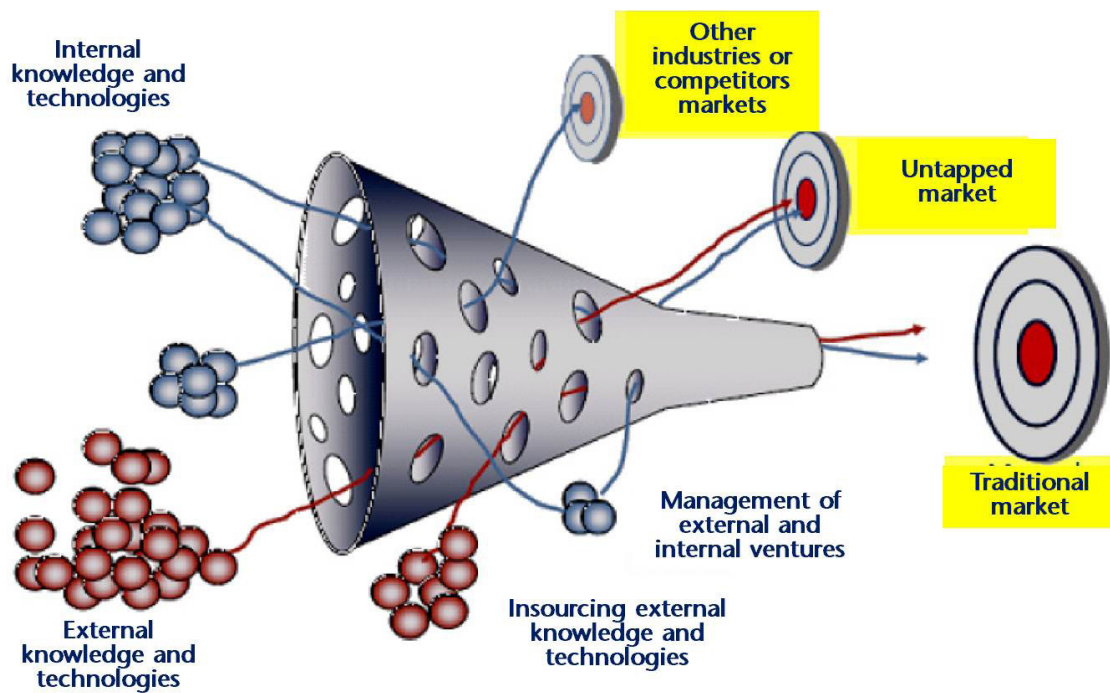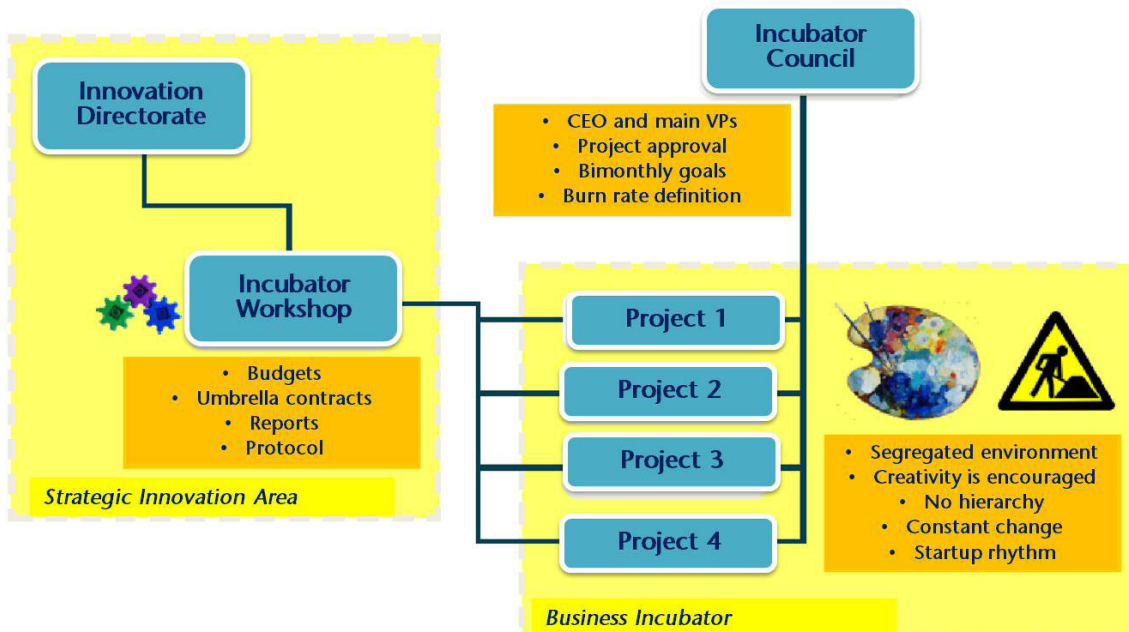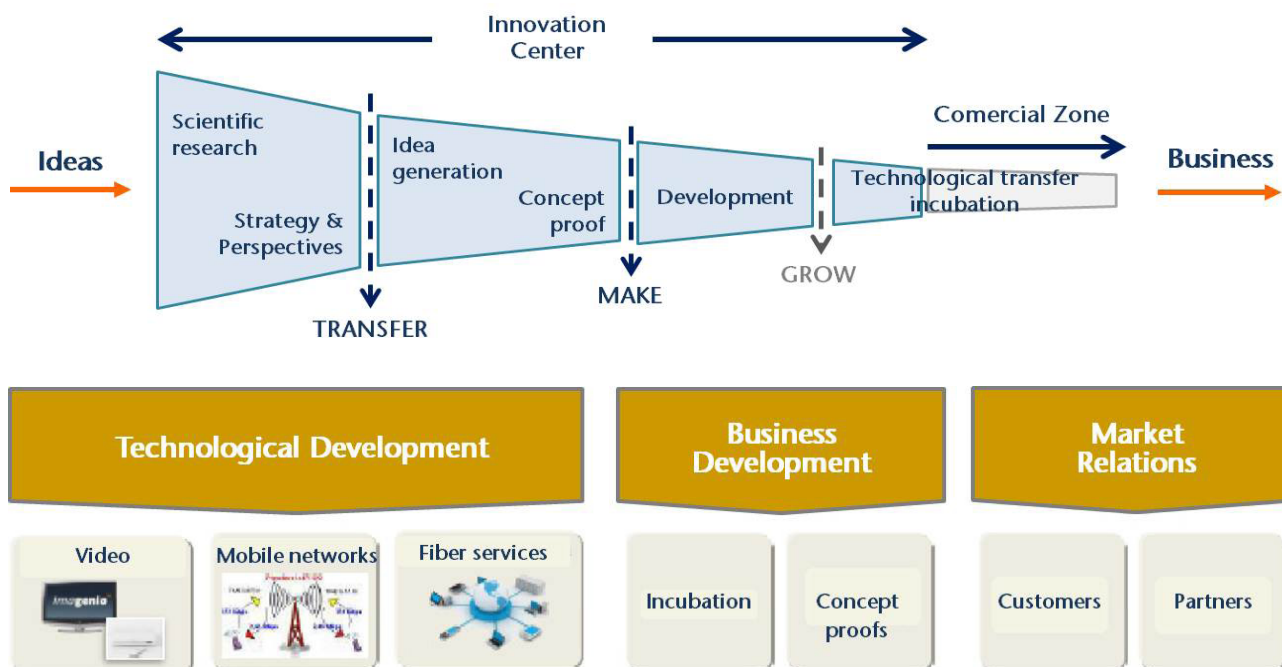
ANNEX 1
TELEFÔNICA'S INNOVATION WORLDWIDE

7 Global Innovation Units

Transforming technology into applications and services

ANNEX 2
TELEFÔNICAS PERMEABLE INNOVATION FUNNEL

ANNEX 3
TELEFÔNICA'S BUSINESS INCUBATOR

ANNEX 4
TELEFÔNICA'S INNOVATION CENTER IN BRAZIL

ANNEX 5
WAYRA PROJECT