Corporate Venture Capital:
Would You, Should You,
Could You?

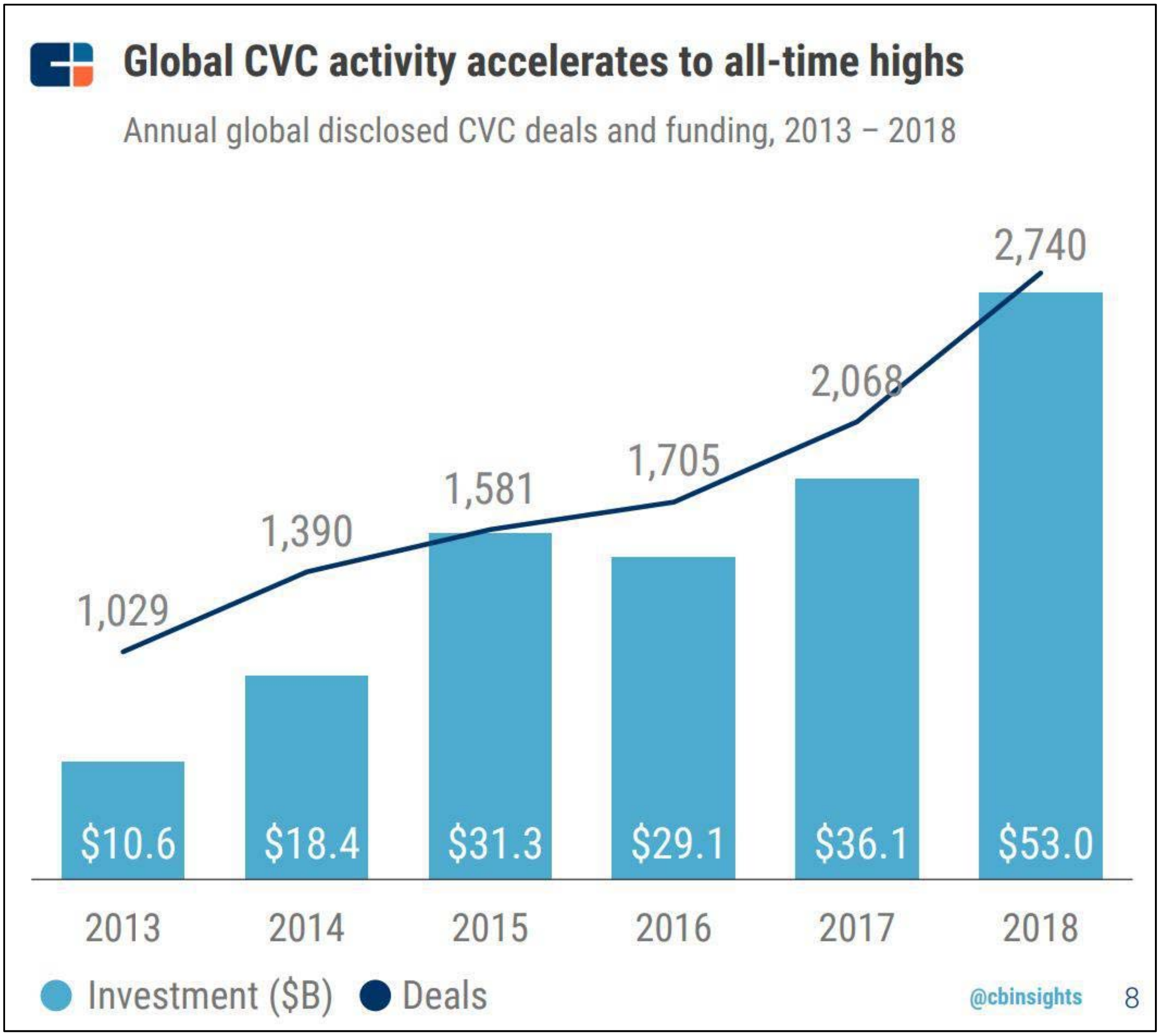
Many Lateral Capital invested companies have considered taking capital from “strategic” investors; typically big companies who invest in Early Stage companies (ESCs) as a way of driving faster innovation in their own companies. To provide perspective, we gathered input from a variety of sources. This report provides a fairly thorough overview of the market for this type of capital – broadly known as Corporate Venture Capital (CVC). It covers the following:

- Why large companies make venture investments.
- What CVC “industry trends” look like.
- How the “big company” decision-making processes actually work.
- What Early Stage companies need to watch out for.

