What is the purpose of this guide?

Corporate Venture Capital (CVC) is a form of equity investment that has evolved greatly since its emergence around 40 years ago. This evolution has resulted in a vibrant and diverse industry that plays a crucial role in the development of a range of industries across the UK and indeed the world. This broadness and diversity, however, can make it challenging to understand exactly what CVC is and the role it plays. In 2012 the BVCA formed an alliance with a number of key players in the CVC industry with the objective of ensuring that CVC had a voice in the wider conversation about the role of equity investment, and the value in deploying under-utilised capital back into the economy. The purpose of this BVCA guide is to provide a quick introduction to the industry for both companies and policymakers, with the hope they might seek deeper engagement with CVC for the greater benefit of businesses across the country.

Contents

What is CVC? 4
Define corporate venturing 4
Review the history of CVC and its various phases 5
The new wave 5
Examples of famous CVC programmes from the past 6
Is CVC right for me? 7
Why now? 7
The business case 7
Investment thesis 7
CVC for you 9
Who does CVC? Some examples 10
Unilever – Making use of corporate strengths 10
ARM – Build your own ecosystem 11
Reed Elsevier Ventures – Stay focused on the returns 12
BP Ventures – Make CVC work for the parent corporation 13
What is CVC?

Defining corporate venturing
Corporate Venture Capital (CVC) is a catch-all name used to describe a wide variety of forms of equity investment exercised by corporations. At the most basic level CVC describes an equity investment made by a corporation or its investment entity into a high growth and high potential, privately-held business. Beyond this basic definition the range of models and systems deployed by these corporations is as diverse as that of the types of corporations themselves. As a consequence, attempts to define CVC further risk excluding some forms of CVC which could provide valuable insights for the rest of the industry.

What are its objectives?
In general there are two main objectives to corporate venturing: developing the strategic capabilities of the parent corporation; and providing a source of financial return for the parent corporation. The objectives of the CVC programme will quite naturally fit the overall objective of the corporate parent. The variation in CVC is a consequence of the infinite variation in corporate objectives, which can shift over the course of time. This variation increases further as some corporations deploy multiple CVC units designed to meet specific objectives.

What are its characteristics?
Given the dual focus of CVC the characteristics of each fund are based on variables relating to the strategic focus and funding of the venture unit. These variables are described in the table below and cover four primary aspects of the fund – purpose, structure, talent and success measures.

How does CVC differ from VC?
At this point it is worth noting that whilst CVC has elements of venture capital, it is quite different. Private venture capital (VC) is a singular pursuit. The General Partners (GPs) of VC fund assess and invest in high growth potential businesses by deploying funds raised from external investors known as Limited Partners (LPs). They hold the committed capital in a fund for 10 years (typically) dispersing returns gained from the sale of investment businesses both during and at the conclusion of the fund’s lifetime. The sole objective of such a fund is financial return. CVC differs in a number of ways. Firstly, CVC activities may comprise the GP or the LP role (some corporations do both as part of their activities, as will be explained later). Secondly, whilst the sole objective of a VC fund is financial return, CVC performance will likely be assessed on both strategic and financial metrics.

<table>
<thead>
<tr>
<th></th>
<th>Corporate/Direct Investment (Balance Sheet)</th>
<th>Internal Dedicated Fund (GP Model)</th>
<th>External Fund (LP Model)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purpose</strong></td>
<td>Gain direct business and technology experience in emerging areas</td>
<td>Emerging business and technology with more autonomy for step out options</td>
<td>Develop internal VC capabilities whilst gaining market awareness and understanding</td>
</tr>
<tr>
<td><strong>Structure</strong></td>
<td>Direct investment, funding each deal, closely related to business divisions and future business opportunities</td>
<td>Corporate acts as LP in a 100% captive fund. Greater fund autonomy</td>
<td>GP external firm LP corporate part investor Decision on investment GP in fund parameters</td>
</tr>
<tr>
<td><strong>Talent</strong></td>
<td>Internal corporate talent</td>
<td>Mixture of external VC hired and internal corporate talent</td>
<td>Experienced VCs and potential secondees from corporate</td>
</tr>
<tr>
<td><strong>Success measures</strong></td>
<td>Measurement of direct strategic inputs</td>
<td>Primarily financial with a level of strategic exposure</td>
<td>Predominantly ROI</td>
</tr>
<tr>
<td><strong>Examples</strong></td>
<td>BP, Bosch, Panasonic</td>
<td>Unilever Ventures, Reed Elsevier Ventures, Bloomberg Beta</td>
<td>Siemens Venture Capital (SVC), Physic (Unilever)</td>
</tr>
</tbody>
</table>
The history of CVC and its various phases

To understand the position of CVC today it is worth understanding its development since its appearance in the 1960s. Since that time there have been broadly three waves of development, with an emergence of a fourth wave underway.

