CORPORATE VENTURE CAPITAL:
Transforming CVC into an Effective Corporate Strategic Tool for Seeking
Innovation and Growth in the 21st Century

by

PERCIVAL BARRETTO-KO

B.S. Biological Sciences with Honors, Cornell University, 1994
M.B.A. Yale School of Management, 2001

Submitted to the MIT Sloan School of Management
in Partial Fulfillment of the Requirements for the Degree of

MASTER OF SCIENCE IN MANAGEMENT

In conjunction with the Sloan Fellows Program
in Innovation & Global Leadership at the

Massachusetts Institute of Technology

June 2011

© 2011 Percival Barretto-Ko. All Rights Reserved.

The author hereby grants MIT permission to reproduce and to distribute publicly
paper and electronic copies of this thesis document in whole or in part in any
medium now known and hereafter created.

Signature of Author __________________________

Percival Barretto-Ko
Master of Science in Management

Certified By __________________________

John E. Van Maanen, Thesis Supervisor
Erwin H. Schell Professor of Management and Professor of Organization Studies
MIT Sloan School of Management

Accepted by __________________________

Stephen J. Sacca
Director, MIT Sloan Fellows Program in Innovation & Global Leadership
MIT Sloan School of Management
CORPORATE VENTURE CAPITAL:
Transforming CVC into an Effective Corporate Strategic Tool for Seeking
Innovation and Growth in the 21st Century

by
Percival Barretto-Ko

Submitted to the MIT Sloan School of Management on May 6, 2011
in partial fulfillment of the Requirements for the
Degree of Master of Science in Management

ABSTRACT

The decline of innovation has hampered the growth of many large corporations as
they seek to remain competitive in increasingly challenging conditions. To
complement, and at times, replace their internal Research and Development
activities, corporations have attempted to seek innovation externally, through
collaborations with academia, government, and start-ups. Over the past half-century,
companies seeking innovation and growth have launched Corporate Venture Capital
(CVC) arms with varied success.

This thesis focuses on the CVC – the challenges it faces, and the opportunities it
brings to the sponsoring organization. I contend that, despite a highly cyclical and
mediocre performance over the last 50 years, CVCs do create value for the
corporation and can be used as a strategic tool for seeking innovation. I introduce
The Four O’s Framework, which illustrates my recommendation for shaping,
developing, and managing CVCs. The framework addresses several issues and
hurdles CVCs face today, and provides a prescription for its success as corporations
seek to reinvent themselves for the future.
ACKNOWLEDGEMENTS

I would like to thank my thesis advisor, Professor John Van Maanen for his insight, advice, and patience. This thesis would not have been possible with his support.

I would like to thank the program office of the MIT Sloan Fellows Program in Innovation and Global Leadership for their guidance, support, and assistance.

My gratitude and appreciation to the Sloan Fellows Class of 2011 for their encouragement, friendship, and support.

I would like to acknowledge the sponsorship and support of Astellas Pharma Europe Ltd. and its President and CEO, Mr. Masao Yoshida.

A very special and heartfelt thanks to Simon Gregory, for his support and encouragement, and my family for their patience and dedication throughout this entire year.
# TABLE OF CONTENTS

| Chapter 1 | Introduction: The Decline of Innovation | 6 |
| Chapter 2 | Overview: An Introduction to Corporate Venture Capital | 13 |
| 2.1 Corporate Venturing | 13 |
| 2.2 Corporate Venture Capital | 15 |
| 2.3 CVC Structure and Organization | 17 |
| 2.4 CVC Investment | 21 |
| Chapter 3 | The Case against Corporate Venture Capital: Does it truly create and capture value? | 24 |
| 3.1 Introduction: A Question of Value | 24 |
| 3.2 Lack of a Clear Objective | 27 |
| 3.3 Short-Term Outlook | 31 |
| 3.4 Unclear Roles and Obligations | 37 |
| 3.5 Lack of Organizational Identity | 39 |
| 3.6 Conclusion: The Case Against CVCs | 41 |
| Chapter 4 | The 4 O’s Framework: Transforming CVCs into an Effective Corporate Strategic Tool for Seeking Innovation and Growth in the 21st Century | 43 |
| 4.1 The Value of CVCs | 43 |
| 4.2 The Four O’s Framework: An Overview | 46 |
| 4.3 Objective: Prioritizing the Strategic Objectives of CVCs | 48 |
| 4.4 Outlook: Looking toward a Long-Term Future | 55 |
| 4.5 Obligation: Understanding and Setting the Complementary Role of CVCs | 58 |
| 4.6 Organization: Developing an Effective Organizational Structure for CVCs | 62 |
| 4.6.1 Autonomy | 63 |
| 4.6.2 Compensation | 64 |
| 4.6.3 Career Development | 66 |
| 4.7 Conclusion: The Four O’s Framework | 68 |
| Chapter 5 | Conclusion | 69 |
| Appendix | Bibliography | 74 |
TABLE OF FIGURES