Overview – We define Corporate Venture Capital (CVC) as investments in ESCs made by large companies, in an effort to get access to something they need and don’t have. This typically includes new technology, but can extend to new business or distribution models which big companies want to learn about and/or later acquire. The chart below summarizes many of the benefits and risks from two perspectives:

	Benefits	Risks
To the Early Stage Company	• Gain credibility • Access investor knowledge base • Access to capital • Possible future exit path	• Divulge propriety secrets • Limit future options for sale • Lose autonomy and control • Not realizing all promised benefits
To the Investing Company	• Low cost source of innovation • Entrepreneurial energy, research and insights • New processes, products, methods • Build long-term M&A pipeline	• Need to “sell” line business managers on making ESC investments • Uncertainty with how/if fit in company • Incentive to keep valuation low • Hard to measure success and ROI

The amount of CVC investments reached an all-time high in 2018. CVCs around the world participated in 2,740 global deals worth $53B in funding in 2018. This was a 32% over 2017 in terms of deals completed, and 47% in total capital invested. The largest CVC-backed deal was a $2B round to trucking logistics company Manbang Group, backed by capital.



The reasons for large companies to do all this venture investing are all over the map:

- **Access to New Technologies** – Some large companies make a genuine strategic decision to outsource innovation for their current business categories by making investments in small company technology they can later buy or in-license. This activity has been more frequent since the 2008 recession when many large businesses were forced to lay off much of their internal R&D capability. This approach is often led by the R&D organization, although research managers are unlikely to have decision making authority and must “sell” operating managers on the investment.

- **Access to New Categories** – Companies sometimes make “learning lab” investments in categories which are new to the investing company. The theory is that investments in small entities can teach big organizations how to approach new distribution channels, product lines or business models better/faster/cheaper than doing green-field launches with their own people. These types of investments are often led by a staff department, typically M&A, which is populated by financially-oriented managers who report to the CFO or a “new business” function in an operating division.

- **For Pure Investment** – Still other large companies see CVC as a purely financial exercise; as a chance to re-deploy internally generated cash into opportunities with higher projected returns that they can get by investing in their current businesses. This sometimes extends to out-licensing of technology which the investing company owns and believes someone else can “monetize” better than they can. This latter activity is often driven by a box of unused technology "on the shelf" which the CFO heroically offers to find a home for!

For ESCs, one pitfall should be instantly obvious: CVC investments are rarely led by line managers who have a genuine business interest in helping to build entrepreneurial dreams. In that context, taking CVC money represents a huge tradeoff from the very beginning. ESCs have to be sure that someone high up in the line management of the investor actually understands how the technology from NewCo can benefit BigCo.

Many Companies Make CVC Investments. Corporate Venture Capital (CVC) is one tool established companies can use to drive innovation, do market research and put chips down on long-term growth – without using large amounts of internal time or capital. CVC is most popular amongst technology companies due to the speed of change in that space, but it has expanded to almost every other industry including healthcare, food, and financial services. Here are some examples:

- **American Family Ventures (American Family Insurance)** – A medium-sized insurance company participating in Corporate Venture Capital? Yes, and they are very active. This shows just how far the trend has swung in recent years. The financial services industry expects to experience huge online disruption, so it is not surprising that risk adverse insurance companies are trying to get ahead of the curve. American Family has invested in dozens of companies, with plans to invest $50MM over the next 5 years.