First Wave – 1960s to 1970s

The first wave in the 1960s to early 1970s was driven by three factors: the need to diversify rapidly growing corporations; the need to exercise correspondingly healthy balance sheets; and recognition of the success of the private venture capital model. At this time the primary manifestations of corporate activity surrounded external start-ups or employee-based internal ventures, with very few corporations encouraging what we would recognise as spinout businesses with financial and technical support from the parent. The first wave was brought to a close by the twin influences of the oil shocks of the 1970s and the collapse of the IPO market.

Second Wave – 1980s

The second wave arrived in the 1980s and focused on areas such as high technology and biotech, but was brought to a close by the financial crash of 1987.

Third Wave – 1990s to early 2000s

The third wave arrived in the 1990s, unsurprisingly mirroring the focus on internet based businesses and the phenomenal growth of private venture capital later in the decade. A wide range of corporations piled in, with over 400 technology-focus venturing arms during this period creating levels of investment far in excess of anything seen in previous waves. As with the private venture market, this wave was brought to a sharp end by the technology crash in 2001–2002.

As we can see from this review of historical developments, it has taken time for CVC to develop a role in the innovation process, but there are four main points we can observe from the historical role of CVC:

- CVC was pro-cyclical. Corporates followed private VC and were comparatively late to the market. Consequently its ability to make good financial returns was hindered.
- CVC was driven by excess capital on corporate balance sheets. The need to deploy excess cash accentuated the pro-cyclical nature of the investments and as balance sheets tightened, venture units were wound up.
- CVC was based on a model. Models were typically selected as if from a menu and often bore little relation to the culture or attitudes of the parent corporation. This created an inevitable tension between the two parts of the organisation.
- CVC programmes were short lived. As a consequence of the previous points, operations were rapidly wound up in the wake of the collapse of the market, resulting in a loss of experience and organisational learning, preventing the organisation from taking advantage of subsequent market upturns.

Fourth Wave – mid-2000 to the present

Bearing in mind the developments of the past, the latest wave differs in some crucial areas pointing to a new direction for CVC.

In previous waves CVCs typically adopted rigid models and structures for their investment units, and although these models have evolved and expanded with each wave, the top CVCs today have evolved further, adopting a tailored approach to better suit their own corporate structures. This individualised approach to CVC means the venturing teams better align with their parent companies, reducing the potential for internal friction.

Along with this more individual alignment, CVCs now also take a far more long term view, balancing strategic and financial imperatives. This change has delivered genuine benefit with many of the top 50 global CVC units boasting impressive track records going back over a decade or more. As a consequence, today the best CVCs find themselves poised at the very start of the economic cycle, with the funding and capability to exploit this position.

The following sections of this guide detail the methodology used by the top CVCs to develop their own funds, which can be applied by many other corporations looking to develop resilience in the face of future uncertainty.
Examples of famous CVC programmes from the past

3M
A programme that became more CVC than R&D
When discussing 3M there is quite naturally a great deal of focus on their famous internal R&D programme and the stream of products it has created, most notably the humble Post-It note. This activity, whilst innovative, is not considered within the realms of CVC, yet 3M was one of the original CVC pioneers.

Alongside its R&D, 3M runs a programme of internally funded spin-out companies – innovation opportunities are able to claim internal grant funding that sits outside the budgets of existing business units. Such a programme enables 3M a far greater innovation flexibility as projects do not need fit within existing silos. The effect is a form of grass-roots innovation that ensures that innovation is captured in any form as and when it arises. Should businesses continue to grow they can be spun out.

What we can learn from 3M is that there are many organisations who are considering running corporate venturing programmes without realising they already do so.

Intel
The inspiration for many of today’s CVC programmes
In the rush to champion independent venture capital, it can be quickly forgotten that one of the biggest and most successful tech investors is actually a corporate. With a track record of more than 20 years and numerous successes to its name, Intel Capital has been patiently working away as a stalwart of the industry. Since 1991 Intel Capital has invested well in excess of US$10bn into over 1,200 portfolio companies worldwide, adding 34 new investments in the first six months of 2013 alone.

