How investing via Corporate Venturing is a worthwhile alternative to fuel innovative growth.

Investing in Your Innovation Toolkit

By Ryan Nichols

Due to the disruption caused by the COVID-19 pandemic, firms are facing new challenges to sustaining and growing their businesses. Supply chains have sputtered, capital and credit have dried up, and many customers can no longer afford products and services once thought to be ubiquitous.

With companies facing so many new challenges, they cannot rely on the old guard solution set — these novel times call for new innovative solutions, especially when it comes to growth. In fact, according to a survey by MIT Technology Review, **32 percent[1] of firms strongly agree that COVID-19 is acting as a catalyst or accelerator to innovation** within their business.

But if the need for innovation has never been greater, what does innovation look like? How should your organization approach innovation in a new way? How can companies avoid some of the common challenges and pitfalls of innovation in a wildly disruptive time, especially given that innovation can mean different things to different companies?

Some firms may not be built with an innovative mindset or strategy, while others do not properly incent resources to generate innovative solutions. Innovation can be perceived as too time consuming or too expensive, and it can require patience to see ROI in the marketplace. Not all firms know how to innovate or are se up to do so.

Moreover, many of the traditional growth strategies designed to achieve innovative outcomes require heavy capital deployment, which make them a nonstarter for smaller, capital-strapped companies. Simply put, innovation can be hard to do.

So, what is the answer? How can companies in need of innovation overcome the roadblocks?

The Answer: Look to others for collaboration and partnership — do not go it alone. Even Google knows it cannot rely solely on itself for innovation. Same with Salesforce. And Toyota. And McKesson. What do all those forward-thinking, innovative firms have in common? They have corporate venture arms. In recent years, more and more companies are beginning to wade into the waters of corporate venture capital, and it is not just for tech companies anymore.

Leveraging the power of partnerships — via ecosystems and adjacent entities and startups — offers your firm the opportunity to fuel an innovative growth engine it may not otherwise be capable of doing on its own. In fact, evidence has shown that companies most active in Corporate Venture Capital investing, outperform their peers in both the short and the long term.[2]

To evaluate potential paths going forward and to highlight the potential of corporate venture capital, it is important to first understand traditional growth strategies. Let us quickly evaluate other methods of growth via a popular framework.

The Case for Partnership Solutions in Disruptive Times

Buy-Build-Partner is a popular framework often used when making business decisions, such as evaluating new technology solution options or future areas of investment within a firm. The framework can also be leveraged for firms looking to innovate for future growth.

In disruptive times, because firms may not have excess capital to deploy or the time required for either the Build or Buy options, partnering becomes an even more valuable avenue. In fact, the benefits of partnering — sharing risk and resources and increasing speed to market — make it in an attractive alternative to traditional methods. Firms are recognizing this, and when asked about shifting business priorities and re-ranking ongoing or planned initiatives in the MIT survey cited earlier, 55 percent of them stated that they now have a heavier emphasis on "seeking new partnerships,"[3] the most of any response.

Additionally, there is no one-size-fits-all approach to partnering, and many ways exist to invest in your innovation toolkit via the partnering path. Firms can curate a tailored partnership approach to meet their unique needs. The most traditional and perhaps widely known example is joint ventures.

Further, newer options have included a heavier focus on emerging technology capabilities, as well as engagement with larger corporations and smaller startup companies. This includes corporate incubation arms and accelerators, some strategic partnerships, license agreements, etc. Inclusive of this concept of larger firms partnering with smaller startup companies is the notion of Corporate Venturing.

The Power of Partnering through Corporate Venturing

Although it is not a new concept, Corporate Venturing or corporate venture capital (CVC for short), has increased in popularity over the last two decades as corporations seek new avenues for growth. Often considered a bedrock of Silicon Valley and tech firms, CVC is quickly becoming a more mainstream way for other industries to scout their ecosystems and adjacent industries to identify and invest in startups to fuel innovative growth. Last year alone, despite the pandemic impacts, CVC participation reached its highest level ever, at 25.7 percent of all U.S. venture deals.[4] This contrasts with the years following the global financial crisis. In 2012, for example, CVC participation fell to its lowest rate within the last fifteen years, at just 16 percent of U.S. venture transactions.[5]

At its foundation, CVC is when firms deploy direct capital investment into smaller startup companies via an investment fund or other means. In contrast to traditional venture capital, CVCs typically have both financial and strategic objectives in mind. While not typically involved at more mature development stages leading up to and after an IPO, CVCs have been known to provide investment across early stages of a startup's growth and development.

This juxtaposition of large corporate firms and small startups may appear disproportionate at first glance. However, similar to the benefits described in the Partner path of the framework, there are unique mutual benefits to this type of symbiotic arrangement.

For example, the larger firms facing disruption receive creative talent and a chance to keep pace with pervasive change, via the capabilities and speed of the startup, that they may otherwise lack internally.

BUILD	BUY	PARTNER
Develop and refine innovative solutions in-house:	**Survey market and acquire innovative solutions:**	**Collaborate with relevant partners in the ecosystem for innovative solutions:**
+ Greatest amount of control + Own the IP and profit opportunity - Slowest to market - High development cost and internal resource dependent	+ Own the asset and control the IP + Shorten time to market - High cost/capital considerations - Integration considerations/ loss of knowledge potential	+ Speed to market/less capital + De-risk and shared accessibility of talent and resources + "Try before you buy" - Minority ownership interests/ least amount of control - Shared profit margins

The startup receives the brand recognition and prestige that comes from being affiliated with the large corporation, as well as resources beyond just capital. A good CVC will often offer and demonstrate true value, either through resource sharing and expertise, the traditional benefits of having the large infrastructure of a big team, or even through connection points and networking.