- **Intel Capital (Intel)** – Intel has one of the longest running and most visible Corporate Venture Capital groups. Since the groups founding in 1991, the company reports $11.8 billion has been invested in over 1,478 companies of which over 600 have either gone public or been acquired – by Intel or others. However, in late 2016 the company announced that it was looking to sell its share in some of its 430 portfolio companies due to lack of on-going strategic relevance[i]. This demonstrates how hard it is for even the biggest CVC investors to realize long-term operating value from CVC investment into early-stage companies.

- **Google Ventures and CapitalG (Alphabet)** – Alphabet, the holding company which "owns" Google, has two separate Corporate Venture Capital groups with portfolios worth billions of dollars. GV (formerly Google Ventures) is more focused on early-stage idea companies, while CapitalG (formerly Google Capital) is focused on later-stage investments. GV is willing to invest in a wide array of industries, while CapitalG is focused more on strategic investments. Alphabet's own internal M&A group also buys outright companies that operate as standalone entities. As Alphabet becomes more of a technology conglomerate, this CVC strategy may work nicely to build its portfolio.

- **301 INC (General Mills)** – This CVC group invests in small, early-stage food businesses that have a unique and "healthier" consumer product offering with a demonstrated following. Having a brand that is resonating with consumers is a key advantage to getting this group's attention. 301 INC also likes to see that a product has had some success scaling distribution so that it can handle the growing pains of becoming a national product. For General Mills, 301 INC offers insights into customer tastes and trends. Typical investments from 301 INC range from $1-5M and have included both Private Equity and VC investors as partners. Importantly, 301 INC was scaled back dramatically in 2017, from 30 people to perhaps 5.

- **In-Q-Tel (United States Government/Central Intelligence Agency)** – The U.S. Government is one of the oldest CVC investors. While it is very difficult to find public information about how the group operates or what strategy they follow (IQT business cards have only first names on them), it is fair to say that In-Q-Tel takes a more hands-on approach with its invested companies. The Wall Street Journal ran a report in 2016 on the group and some of its conflicts of interest as well as the difficulties of using tax payer dollars for such purposes[ii]. This is a possible path for only a very select group of startups. Another Department of Defense group, DUIx, seems much more approachable.

- **The Founders Program (Coca-Cola)** – The Founders Program was started by Coca-Cola in 2012 in order to "create disruptive innovation," but Coke has recently announced that it is no longer funding new ideas. The company believed it could create a model on how to repeatedly create disruptive beverages. Companies involved in the program were put through a company-run accelerator and given access to Coca-Cola resources. But somehow, nothing "clicked." This demonstrates the hunger large companies have for innovation, but also how difficult it is for them to capture it.

CVC As Seen From The Inside – It's not pretty. Big companies go through multiple rounds of internal heartburn on their way to forming a CVC group or committing to a CVC investment. They tell themselves all kinds of things as justification for why they "need" to do CVC investing. But there are probably only four good reasons:

1. **To understand the potential market changes which are about to run them over.** Areas like robotics, AI and machine learning. There is probably no other way for some big companies to prepare for the pace of innovation that threatens to put them out of business.
2. **To diversify into rapidly changing businesses they are not in.** They have to understand leading edge thinking – which they do not have internally – and which they may not be able to acquire in "big" M&A transactions.
3. **To access human capital.** People who would never think of applying to work in "BigCo" can sometimes be "acquired in." Today's best people work at Early Stage companies, not in big business. Often, "buying" a startup company is cheaper than hiring and training people from scratch; from Ph.D. programs or competitors.
4. **To create a PR/Investor image for the company.** Investing in ESCs suggests that your company is hip, leading edge and a place the markets want to invest in. This is BS, of course, but it is a more important motivator than you would think.