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 2.1</td>
<td>CVC Organizational Forms</td>
<td>18</td>
</tr>
<tr>
<td>Figure 2.2</td>
<td>CVC Reporting Line</td>
<td>19</td>
</tr>
<tr>
<td>Figure 2.3</td>
<td>CVC Types of Capitalization</td>
<td>20</td>
</tr>
<tr>
<td>Figure 2.4</td>
<td>CVC Sources of Capital</td>
<td>21</td>
</tr>
<tr>
<td>Figure 2.5</td>
<td>CVC Roles in Investment Deals</td>
<td>22</td>
</tr>
<tr>
<td>Figure 3.1</td>
<td>Perception of Key Stakeholders of CVCs</td>
<td>27</td>
</tr>
<tr>
<td>Figure 3.2</td>
<td>CVC Investment Objective</td>
<td>29</td>
</tr>
<tr>
<td>Figure 3.3</td>
<td>CVC vs. IVC History of Investment</td>
<td>32</td>
</tr>
<tr>
<td>Figure 3.4</td>
<td>CVC and Venture Capital Investment</td>
<td>36</td>
</tr>
<tr>
<td>Figure 4.1</td>
<td>The Four O’s Framework</td>
<td>47</td>
</tr>
<tr>
<td>Figure 4.2</td>
<td>Four Types of CVC Investments</td>
<td>49</td>
</tr>
<tr>
<td>Figure 4.3</td>
<td>Use of Parent Company Personnel for Due Diligence</td>
<td>61</td>
</tr>
</tbody>
</table>

TABLE OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 2.1</td>
<td>Characteristics of Surveyed Venture Units</td>
<td>17</td>
</tr>
</tbody>
</table>
For the past two decades, the decline of innovation has crippled the success of many large corporations. From the slow death of pharmaceutical innovation to large technology companies being overtaken by upstarts, multiple examples over the past 20 years have surfaced, exhibiting this pressing challenge to the corporation. With innovation critical to the success and continued growth of a company, the lack of innovation threatens its existence, amidst an increasingly competitive landscape and an industry clock speed ever hastening. This innovation vacuum in some companies has led to consolidation, mergers and acquisitions, and other corporate initiatives
aimed at supporting, if not replacing, internal means of seeking and delivering innovation. However, whilst these actions have provided some companies momentary life support, they have failed to improve the condition of other firms seeking to remain competitive.

Ackerman (2008) discusses how Research and Development (R&D) arms of corporations are a “dying breed”, slow and inert, and at risk of being overtaken and replaced by quick-footed start-ups that are evolving at a significantly faster rate. Hampered by inefficiencies, and held back by internal bureaucracy, these behemoth corporate R&D organizations struggle to remain innovative against relatively smaller firms unencumbered by the impediments of scale and heft.

According to the National Science Foundation (NSF) (Wolfe, 2009), between 1981 and 2007, the share of industry R&D in the US done by companies with more than 25,000 employees declined from 70% to 35%. Over the same period, the share of industry R&D by small companies (less than 1,000 employees) rose from 4% to 24%. In addition, according to the same study, in 2007, small companies employed 30% of all R&D scientists and engineers, against a mere 28% in companies with more than 25,000 employees. Despite their limited scale, the impact of small companies is unmistakable. With their share of industry R&D growing and a large proportion of scientists and engineers flocking to small companies, the cogs of the innovation engine of these small firms will undeniably run at a faster speed than
larger organizations who are continually cutting their R&D spends amidst difficult economic conditions.

