

## REFLECTING ON CORPORATE VENTURE CAPITAL

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While corporate venture capital (CVC) is not a new phenomenon, it is also not that old! DuPont's investment in a fledgling General Motors is a celebrated event, but many argue that CVC did not achieve prominence until the late 1960s. In the intervening years we have witnessed a proliferation of diverse efforts by many of the largest global companies. A close assessment of the details and overall outcomes to date has not been undertaken, but a few observations are worth noting even in the absence of complete data:

- The pattern of activity has generally been cyclical, usually matching the ups and downs of the economic cycles. Crudely speaking, companies have had the tendency to enter the venture capital arena during economic booms and too often have exited during recessionary times.
- To date, the perceived results of corporate venture capital efforts for many firms are not encouraging. Excluding the last cycle, roughly the last 4-5 years, the visible results have predominantly focused on the disappointing performances of many corporate funds rather than on successful investments, despite important exceptions in regard to both financial and strategic payoffs.

Based on the above, private venture capitalists, entrepreneurs and consultants, have frequently thought of corporations as entities that “buy high, sell low” and don't have the determination to weather down cycles, thus preventing their portfolio companies the opportunity to mature. However, those of us that have closely watched the performance of these groups, over an extended period of time, understand that the facts are a bit more complex. Granted that by either strategic or financial metrics many companies within this group have underachieved. But these results have been greatly influenced by severe organizational constraints, i.e. lack of consistent top management sponsorship, and a lack of accumulated knowledge created by the stop and go nature of the efforts.

Despite past experiences, it must be well understood that corporate venture capital can and should play a critical role in the achievement of corporate growth objectives. That is especially true today, when internal research efforts are more decentralized and primarily focused on short-term deliverables. A well-structured and agile CVC organization can provide both a valuable window on emerging technologies and an acceptable financial return. It can accelerate the pace and effectiveness of internal new business development efforts, and it can help to stimulate entrepreneurship and innovative behavior within the parent firm.

To succeed, the organization must clearly recognize several key drivers, none more important than knowing how to adapt and manage through the various phases of the economic cycle. Three issues, among many to be addressed, are:

- **Timing of entry and exit.** Carefully learning from the behavior of the successful private funds, companies must discipline themselves from starting the activities too late and bailing out at the bottom of the cycle. This requires proactive and fast decision-making at both ends.
- **Planning for more than one cycle.** From the very start, the charter of the group must recognize that downturns are inevitable and the continuity of the activity is safeguarded as much as possible. Obviously a full guarantee cannot be achievable but recognizing the issue at the start will minimize the shock when it occurs. Furthermore, if management is not willing to initially provide a guarantee, a more practical strategy would be to take a pass in starting a group.
- **Adapting to different phases.** One of the major strengths and weaknesses of large organizations is the management of processes. On one hand, it allows for maximum efficiency and control of repeatable processes. On the other hand, it stifles agility and CVCs must be agile. Anticipating events, CVCs must quickly morph from investors to divestors, from active to passive, from internalizers to spin-out experts.

The task at hand is a complex one but there are a few bright spots. There are some indications that slowly but surely the industry is learning and maturing. The number of corporate venture capital groups that have weathered the most recent recession is a good example. Most importantly, right now the timing for initiating or accelerating CVC activities appears to be most opportune. With the

improvement in the economy, the pace of investment/deals is accelerating. Private VC firms have stepped up their capital raising and investment efforts. The pace indicates that a growth cycle is on the way but it is evolving steadily and at a moderate rate allowing for a good window of opportunity during the next few quarters. The other favorable factor is the imbalance of the capital markets. Private VC firms have migrated to the later stages of investment, leaving a significant void in the early stages. While the latter are riskier opportunities, they are better suited for the strategic objectives of the CVCs. The ultimate outcome might be a complementary positioning of private and corporate groups and a strong need for better interactions between two parties that have overlapping interests but have not yet meshed.

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