Short-Time Commitments – Big company decisions to do Corporate Venture investing typically don't last very long. According to a study of 100 CVC investment programs by Andrew Romans, author of "Masters of Corporate Venture Capital," the typical CVC program lasts between 2.5 and 3.5 years – the typical life of the CFO or CEO whose brainstorm the program likely was. Sometimes, the same company will go in and out of CVC multiple times – depending on who's in charge, comments made at the last Board meeting, etc. For example, Hewlett Packard is said to have announced the formation of an HP Ventures group eight times since 1993.

Unfortunately, investments done by "earlier" CVC funds sometimes get lost – some companies can't even find them after 4-5 years. This is one reason some companies are investing in Venture Capital funds where they can get a window into the companies they want to learn from without having to account for them. Implication: If an Early Stage Company takes CVC money, this doesn't mean that the new company will have a long term, productive relationship with the investor.

Another issue is that over the 2-3 year period any one company is "in love" with CVC, perhaps half the people working on their CVC program will have left. If the people are any good at all, they often leave to do the same kind of work in an outside fund where they can earn more than "corporate" money. Alternatively, they move back into line work where they can better advance their careers. Said another way, working in CVC is not the best career path for corporate lifers.

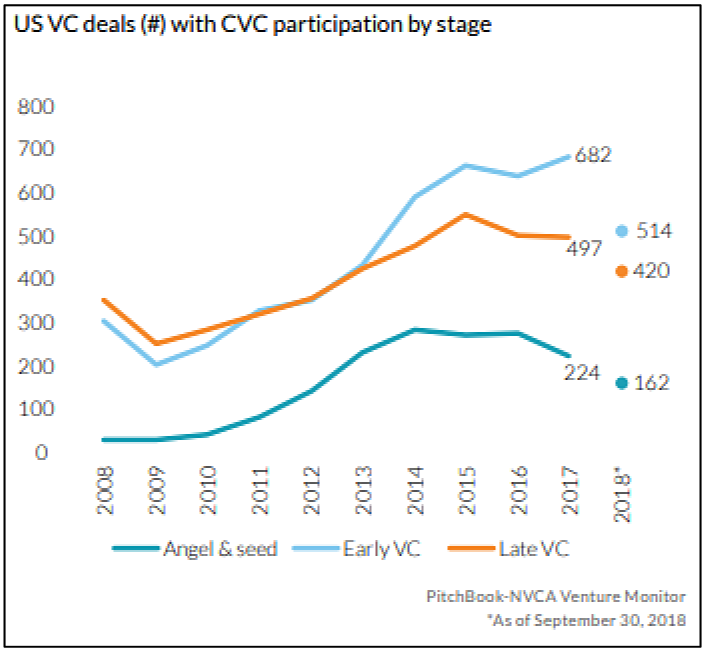
CVC Accounting – There are several kinds of CVC investment structures including those which are on BigCo's corporate balance sheet. Others are set up from the beginning as standalone companies in which BigCo is an equity investor or lender. Still others are funds where BigCo is simply a Limited Partner.

- If the CVC is on BigCo's. balance sheet, it is typically run as part of the M&A/CFO function. Depending on BigCo's size, the investments may be so small relative to the corporate balance sheet that all CVC investments can be covered as a group in an obscure footnote. They are not "material" in an accounting sense.

- <u>If the CVC is set up as a standalone, off balance sheet fund</u>, there is often a "2% and 20%" fee structure to attract professional investors to run the fund. This structure causes significant control worries for auditors and lots of jealousy with the inside employees. But it keeps the company from having to worry about multiple, very small investments.

Every structure has positives and negatives, but it's worth learning right up front how the company CVC investor you are talking with plans to account for its Early Stage investments.

<u>CVC Market Size</u> – Here, from CB Insights, is some perspective on recent trends in the CVC market. These numbers span the entire range of CVC investments: Seed Stage (typically for startups), Early Stage (Series A) and Late Stage (typically Series B) deals. You can read more about global CVC investors and trends in CB Insights.