This erosion and decline of innovation in large corporations have exposed a difficult reality for multinational companies seeking to continually innovate and grow - the traditional model of innovation is becoming obsolete (Birkinshaw, 2005). Whereas the centrally-located R&D system, where one hub served all functions globally ("center-for-global"), worked successfully in the past for large organizations, the effectiveness of this model has been questioned due to inefficiencies and its inability to adapt to regional or local needs. At the other end of the spectrum, the alternative organizational model where individual subsidiaries are responsible for generating their own innovation ("local-for-local") has also been criticized as being too unwieldy and unable to exploit economies of scale for substantial impact. Both traditional models, center-for-global and local-for-local, in large corporations, have been considered to be too slow and inept at providing the necessary rates for innovation. As such, large corporations find themselves flat-footed and sidelined by small firms generating sufficiently faster innovation cycles.

To compound this dilemma further, large corporations have also been criticized for being unable to adequately recognize and exploit the interconnectedness of its own multi-geographic entities (Birkinshaw, 2005). Whilst a large corporation may boast of many subsidiaries globally, some have proven to be ineffective in achieving synergies of scale in identifying and aggregating innovative advances from all its
divisions. As such, whilst it may have scope and scale, it falters in capitalizing on its strengths due to this failure of agglomeration. Therefore, as geo-political shifts occur and as business landscapes shift, the local-for-local model fails to be appropriate in certain situations whilst the center-for-global model only proves to be effective in a few circumstances (Birkinshaw, 2005).

Realizing these challenges and the precipitous decline of innovation, the search for innovation by large corporations has expanded beyond the confines of its own R&D headquarters, and toward other sources previously untapped. Corporations have started to recognize (Birkinshaw, 2005) that whilst it may still guide innovation from one hub, its spokes need to extend further to generate insight and knowledge it could not have gained otherwise. This “open model of innovation” (Birkinshaw, 2005) has been adapted by several corporations over the past decade including GlaxoSmithKline, Unilever PLC, and Procter & Gamble Co.

According to Teece et al (1997), the core of competitive success is the ability to acquire knowledge, skills, and capabilities that position the corporation toward favorable strategic positions. Therefore, if the organization is unable to generate innovation and creativity internally, the more successful organizations seek such competencies externally, capitalizing on any assets it can acquire (Henderson and Cockburn, 1994). Several studies have shown that by extending its reach toward external sources, including government, universities, and start-ups, the corporation gains substantial financial and strategic benefits from its expanded knowledge base.
(Agarwal and Helfat, 2009, Eisenhardt and Martin, 2000). The incorporation of these new technologies absorbed from external sources, these studies claim, provide an opportunity for large corporations not only to improve their product lines, but more importantly, to upgrade their own internal capabilities and resources. Considering rapidly churning markets and technological environments constantly shifting, the ability for corporations to seek out these new opportunities and incorporate these skills into their own capabilities will yield competitive advantage (Benson and Ziedonis, 2009).

However, the search, identification, acquisition and eventual implementation of these new technologies by large corporations have often been fraught with difficulties (Benson and Ziedonis, 2009). As a result, a large body of work has been done to describe and explain how corporations have attempted to improve their processes in searching and incorporating technologies developed externally (Cohen and Levinthal, 1990).

Over the past three decades, several large corporations have established Corporate Venture Capital (CVC) arms, in search of innovation externally. However, whilst CVCs have been proposed as an important strategic tool to acquire and develop novel technologies (Dushnisky and Lenox, 2006), their performance and consistency in yielding strategic and financial benefits to the large corporation have been questionable.
This thesis focuses on the value of CVC and questions whether or not it is a viable strategic tool for large corporations seeking innovation and growth. To accomplish this, I consulted both primary and secondary sources. First, interviews (n=4) were conducted with professors from the Massachusetts Institute of Technology and Harvard Business School who had particular knowledge and expertise in Corporate Entrepreneurship (CE), Independent Venture Capital (IVC), and CVC. Second, interviews (n=5) with current CVC Managing Directors were conducted in Boston, MA, Cambridge, MA, and San Francisco, CA. Discussions focused on their views on the mission, purpose, and future of CVC and its viability as an effective strategic tool for firms seeking innovation and growth. Finally, an extensive secondary research of the relevant literature was conducted to supplement the information gathered via my interviews.

The next chapter introduces CVC, including its definition and objectives. Types of CVC firms will also be discussed. Also, the general structure and organization of CVCs will be described, to provide the reader a broad understanding of CVCs and how they function.