What results is a unique way to innovate — by sharing talent and resources — that minimizes many of the traditional challenges associated with innovation.

CVC can come in a variety of mechanisms and maturity levels, depending on the firm's objectives and how it wants to operate the vehicle.

Institutional In some cases, the most experienced CVCs will mimic traditional institutional VCs. They likely have dedicated capital resources and will leverage an investment fund to use when deploying investment to startups. Similar to traditional VC, they too may be more focused on financial returns and exit strategies than strategic or product/market objectives. They also likely have a dedicated investment team managing the fund and its portfolio and a well-defined process and governance to support. Subsequently, they likely have the highest volume of deal flow in any given period and provide the highest amount of investment.

Middle of the Road In the middle of the spectrum, perhaps less mature than savvy institutional CVCs, are some CVCs that may value strategic fit more than financial exit return opportunities. They may also not have the wealth of resources dedicated to the function. For these reasons, their deal flow volume may not be as heavy, and they may not have dedicated team members or funds for every investment. They could be seeking technology fits for their parent company to fuel innovation and may possess governance mechanisms to guide the process.

Tourist In other cases, newer or inexperienced CVCs, sometimes labeled as "tourist" CVCs in the industry, will pull capital from the balance sheet to engage in CVC, but only after approval from the finance team or a governing board. Transactions may be more opportunistic and ad hoc in nature, and sparse compared to those of their more experienced counterparts. Consequently, these CVCs may not have dedicated, centralized resources and will likely pull together a roster from cross-functional teams. They may not have a dedicated process or governance structure.

Given the potential benefits of investing in CVC, the biggest question and challenge for many firms is "How do we get started?"

4 Considerations to Getting Your CVC Function Right

There are a lot of questions to answer when considering CVC as an innovative growth engine. But taking time in the beginning to contemplate these four key areas will go a long way to aiding the long-term sustainable success of your enterprise.

01

02

03

04

Conclusion

Investing in your innovation toolkit, while necessary to keep up with pervasive change in the market, is no small task. Corporate Venturing offers a mechanism to de-risk, leverage the power of ecosystems, and collaborate with others to find innovative solutions for future sustainable growth. For many companies, it is a smart way to innovate by sharing resources and capabilities with smaller startup companies. Moreover, CVC offers the nimble and speed to market benefits that comes with Partnering, without all the capital and time considerations of 'Building' or 'Buying.' So first ask yourself, especially in these disruptive times, if the attractive benefits warrant an investment in your firm's innovation toolkit. Then contemplate the four considerations to effectively execute and begin your CVC journey.

Ryan Nichols
ryan.nichols@jabian.com

Sources:

1 *DLA Piper presentation, referencing MIT Technology Review Insights' survey of 372 global panel members, 2020 % of respondents (early results)*

2 *Touchdown Ventures, Google Finance, EY Foundry Analysis*

3 *MIT Technology Review Insights' survey of 372 global panel members, June 2020*

4 *PitchBook-NVCA Venture Monitor, Q4 2020*

5 *https://pitchbook.com/news/articles/corporate-vc-firms-pandemic-dealmaking-rate-bucks-tourist-reputation*

Culture/Philosophy

Before departing on your corporate venturing journey, it is best to take inventory of internal capabilities and assess your firm's current innovation state, meaning leverage existing resources and skill sets where available, and cultivate an innovation philosophy if one does not exist today. You may be asking yourself and team members the following:

- Does our firm have an innovative philosophy or mindset?
- What investments do we make in innovation today?
- Do we have an idea of "where we want to play" and how we will engage?

Note: Some of these questions and their subsequent responses may require a fundamental shift in the firm's mindset or culture to achieve the intended outcome.

Strategy

As it is with any other business function or initiative, strategy is at the cornerstone and integral to a successful outcome. There are many models and many questions firms need to ask themselves at the outset to ensure they achieve their intended results:

- How will we measure success? What is our investment thesis?
- How does our vision align with our corporate strategy?
- Will we act as a traditional, institutional CVC, or more of a tourist VC?
- What ecosystem do we want to engage?
- Are we looking to invest in emerging technologies?
- Are we interested in adding additional products or capabilities to our current portfolio?

While the strategic questions may seem endless, they are paramount to amplifying the intended outcomes for innovative solutions. The more concrete and decisive the strategy, the less risk of being overwhelmed in an ocean of options.

People/Organizational Structure

Arguably the next most important component in the strategy to launch a successful CVC engine is its people. Determining and engaging the right mix and cross-function of talent, as well as designing an appropriate organization structure, is crucial to success. Questions to ask include:

- What capabilities or talent is needed to support?
- Should we dedicate and centralize resources or develop a cross-functional team? What functions do we include?
- Should we have an external investment committee or governing body?

A subsequent, but by no means secondary, consideration to take into account is the complementary nature of the relationships with the startup entrepreneurs and others interacting in the ecosystem. After all, your firm will see benefits in partnering with others in the ecosystem that boast capabilities and talents your team does not possess. Thoughtful ways to engage a broad swath of talent within the ecosystem will be needed.

Governance/Process

Equally integral to the composition of a CVC is the choice of governance model and the mechanics of the supporting process. Some initial questions to ask are:

- Do we develop a fund or rely on an investment process?
- Where will we source capital from, and how will we execute?
- What is our target investment sourcing process?
- How will we measure and report outcomes?
- How will we manage our ongoing portfolio?