To be clear, no individual company does very much CVC investing – at least compared to Angels, Angel Groups or Venture Capital firms. This goes for all three levels of investment: Angel/Seed, Early Stage and Late Stage. The chart below from PitchBook shows the number of investments done by the "most active" venture stage investors in 2018. The only significant corporate investors are Intel, Comcast, OrbiMed, Salesforce, Cisco and GE Ventures. Google (GV) made 78 Early and Late Stage deals. None of these companies invested in a significant number of Angel/Seed companies.

PitchBook

Co-sponsored by affinity

VC firms

1Q 2019 global investors by VC deal stage

Angel & seed

1	Enterprise Ireland	26
2	500 Startups	19
3	Plug and Play Tech Center	16
4	Hatcher Plus	14
5	SOSV	13
6	Innovation Works	10
7	High-Tech Gründerfonds	8
7	Alliance of Angels	8
9	Ben Franklin Technology Partners of Southeastern Pennsylvania	7
9	Village Global	7
9	Connecticut Innovations	7
12	ATX Venture Partners	6
12	Y Combinator	6
12	Ulu Ventures	6
12	Techstars	6
12	Service Provider Capital	6
17	Alumni Ventures Group	5
17	Right Side Capital Management	5
17	Founders Fund	5
17	Speedinvest	5

Source: PitchBook

Early stage

1	Keiretsu Forum	30
2	Mercia Technologies	21
3	Kleiner Perkins	18
4	New Enterprise Associates	16
5	SOSV	15
6	Y Combinator	13
6	Plug and Play Tech Center	13
8	Accel	12
9	Enterprise Ireland	11
9	Index Ventures (UK)	11
11	Quake Capital	10
11	GV	10
11	Elevate Ventures	10
14	Andreessen Horowitz	9
15	Alexandria Venture Investments	8
15	Connecticut Innovations	8
17	Artesian Capital Management	7
17	OrbiMed	7
17	Global Founders Capital	7
17	High-Tech Gründerfonds	7
17	Cottonwood Technology Fund	7
17	Lightspeed Venture Partners	7

Source: PitchBook

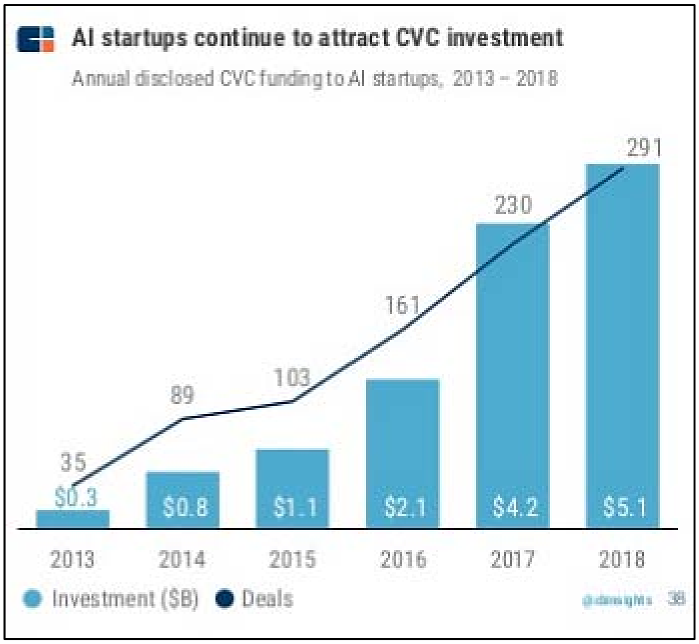
Late stage

1	Kleiner Perkins	17
2	Sequoia Capital	15
3	GV	14
4	Salesforce Ventures	13
4	GGV Capital	13
6	Bessemer Venture Partners	12
6	Keiretsu Forum	12
8	New Enterprise Associates	11
9	Norwest Venture Partners	10
10	Index Ventures (UK)	9
10	Accel	9
12	Insight Partners	8
12	Enterprise Ireland	8
12	Bain Capital Ventures	8
15	Tiger Global Management	7
15	Battery Ventures	7
15	Canaan Partners	7
15	Sapphire Ventures	7
15	Mercury Fund	7
15	Connecticut Innovations	7
15	Lightspeed Venture Partners	7