Chapter 3 introduces the challenges and issues faced by CVCs. A historical view of CVCs will be introduced, showing the cyclical, opportunistic, and haphazard participation of large corporations in Corporate Entrepreneurship. This chapter considers whether or not CVC is merely an extraneous component of Corporate Strategy, and provides no tangible or measureable value to the corporation, either
financially or strategically. Structural issues plaguing the CVC industry will also be discussed. I argue here that CVCs are somewhat “schizophrenic”: Are they “Corporate” or are they “Venture Capital”? Should they mirror IVCs, which have been enormously successful in recent decades, or should they embody the traits of a corporate department or entity? Finally, and most importantly, a key question is raised: Do CVCs yield innovation and growth for the sponsoring large corporation?

Chapter 4 will introduce the Four O’s framework, which I developed to address the complications and issues raised in Chapter 3. The role of CVC as an important strategic tool for large corporations is discussed, as well as the CVC’s need for clarity of purpose – to achieve long-term strategic goals instead of exploiting short-term financial gains. I use the Four O’s framework to explain how CVCs could and should be developed and structured to ensure success in the future.

Finally, Chapter 5 considers the implications of the proposed framework. Also, areas for further research will be suggested to ensure further study is done on a topic currently not well studied or understood by academia.
Chapter 2

Overview: An Introduction to Corporate Venture Capital

2.1 Corporate Venturing

The decline of innovation over the past two decades has prompted corporations to seek alternative sources of creativity and growth. From organic to inorganic means, companies have sought a myriad of ways to innovate amidst an increasingly competitive marketplace. In so doing, corporations are able to tap into their internal resources whilst seeking innovation beyond their own capabilities, resources, and functions.
Corporate Venturing involves the creation by the parent company of an organizational unit charged with investing in or developing new businesses (Birkinshaw and Hill, 2005). There are primarily two types of Corporate Venturing: (1) internal venturing, and (2) external venturing (MacMillan et al, 2008). Internal venturing refers to initiatives by the corporation to seek innovation from within the firm, through the creation of entrepreneurial ventures to discover and develop internal projects that may then be commercialized in the future. Looking internally, companies have sought to innovate through various paths including: (1) the incubation of new businesses within the existing business (Henley, 2005, MacMillan et al, 2008), and (2) the transformation of existing businesses through strategic change and renewal (Guth and Ginsberg, 1990). These organic means of seeking innovation entail strategic investments into the corporation’s internal R&D capabilities and its own internal business functions.

Over the past few decades, however, as internal R&D capabilities struggled to generate innovative products and services, several corporations have tried an “inorganic path” towards growth: External Corporate Venturing. Recognizing that innovation can be discovered beyond its own borders, “open innovation”, or the means of bringing innovation into the firm from external sources regardless of its origin (MacMillan et al, 2008), has been utilized by corporations to supplement, complement, or replace its own internal R&D capabilities. Companies have sought growth through open innovation through a variety of means including strategic alliances (Ahuja, 2000, Mowery et al, 1996), employee mobility (Almeida and
Kogut, 1999), technology-related acquisitions (Ahuja and Katila, 2001), and affiliations with universities (Cockburn and Henderson, 1998, Zucker et al., 1998). By seeking innovation elsewhere, Cohen and Levinthal (1990) argue that corporations are able to tap into resources of creativity beyond its borders, thereby enhancing its own capabilities, thus driving growth.

2.2 Corporate Venture Capital

In addition to several external venturing means of tapping into open innovation, over the past half century, corporations have also established investment vehicles that seek to mirror and model the success of Independent Venture Capital (IVC) firms. Corporate Venture Capital (CVC) is the investment of corporate funds directly into external fledgling start-up companies (Chesbrough, 2002). By investing in a small yet innovative or specialist firm, the corporation is able to take an equity stake in the firm whilst providing management, marketing, production, and strategic expertise to the start-up. In return, the corporation’s objective is to gain a particular competitive advantage by tapping into future technologies whilst reaping a financial benefit (MacMillan et al, 2008). CVCs also invest corporate funds into start-ups that a corporation has already spun off as independent businesses (Chesbrough, 2002).

CVC, however, should be distinguished from Corporate Venturing. Whilst the latter is broader in scope and includes funding of new internal ventures or divisions within the firm, the former focuses primarily on investments in external entities wherein the corporation takes a minority investment stake (Chesbrough, 2002, Guth and...
Ginsberg, 1990, Thornhill and Amit, 2001). In addition, CVC excludes any investments made through an external fund managed by an a third party, such as an IVC or other entities unaffiliated with the corporation (Chesbrough, 2002).