Intel Capital’s strategy has always provided it with a hedge against future uncertainty in an ever-changing business environment, making equity investments of between US$500,000 to over US$100m in high-growth potential businesses depending on opportunity and circumstance. Intel follows no strict pattern with its investments. It follows general principles: a single investment team makes decisions; portfolio companies are encouraged to develop independently; remuneration and financial structures follow VC-style disciplines; and Intel Capital does not buy to acquire, preferring to improve the general business ecosystem (thereby creating demand for its core products). The development and evolution of Intel Capital’s model has provided, if not a template, then a useful guide which other CVC programmes have tended to follow.
Is CVC right for me?

Why now?
When considering the development of a CVC capability, it may be tempting for corporations to look at external factors first – timing matters when making investments, so why not when investing in such a capability? However this is a mistake. The first and only consideration should be to examine the strategic requirements of the business itself.

The business case
All CVC programmes sit on a continuum between strategic and financial imperatives. However, when considering building a CVC programme from scratch, the focus should only ever be based on strategic objectives – in almost all cases a diversified strategic portfolio is more vital to business success than a diversified investment portfolio. As a result financial objectives tend to be used to drive organisational discipline, ensuring that strategic objectives are met in a manner that ensures the CVC program remains sustainable.

There are typically three strategic objectives driving CVC programmes:

Access to IP
CVC programs provide a route to new areas of IP development that companies may find beneficial. Understandably there can be some sensitivity around building a CVC programme with this express objective, however as a side benefit it can prove useful. In a wider context, a CVC programme will force a company to engage more with the venture capital community, delivering both insight and potentially talent.

Extend innovative capacity
Many companies considering CVC will have internal R&D. CVC acts to extend internal capabilities, initially providing capabilities that internal R&D are unable to match, before eventually extending the capability of internal R&D via knowledge transfer. This cycle becomes virtuous: as internal capabilities improve CVC allows external innovation to push further into new areas. This objective can also be used to push development through the supply chain – an innovation may not be directly beneficial to the CVC parent company, however it may create a new supplier or provide innovations useful to companies within the wider supply chain driving improvements such as efficiencies and thereby reducing costs.

Future disruptive innovation
Corporations face many unknowable sources of potential disruption and historically CVC programmes were designed to find “silver bullets” to deal with this uncertainty. However this sort of approach has rarely proven successful or efficient. Instead, today CVC programmes are intended to enable corporations to be more outward-looking not only allowing them to be more responsive to trends and changes, but in some cases leading such change. In this way the CVC programme becomes a lens on future disruption as well as sourcing potential future revenue streams.

“The first and only consideration should be to examine the strategic requirements of the business itself”
Investment thesis
Once the business case has been clarified, the next step is to establish an investment thesis. As covered earlier, in previous CVC investment cycles the recommended practice was to adopt a particular “model” of investment. In recent years far more specialised, adaptive and iterative practices have taken over. Corporations are now far more likely to work to a general investment thesis (as outlined below) which allows the development of familiarity and experience capabilities within the organisation, iterating as competencies develop, and making unique adaptations to provide a better fit within the parent organisation:

Building capability
The first phase for many CVC programmes is what could be called the “building capability” phase. In this phase the objective is the development of the venturing capabilities of the organisation – both the managers of the CVC unit, the management within the wider organisation, and others like business units within the organisation. CVC investments made during this phase are likely to be minority positions in syndicated deals with independent VCs, enabling the development of the financial disciplines and sector knowledge necessary to become operationally competent.

“Corporations are now far more likely to work to a general investment thesis... which allows the development of familiarity and experience capabilities within the organisation”

Active partner
The active partner phase is one where the CVC unit takes a more active role within investments, something more akin to traditional independent VCs. More active roles are taken on the boards of portfolio companies, as well as becoming more actively involved at the early stages of the deal sourcing process. Depending on their appetite for risk and existing capabilities, some organisations jump directly into the active partner phase, bypassing the building capability phase.