Source: PitchBook

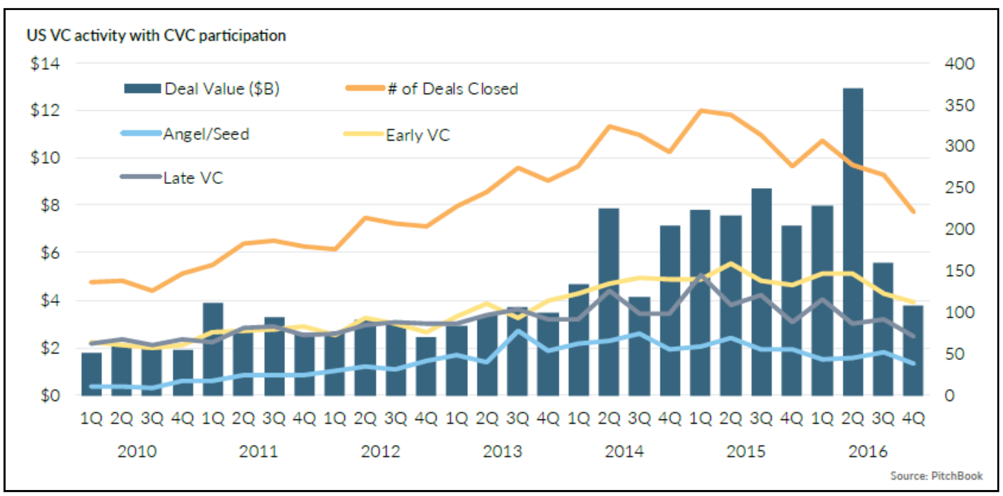
One thing Corporate invested do know how to do is to follow the crowd. As shown in the chart below, many, many companies have signed up to invest in "AI Companies," whatever that means. This is Buzzword Strategic (BS) planning at its finest!

Lateral Capital Insights
Perspective for Early Stage Company CEO's



VC Partnerships with Large Companies – While we don't have the recent data, the number of CVC deals done in conjunction with Venture Capital funds has generally been dropping, having peaked in Q1 2015. This may reflect that CVC investors are becoming more confident in making their own deals, or that they have learned what we all know: "Partnering" with Venture Capital funds can be a one-way arrangement. The number of CVC/GVC investors fell about 20% in 2016, from a peak of 1,268 to 1,069 companies.

Need updated chart



One reason for this decline may be that many VCs don't want big companies as partners. The reason: VCs fear that CVC groups will have an incentive to keep valuations lower, if they want to buy the invested company for themselves. Venture Capital investors, by contrast, look to raise future valuation as quickly as possible for the largest possible dollar value at exit. More broadly, it is worth noting that all Venture Capital funds have reduced the number of "First Financings" over the last 5-7 years.

When It Works, What Makes It Work? If companies have a strong internal approach to innovation, they may also have the fortitude to be good Corporate Venture investors. Early Stage companies looking for CVC should try to learn what the company's internal innovation approach looks like. If it includes these two elements, there might be "a place for you":

1. Willingness to embrace uncertainty, experimentation, and the messy inconsistencies which define Early Stage innovation.
2. The belief that critical new ideas may arise in a way different from the way their company usually operates.

Different companies have different perspectives on the benefits and the goals of Venture Capital investing. Few of them have clear, written Why's, Where's and What's. Rather, they often start with CVC investing as a top down suggestion from the CEO, then "back in" to making it an organized corporate program. While most companies say that the primary objective is not direct financial gain, big company Boards often see this as the only benchmark they can track and call the management to task. ESCs want to be sure the company really understands how long it takes for new companies like yours to deliver profits.