CVCs, in general, have a strategic mission to help grow the business by tapping into new sources of innovation in the external sphere (MacMillan et al, 2002). In doing so, a large company is able to develop new products, services, or processes, enter new geographic or competitive markets, enhance existing businesses, and consequently, improve their top- and bottom-lines (Roberts and Berry, 1985). In addition, CVCs may be used to supplement new business development strategies by providing firms with a window on emerging technologies (Roberts, 1980).

Corporations seeking to gain a competitive advantage through the establishment of CVCs argue that they possess an inherent advantage over IVCs due to several factors including their superior knowledge of markets and technologies and a strong balance sheet to support any additional investments required in the future (Chesbrough, 2002). In addition, academics and corporations alike argue that corporations will tend to be more patient in investing than their IVC counterparts since the CVC mission is driven by strategic rather than financial impulses. Finally, the corporation’s brand is thought to provide a signal to the marketplace of the quality of the start-up to other investors and potential customers, ultimately yielding an incremental advantage to the original investor (Chesbrough, 2002).
As a result, corporations seek to replicate, if not surpass, the performance of IVCs by retaining its venture capital efforts in-house. In establishing its own CVC, the parent company endeavors to gain a competitive advantage in the marketplace, thus shielding the corporation from the decline of innovation.

2.3 CVC Structure and Organization

Whilst CVCs vary significantly as a function of their parent company’s philosophy and strategic intent, there are characteristics across CVCs that appear to be consistent from one unit to another. In 2008, MacMillan et al conducted a comprehensive survey of 95 CVC entities focusing on a variety of industry sectors ranging from software and telecommunications to biotechnology and healthcare services. A summary of the characteristics of the surveyed venture units is shown in Table 2.1.

Table 2.1. Characteristics of Surveyed Venture Units (MacMillan et al, 2008)

<table>
<thead>
<tr>
<th>Characteristics of Surveyed Venture Units</th>
<th>Mean Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age of Venture Unit (in years)</td>
<td>4.5</td>
</tr>
<tr>
<td>Number of full-time employees</td>
<td>16.7</td>
</tr>
<tr>
<td>Total number of investments made</td>
<td>42.1</td>
</tr>
<tr>
<td>Proposal data</td>
<td></td>
</tr>
<tr>
<td>Incoming proposals per annum</td>
<td>631</td>
</tr>
<tr>
<td>Number evaluated in detail per annum</td>
<td>69.2</td>
</tr>
<tr>
<td>Number invested in per annum</td>
<td>6.8</td>
</tr>
<tr>
<td>Investment data</td>
<td></td>
</tr>
<tr>
<td>Investments still in portfolio</td>
<td>25.5</td>
</tr>
<tr>
<td>Investments having experienced a trade sale/IPO</td>
<td>12.3</td>
</tr>
<tr>
<td>Investments closed down</td>
<td>4.4</td>
</tr>
<tr>
<td>Investments integrated into parent company</td>
<td>0.5</td>
</tr>
</tbody>
</table>

n=95
In general, according to MacMillan et al (2008), CVC units tended to be relatively young, with a mean value age of 4.5 years. In addition, in contrast to larger and well-established IVC firms, CVCs were smaller with less than 17 full-time employees on payroll. Further, out of approximately 70 proposals evaluated in detail per annum, less than 10% were deemed suitable for investment. On average, CVCs carry approximately 25 investments in their portfolio with less than half of their load ultimately experiencing a trade sale or an IPO. Finally, and perhaps most surprisingly, a very small proportion of their investments (0.5) are integrated into the parent company.

According to the MacMillan et al survey, CVC units are structured in a variety of ways. Whilst some CVCs were established as independent subsidiaries of their parent companies, the majority of CVCs operate as a department or entity within the parent organization (see Figure 2.1). This organizational structure for CVCs ensures greater control for the parent company and stronger communication links between the CVC entity and its larger corporate sponsor. Further, by establishing an in-house, directly controlled CVC entity, the corporation presumably will be able to better manage coordination between its CVC arm and the rest of the company.

Figure 2.1 CVC Organizational Forms (MacMillan et al, 2008)
In addition, almost a third of CVCs report to the Strategy and/or Development functions whilst one-fifth report to Finance, and another one-fifth report to R&D (see Figure 2.3). This disparity in reporting line structures amongst CVCs illustrates the differences in how they are viewed within corporations. Whilst some organizations view CVCs as strategic arms, others perceive them as investment vehicles with a predominantly financial focus. Still, others view them as windows to external technological innovations, and as such, report to their R&D functions.

