

An introduction to corporate venturing

The origins of corporate venturing can be traced back to the US where, in the early 1960s, large companies began establishing specialist, and often independent, units in search of strategic and financial expansion. Today, corporate venturing plays an increasingly significant role in the mainstream of British business, with many large firms and their start-up counterparts involved in this field. This research note introduces some of the hallmarks of corporate venturing, and explores the role it could play in the future.

What is corporate venturing?

Corporate venturing (CV) can take many different forms and the distinction between it, traditional 'research & development', and corporate development can easily become blurred. Chesbrough (2002)¹ described CV as the 'investment of corporate funds directly in external start-up companies.' He identifies the key characteristics as, firstly, the recognition of mutual objectives – namely strategic and/or financial – between the companies involved, and, secondly, the extent to which the operations of both companies are connected. Corporate venturing can be broadly categorised into the following areas:

- Dedicated CV fund. Regarded as the traditional form of CV, here the parent company places capital into a separate, arms-length fund outside of the organisation. This capital is then invested into (start-up) businesses with high growth potential in sectors that are likely to be of strategic importance to the parent organisation in the future.
- Corporate venturing can be undertaken in-house. A more recent trend has been the origination and execution of opportunities undertaken by in-house CV teams, deploying the internal resources and capital of the parent in research & development (R&D) projects or firms that have some association to the core activities of the parent. Over time, these opportunities are actively nurtured and commercialised, and thus develop into a future source of growth for the parent firm.
- External CV. Here, the parent firm may invest in a company via a passive, minority stake or allocate capital to a conventional, externally managed venture capital (VC) fund.

Corporate venturing has become a global activity with many of the world's most recognised companies setting-up programmes. In the UK, the likes of Reed Elsevier (Reed Elsevier Ventures), BP (AE Ventures), and Unilever (Unilever Corporate Ventures) have well established CV units. These organisations followed in the footsteps of the likes of British Gas, which is regarded by many to have pioneered CV in the UK with their BG Ventures fund in the 1980s.

Impact of CV investment

Given the majority of the players in this area are often large corporations, the financial costs in relation to overall operating costs are negligible. In the majority of cases, the main rationale for involvement in CV is the potential to gain a competitive advantage by taking the opportunity to tap into the (potential) strategic benefits that could arise from the development of these cutting-edge and market-disrupting technologies.

¹ Chesbrough, H (2002), 'Making Sense of Corporate Venture Capital', *Harvard Business Review*, Vol. 80, No. 3, pp. 90-99.

The investment into a young start-up company can also be strategically rewarding. Young firms often innovate with new technologies, and so an investment can yield access to this emergent technology and the associated future benefits. An investment can also mean that the parent explores a new direction and gains a toehold in a largely unproven but lucrative market, enabling access to technologies that complement their existing products without having experienced much development/innovation risk.

Investee companies also stand to gain. At a basic level, with a near market-ready product, young firms receiving CV investment can access the vast resources the parent organisation has at its disposal. This can, for example, ease the progression from prototype to a formal technology/product. Allied to this, commercialisation is also an important effect. Given that CVs often invest in companies that are associated with their own activity, those companies can exploit the sales channels and market positions to bring their own technology to the marketplace, in essence gaining a 'certification benefit' from the parent.

Finally, and probably most important of all, constant interaction with experienced industry specialists should not be discounted. Previous research (Maula et al., 2005)² has shown the importance of venture capitalists and their social and economic influence. Through the provision of support, criticism, and knowledge transfer, this enables the mature development of technologies, companies, and the entrepreneurs themselves. Alongside this face-to-face interaction, a greater strategic mentality tends to engage both parties, with the beginnings of a more corporate and entrepreneurial culture starting to develop within the company receiving CV capital.

With the current medium-term focus on austerity and generating economic growth, it will be up to businesses to drive the UK economy forward and create employment. Amidst all the turmoil that has engulfed the economy, the past three years have seen larger companies shore-up their balance sheets with cash holdings in the face of falling stock markets and worsening trading conditions. The need to deploy this cash in an effective manner, say through targeted R&D and/or CV programmes, could be a key driver of growth in the short to medium-term as they search for better returns than those yielded from traditional investments.

Regulation could also encourage CV activity. With the likes of the forthcoming Solvency II framework and the IORP Directive (applicable to occupational pension funds) hampering traditional investors into private equity and venture capital funds, CV can step in to fill the gap in equity funding that could arise in the future from the relatively lower fund sizes. At the same time, the European Union's growth initiative for the coming decade could also be a driver given the significant weight it places on innovation and R&D.

Despite its relatively short lifespan, corporate venturing has evolved in to one of the main tools that a corporation can use to develop nascent technologies and products, often those that are created by traditional VC-backed investee companies or entrepreneurs. And for VC firms and their investee companies, CV is an alternative avenue by which the venture capitalist can realise their investment via a trade purchase. Those entrepreneurs and business managers that have established these new technologies also benefit from CV, as specialists within the industry can come on board and help take the product and company to the next level. As this type of strategy matures, and firms of all sizes recognise the pecuniary and non-pecuniary returns that are generated, we may well start to see the next wave of activity in this space sooner than industry commentators think.

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² Maula, M, Autio, E, and Murray, G (2005), Corporate Venture Capitalists and Independent Venture Capitalists: What Do They Know, Who Do They Know and Should Entrepreneurs Care? *Venture Capital*, Vol. 7, No. 1, pp. 3-21.