Watch Out for Lookie Loos – Companies often look to benefit from the insights gained by meeting with Early Stage companies – kicking the tires – with no real intention of investing. Whether or not an investment is made, the company gains valuable insights by talking to different ESCs to learn about new ways to meet customer needs. This learning can also be fed into the company's core business as market research. Just remember: Talk is cheap.

Even when large companies invest in startups, they rarely buy them until they get big enough to be brought into the company without being crushed by the bureaucracy. This is smart, as most big companies have no idea how to produce entrepreneurial entities. Here are some examples of big companies buying Early Stage businesses, many done as "aqui-hires" of key people:

- 2017 – Kickstarter acquired Huzza Video Technology; to launch KS international.
- 2016 – Time Out (travel publisher) bought Hall Street; then closed it immediately and brought their people in to the company in various capacities, closing the business they bought.
- 2015 – McKinsey bought design firm Lunar to get access to their clients including Apple and Nike.
- 2013 – Facebook acquired 16 year-old Hot Studio, closing the business and placing their people across the FB empire.

What Is In CVC For Early Stage Companies? This is about all there is: Expertise, capital, and a very small chance for an exit at a reasonable price. For an ESC in the right stage of growth and in the right industry, this combination of benefits could be the perfect fit. There is also some level of reputational benefits gained through the credibility of taking a CVC investment.

However, CVCs rarely lead investment rounds alone, and when they do, it is often with a large group of supporting financial investors. And Corporate Venture Capital is typically more risk averse than your average VC or Angel group. Most CVC groups want to see a new company that has grown a business successfully, not just one which has developed a promising product. An ESC with a successful brand or track record of sales that is looking to scale its growth through the distribution channels of a large corporation will get the most benefits.

For Early Stage investors in ESCs (particularly Angels), Corporate Venture Capital may look like a promising path to exit. This may make sense if the ESC's growth has "come to a stop." But if a startup believes it has found a new and better way to do something, Corporate Venture Capital may not help you get further down that path. A large company is unlikely to change drastically to incorporate the new thinking of an ESC, but rather is more apt to absorb the company into its existing operational machine. By their very definition, disruptive startups look to avoid this type of institutional absorption.

How Do ESCs Navigate? Just as Venture Capital investors are known to believe as much in the management team as in the company itself, entrepreneurs need to consider a potential partnership with Corporate Venture Capital on the basis of the people to which it gains access. If an ESC is at the right stage in its development where long-standing industry experts will help, this is an appealing option. Big company people know the existing systems and have deep industry relationships which can prove to be beneficial, especially when working with other third party organizations is necessary.

But ESCs need to vet the CVC investors before assuming this benefit is a given. Some CVC groups function so independently of the line operators in the parent company that getting time or attention from the desired internal contacts may be extremely difficult or impossible.

Another point based on experience: ESCs who want CVC need to find an internal champion inside the company who will sell the idea of investing in a small company. Nothing happens until the internal champion can sell the investment to the line operating unit who will be responsible for the investment's success – or failure. In our experience with large companies – Unilever, 3M, P&G, Alcoa, Ford, etc. – this process requires at least six months to accomplish. And whether it works or not is largely dependent on what else is going on inside the company at the time. CVC investments are broadly seen as distracting from the company's short-term, quarterly P&L responsibilities. If things aren't going well, "done deals" can dissolve in an instant.