In sum, whilst there seems to be disparity in the structure and reporting infrastructure of CVCs, majority of CVCs are established and run as groups within the parent company with a corporate wide mission, reporting to the company functions of Strategy, Finance, or R&D.

Types of funding for CVCs also vary across the industry (MacMillan et al, 2008). Approximately one-third of CVCs have a “dedicated” fund allocated by their parent company (see Figure 2.3). This dedicated fund, a fixed amount of committed
investment capital provided by the corporation to the CVC, provides a stable yet finite source of funds that the CVC can utilize as it seeks investment opportunities. This mimics the investment capital structure found in IVCs. In contrast, a majority of CVCs have a “discretionary” or “evergreen” investment capital structure, wherein the parent company provides funds as attractive investments or opportunities arise. These two types of CVC capitalization (dedicated vs. discretionary) yield substantially different relationships between the CVC and its parent company. Whilst the “dedicated” fund affords the CVC with a stable source of capital, it also caps the amount of capital made available, regardless of the attractiveness of the investments. In contrast, whilst the discretionary fund is more responsive to investment opportunities in the marketplace, it forces the CVC to approach its parent company for funds each time an opportunity arises – thereby providing the corporation greater control.

Whilst the types of funding vary across CVCs, the sources of funding also differ and are typically tapped from three primary sources: corporate, business units, and external investors (MacMillan et al, 2008). In general, more than four-fifths of CVCs receive capital from their corporate headquarters (see Figure 2.4). In addition, business units may also contribute funding, particularly when the CVC mission is aligned with the focus and goals of the business unit. According to MacMillan et al
(2008), approximately a quarter of CVCs receive funding from business units. Finally, a small minority of CVCs receives investment capital from external investors – third parties seeking to partner with the CVC on their investments.

**Figure 2.4 CVC Sources of Capital (MacMillan et al, 2008)**

<table>
<thead>
<tr>
<th>Corporate</th>
<th>Business Units</th>
<th>External Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes 17%</td>
<td>Yes 73%</td>
<td>Yes 4%</td>
</tr>
<tr>
<td>No 83%</td>
<td>No 27%</td>
<td>No 96%</td>
</tr>
</tbody>
</table>

### 2.4 CVC Investment

With investment capital support from the corporation or the business unit, CVCs seek investment opportunities that will benefit the larger corporation – either financially or strategically. The types of CVC investments made, however, span a wide spectrum, depending on how much controlling interest the CVC has on the start-up (Gompers and Lerner, 2000). In most circumstances (see Figure 2.5), a majority of CVCs invest in syndicated deals alongside other investors. This provides the CVC experience in venture investing, whilst building and strengthening their relationships with other IVC and CVC investors in the community. Further, it grants the CVC entity a window to the “deal flow” process, with minimal downside risk to the entity and the corporation. As CVCs gain confidence and sufficient notoriety in
the investment community, they may then “Invest as Lead”, where they utilize their investment experience to take investment leadership in deal flows they wish to pursue. In this type of investment deal, CVCs still work alongside a syndicate to raise capital for an investment opportunity. Finally, less than half of CVCs, according to MacMillan et al’s (2008) survey, invest alone, without the support or assistance from an investment syndicate. Whilst this investment deal route provides the greatest control and potential upside reward to the CVC, it also threatens the firm with the highest degree of risk in the event the investment fails or falters in the marketplace.

**Figure 2.5 CVC Roles in Investment Deals (MacMillan et al, 2008)**

Overall, whilst CVC firms are heterogeneous in several aspects, driven by the philosophy, focus, and structure of their parent company, there are underlying characteristics that are consistent from firm to firm. CVCs are generally corporate subsidiaries of their parent organization, with a discretionary or “evergreen” type of
capitalization that makes funding available depending on the investment opportunities in the marketplace. Further, whilst CVCs typically embody a corporate mission of enriching the strategic or financial resources of a corporation, they report to different company functions (e.g., Strategy, Finance, R&D) depending on how they are viewed within the organization and how they are expected to contribute to the growth of the firm. Also, whilst some business units will contribute to CVCs, especially when the CVC mission is closely aligned with those of the business unit, majority of CVCs receive their funding from corporate headquarters. Finally, most CVCs invest in a syndicate to gain investment expertise and a window into “deal flows”. However, as they gain experience and notoriety in the marketplace, they then evolve into becoming the lead investor or sole investor in an investment opportunity.