Ecosystem
Once CVCs programs have become fully developed they ultimately become a driver of their own ecosystem, not only investing in businesses which help improve their parent corporation, but ones which drive their business ecosystem. As would be expected, this takes a far greater degree of operational competence as the CVC management, and those with internal oversight, must be able to perceive the wider benefits of taking an active role beyond the immediate needs of the company itself.
Deciding the best fit
The hybrid nature of CVC programmes means that designing a best fit CVC programme comprises a series of tradeoffs. Managers must decide where the key components of a typical independent VC program intersect with those of the parent corporation. Failure to find balance in the initial stages may not be fatal, but it is vital that managers maintain communication and adaptability to ensure the program is optimally structured throughout its lifetime. Given the range of parameters below, the vast potential for variation inherent to the industry becomes clear.

Strategic imperative vs financial imperative
Of the range of potential investment activities a business may undertake, CVC probably carries the most risk, so in general the basis for any CVC initiative should be strategic, especially where no CVC capacity is already established within the organisation. Financial imperatives become vital for maintaining a disciplined approach to investment. Over time more experienced corporations may consider purely financially-based CVC, though usually this occurs once a strategic CVC program has passed on its organisational learnings.

Fund size
Whilst the majority of businesses with a CVC unit are very large, there are no hard and fast rules as to which businesses are capable of supporting a CVC programme, or what sort of financial commitment is required. This variation mostly comes down to the internal appetite for risk and willingness to accept potential losses. Managers will need to find a balance between committing enough capital to maintain equity commitments (avoiding dilution) whilst ensuring any losses will not endanger internal support for the CVC programme.

HR – Compensation and remuneration
This area differs within organisations. Many CVC programmes adopt compensation and remuneration practices similar to those of independent VCs. The logic is that such an approach will allow CVCs to attract and retain key talent, something that is vital, especially in the early stages. This approach links into the key financial disciplines and incentive structures which are a feature of independent VCs. However, this must be balanced against existing organisational culture and remuneration structures. If these are not considered, the incompatibility between CVC and non-CVC teams will likely see a breakdown of the programme over time.

HR – Skills and experience
Driven by the need to ensure financial discipline in the establishing phase of a CVC program, many companies choose to employ external VC specialists, with the longer term aim of developing this capability within the parent company. External VCs bring with them networks, methods of working and a focus on scaling businesses that are vital for the success of a CVC programme and skills that are likely to be lacking in internal candidates. Again, this comes with a trade-off on compensation and remuneration as explained earlier.

R&D
In the majority of organisations CVC programmes are designed to complement and extend existing R&D activities as well as provide a source of new ideas. Therefore efforts must be made to ensure there is effective communication between CVC managers and R&D managers. If this is not appropriate, there should, as a minimum, be some form of strategic oversight must be implemented to ensure efforts do not compete or overlap.

P&L constraints
Many CVC units are funded “off-balance-sheet”. This method allows more accounting flexibility as it takes into account the particular challenges of CVC, such as the scale of the investment and time required to bring investments to fruition. Businesses that invest off-balance-sheet face particular challenges in regards to P&L as listed companies may have to account for equity investments in quarterly and annual reporting. In such situations it can be challenging to justify the accrual of apparently heavy losses over what can be a number of years.

Due to these challenges, business should carefully consider which method is most suitable when establishing the financial structure of their CVC program.
Unilever
Making use of corporate strengths

Fast-moving consumer goods companies run a constant race based on product innovation – not only must they continue to advance and expand their own product lines, but they are aware that the next shift may come from an unexpected source. This strategic imperative drove the creation of Unilever Ventures in 2002.

With over €600m invested to date, Unilever has a broad interest in innovative companies which are able to complement its existing business capabilities. Its investments cover not only consumer products, but areas like digital marketing and, in line with Unilever’s commitment to corporate social responsibility, sustainability innovations.

Like many of the current leaders of CVC programmes, we can detect the methodologies that proved successful for Intel Capital: there is a fixed capital allocation that runs for a set period of time (five years) and is held off-balance sheet; the investment practice is one of co-investment; and the independent VC model is applied to aspects such as remuneration and investment size. However, in a practice that is becoming increasingly common, Unilever Ventures has adapted and evolved its model to suit the inherent benefits (as well as challenges) of its parent organisation.

In some organisations a close relationship between the CVC and main business units can be problematic, as discussed in the earlier section on trade-offs. For Unilever Ventures however, a close relationship delivers enormous benefits as the overwhelming experience of the business units in areas such as scale, distribution and marketing are passed on to investment companies. Simultaneously, Unilever benefits from the reverse integration with its own R&D units.
**ARM**
*Build your own ecosystem*

The corporate venture capital function of chip designer, ARM has been around for less than five years, yet they have clearly learned from, and then adapted, successful CVC programmes. Though ARM did not set out to replicate any existing CVC models (given their involvement with similar industries) there is more than a hint of the successful program developed by Intel Capital: both invest off-balance sheet, both use VC-like financial discipline to offset strategic objectives, and both work toward the expansion of their wider business ecosystem.