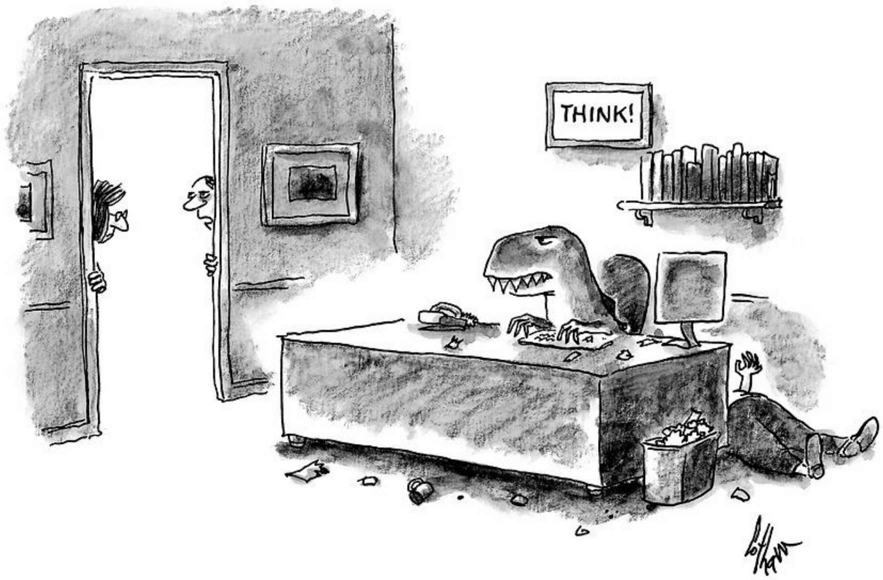
Be Careful with Your IP – Protecting the ESC's "secret sauce" will be a continuing issue. Be sure you have robust patents or patent applications in place before engaging with Corporate Venture Capital; beginning with the very first conversation. A non-disclosure agreement is likely to be ignored at some point, so patents are a much better way to protect your company from competitive risk. If the Corporate Venture Capital group can copy what you are doing without significant legal risk, don't be surprised if they do so. And remember: CVC investors will want to know a great deal about specific techniques used in your business to ensure the idea is worthy of investment.

In this context, it is important for ESCs to conduct their own due diligence on the Corporate Venture Capital team. Interview the leadership. Understand what their vision is for the venture group and how your company fits into that vision. Find out if the staff really has the expertise your business needs. Can they connect you with those who do? Talk to other companies that have received investment from the company in the past. How do they view the experience and what have they gained? Or lost?

What Does the Future Hold for Corporate Venture Capital? Corporate Venture Capital is not something new. Companies have always wanted to learn from the competition and innovative startups are one of the best places to do that. However, company commitment to their CVC groups tends to ebb and flow based on unrelated market conditions. Public companies are constantly scrutinized for their short-term results, so capital tied up in long-term "moon shot" ideas is often questioned, especially when times get tough and the purse strings are tightened.

Still, big companies are constantly looking for cheaper ways to find innovation. Crowdsourcing innovation is another tool in corporate venturing as companies look to the internet to find new ideas. Companies create competitions where anyone from anywhere can choose to submit an idea on how to solve one of the company's biggest problems. P&G started doing this in 2000 ("Connect and Deliver"), Johnson & Johnson does a lot of it now with innovation offices across the U.S. Unfortunately, our experience is that computerized new technology portals simply don't produce much for either party. The key reason: no one who has the ability to evaluate big ideas spends much time sifting through mountains of what are mostly "crack pot" ideas. Moreover, big companies won't staff to support the kind of handmade evaluation which online processes require.

Another reason that CVC groups do not seem to have staying power is that so much of the group's success depends on the leadership behind it. A CVC group may be started under an energetic CEO. But as soon as new leadership comes in, or the business falls off a cliff, the focus changes and the continuity of the vision is hard to maintain – often leaving the portfolio companies in limbo. We can predict that Corporate Venture Capital will never entirely go away, but a company's dedication to the space can change at any time. Having a good understanding of how to get the most out of a CVC relationship is crucial when evaluating its potential for your company.



"I've discovered why our flow of ideas has stopped."

Other Sources: Wired, 170300, Pitch Book, JLSI Interviews, Inc., 170400.

(Update 190910)

---

[i] http://fortune.com/2016/03/16/read-the-memo-intel-capital-just-sent-its-portfolio-companies/

[ii] https://www.wsj.com/articles/the-cias-venture-capital-firm-like-its-sponsor-operates-in-the-shadows-1472587352