Considering the definition, scope, and structure of CVCs, the question arises: Do CVCs truly provide value to the corporation? Considering the remit and structure of CVCs, are they best positioned to extract as much value, both strategic and financial, for the parent company? If not, then what are the factors preventing CVCs from creating and capturing value? The next chapter will delve into the challenges and issues faced by CVCs, and why several pundits claim that CVCs, to date, have failed to deliver value.
Chapter 3

The Case against Corporate Venture Capital: Does it truly create and capture value?

3.1 Introduction: A Question of Value

Considering the perceived advantages of CVCs over IVCs ranging from a corporation’s presumed superior knowledge of markets and technologies to their strong balance sheet to support any additional investments required in the future (Chesbrough, 2002), the expected value created and captured by CVCs has been touted over the past decades. With an arsenal of funds to support promising investments, coupled with an in-depth knowledge of the market, companies seeking to gain strategic and financial advantages in a challenging marketplace have
established CVCs, expecting gains in return. However, after over a half century of seeking innovation and growth through CVCs, their value is still in question.

Due to the concern about the value created by CVCs, large and highly successful companies, including Boeing and Dell, decided to abandon the idea in the early 2000s. According to Mark G. Heesen, president of the National Venture Capital Association (NVCA), the reasons for the decline in interest in CVCs vary over a wide spectrum. From CVCs falling victim to “corporate restructuring” to their lack of a positive impact on the bottom line, several corporations over the past decade have decided to abandon the CVC route and seek innovation and growth elsewhere (Knowledge@Wharton, 2005).

In the third quarter of 2000 alone, Microsoft wrote off $980 million in its CVC portfolio, a staggering sum considering the success several IVC firms have had in recent decades (Chesbrough, 2002). If Microsoft’s own CVC, with substantial and in-depth knowledge of the market, fails to even stay financially neutral for the corporation, then a critical question about CVCs arises: does it, truly, create value? Does it deliver on its promise of growth and innovation for the organization? Or, is it merely a white elephant that provides no other value except to provide a frivolous investment outlet to the corporation?

According to Dushnitsky and Lenox (2006), “there is little systematic evidence that corporate venture capital investment creates value to investment firms.” Further,
there appears to be little consensus in academia on the financial benefits of CVCs to their sponsoring organizations (Sykes, 1986; Block and Ornati, 1987; Siegel et al., 1988; Block and MacMillan, 1993; Gompers and Lerner, 1998; Chesbrough, 2000).

Worse yet, CVC investments have been observed to be more volatile than investments made by IVCs, whilst the average life span of a CVC fund is far shorter (Dushnitsky and Lenox, 2006). Also, in general, corporate investors seem to pay a premium over their IVC counterparts to secure equity stakes on entrepreneurial ventures.

Finally, according to MacMillan et al’s 2007 survey of CVCs (see Figure 3.1), there seems to be a disparity on key stakeholders’ perception of CVCs and the value they contribute to the organization. Whilst 41% of top management of large corporations reported that CVCs contribute value to “a large extent,” only 24% and 21% of their technical and business managements, respectively, shared their enthusiasm. Further, a significantly larger share of technical and business managements (compared to top management) felt that CVCs failed to deliver or contribute value to the organization. What causes this disparity between top and middle management? Further, do their perceptions reflect reality?

This chapter focuses on the challenges and hurdles corporations and their CVC arms have endured since their inception in the 1960s. Further, the explanations for CVCs’ pitfalls will be discussed, along with an analysis of why, considering their apparent advantages over IVCs, their value is continually being questioned.
3.2 Lack of a Clear Objective

According to Chesbrough (2002), CVCs can be defined based on their objective: financial or strategic. This objective, whether explicit or implicit when setting up CVCs, is crucial in terms of how the investment vehicle is managed and operated. By specifying an objective, either financial or strategic, CVCs are able to assess their own performance and benchmark themselves against comparable entities. The core objective of the CVC is the guiding principle to which any future investments are made; hence, it shapes the CVC portfolio, and determines when investments are either spun out or made public through an initial public offering (IPO).