However, beyond these similarities, in only a short space of time, ARM has worked hard to resolve the trade-offs between the parent company and the venture unit and developed an evolving program that, in only a short period of time, has become ever more closely integrated without losing its vital independence. Examples of their successful negotiation of these trade-offs are especially noticeable in the process of investment decision-making and the integration with existing R&D programmes.

With a single investment committee overseeing both internal R&D and the CVC programme, ARM has produced a CVC programme that is an external replication of its internal R&D programme. The natural benefit of this unified approach is the avoidance of duplication of effort, efficient allocation of resources and the ability for ARM to vastly expand its R&D discovery potential beyond anything it could achieve internally.
Who does CVC? Some examples

Reed Elsevier Ventures
Stay focused on the returns

Reed Elsevier Ventures (REV) is the corporate venture capital arm of media company Reed Elsevier. Founded in 2000, today REV has a number of funds under management, invests in a similar range to independent VCs and its funds follow, effectively, a 10-year lifecycle.

As would be expected, an emphasis on the financial returns aspect of VC is used to focus and maintain financial discipline, whether that is in the due diligence practices surrounding investments, or the remuneration structures of the GPs and portfolio companies. Also, as with many CVCs, there is a natural strategic alignment with its parent company – REV interest lies with internet and digital media, data and large scale analytic technology, as well as healthcare information and technology.

In contrast to the previous examples of Unilever and ARM, however, REV has taken a different approach in how closely it aligns itself with the wider business. In an approach more akin to a traditional VC fund, REV is independently structured and managed, with a single corporate LP parent. This structure gives the management and investment team the freedom to operate with effective independence from the parent. This allows REV the ability to make investments at arm’s length from the corporate parent and overcome the cumbersome decision-making that sometimes puts CVCs at a disadvantage to traditional VC funds.

A further advantage of this structural difference is longevity Reed Elsevier Ventures has survived a number of changes at the top of its parent by focusing on ensuring continuity of both strategic and financial returns.
BP has long been a technology innovator as it focused on R&D to adapt to the changing demands of the energy sector. Traditionally these demands surrounded upstream exploration and extraction of hydrocarbons, however, as the energy sector has diversified, so have its players. Indeed it was the strategic shift into alternative energy sources in the last 15 years that saw BP move to develop a CVC capability, which has so far invested over £1bn.

In the decade or so since its move into CVC, BP has quite closely followed the process described in the Investment Thesis section earlier in this guide (page 8), though it has always retained a strategic imperative. Initial activities included LP investments, though this has evolved, over time towards direct investments so that 85% of deals are direct (by quantity if not by scale). Other evolutions have occurred as BP has become more familiar and confident in forging its own brand of venturing. Firstly, whilst initially investments were made in the broader array of the alternative energy field, as the organisation has become more familiar with the R&D benefits of CVC, so it has applied CVC to organically developing the capabilities of its upstream business. A second evolution has been seen in HR. Initially talent was imported from the VC world to manage the fund. However a combination of the specifics of the program – remuneration models do not follow those seen in VC – and the development of BP’s internal capability means that BP now supplies almost all staffing.

The nature of BP’s venturing can result in challenges, and a key one surrounds the traditional upstream and downstream divisions of the business. BP is an off-balance sheet investor, with investments tied to specific business units. Due to its size, equity accounting of losses has less of an impact financially compared to small companies. Yet challenges emerge in other areas. BP invests both in new technology business that can support its existing upstream and downstream business. However, BP also invests through Castrol innoVentures in businesses that support new internal venturing and business creation in its lubricants division. In this instance the challenge is less concerned with technical viability, but centres more on the strategic fit to commercial activity.
Acknowledgements

The development of this guide would not have been possible without the contributions of the companies featured in the case studies, or the guidance of Tony Askew of Reed Elsevier Ventures, Andrew Gaule of Corven Networks and Jonathan Tudor of Castrol Innoventures. The BVCA would also like to thank Professor Gary Dushnitsky of London Business School, as the historical aspects of the guide are based in large part on his research into the area.