CVCs with a financial objective seek to achieve attractive financial returns, oftentimes with the goal of equaling, if not surpassing, the performance of their
counterpart IVC investors (Chesbrough, 2002). The expected end result is for CVCs to contribute to the topline of the corporation, through an incremental revenue stream generated by the improved valuation, spinout, or sale of successful investments. By exploiting a corporation’s in-depth knowledge of the market, considered deeper than the IVC expertise, CVCs with a financial objective, theoretically, should be able to translate this competitive advantage into financial gains.

In 2000, Dell Computer’s in-house VC operation was an example of a CVC with a primarily financial slant. Whilst Dell hoped for a strategic benefit by their investments to the corporation at large, its CVC’s objective was primarily financial, pouring capital into start-ups unrelated to their corporate strategy or vision. Tom Meredith, Dell Ventures’ co-director, emphasized this point in a 2000 interview with CRN: “We’re doing it to make money...we shouldn’t shy away from talking about that” (Moltzen, 2000). This interview took place following an announcement that Dell Venture had plugged in more than $1 billion into over 100 start-ups in just 18 months.

In contrast, other CVCs have a more strategic objective in mind when seeking new ventures in which to invest. These CVCs seek to make investments that exploit synergies between the corporation and the new venture, thus gaining strategic benefits from the partnership. These benefits can range from a direct access to promising new products, a window to new technologies, the outsourcing of R&D, etc. (Ivanov, 2007). By investing in external sources of innovation and adopting
them into the company, CVCs with a strategic objective can then, theoretically, take a "real option" on technologies and innovative business models, thus gaining competitive advantage (MacMillan et al., 2008).

Lucent Venture Partners (LVP) is an example of a CVC with a predominantly strategic objective. LVP invest in start-ups focused on infrastructure and services for voice or data networks. Aligned with their corporate strategic objectives, LVP seek investments that may not necessarily generate the most incremental financial return, but may provide a window to new technologies and business processes that, they hope, will give Lucent a competitive edge (Chesbrough, 2002).

Whilst only a minority of CVCs is pure-play strategy or finance driven, most attempt to balance both objectives, striking a compromise between their strategic goals and their financial desires. However, as seen in Figure 3.2, according to MacMillan et al.'s 2007 survey of CVCs, despite a majority of CVCs attempting to balance two objectives at once, a predominant objective typically arises to the foreground, with half of CVCs surveyed claiming that their strategic objectives outweigh their financial objectives.

![Figure 3.2 CVC Investment Objective (MacMillan et al, 2008)](image)
Yates and Roberts (1991) argue, however, that it is precisely this amalgamation of objectives that leads to a lack of focus for the CVC. CVC’s strategic objectives can conflict with their financial goals, and vice-versa. Whilst a CVC may wish to pursue a potentially attractive investment offering strategic advantages for the corporation, they may restrict themselves from doing so, because it may be deemed insufficient to meet their “financial requirements”. Conflicting and oftentimes ill-defined objectives of CVCs and their corporate sponsor would then lead to dissatisfaction with outcomes – based on amorphous and vague end points. According to several studies (Fast, 1978, Siegel et al, 1988), these CVC programs suffer due to a lack of focus and, at times, incompatible objectives that can range from providing a window on emerging technologies to generating attractive financial returns (Gompers and Lerner, 2000).

Ironically, whilst the scale and in-market expertise of the sponsoring corporation have, theoretically, been viewed as an advantage of CVCs, they can also prove to be a major limitation to their performance. If a CVC’s objective is predominantly strategic in nature, it will then have to invest with their parent company’s strategy in mind. Whilst this may promote and further strengthen a company’s core competencies, this investment strategy may also restrict the CVC from investing in revolutionary technologies that may confer a genuine competitive advantage to the sponsoring corporation. Further, investing in revolutionary technologies and processes may mean supporting a venture that aims to destroy the traditional core of
the corporation’s business – therefore causing the corporation to view their CVC arms as a threat. As a result, Shane (2010) argues that corporations provide “little venture capital” because of the restrictions and limitations imposed by the sponsoring company.

With a blurred vision, an inherent lack of focus, and amorphous objectives, CVCs have, inadvertently, fallen into a confused state of identity. As half of CVCs attempt to create a window to new technologies whilst still delivering the pre-requisite financial returns, they have essentially destroyed their own value and the value of the corporation (MacMillan et al, 2008). As such, many CVCs languish in a purgatorial state pursuing no real objective.

3.3 Short-Term Outlook

The history of CVCs over the past half-century has been marked by periods of rapid growth, followed by periods of precipitous declines (Dushnitsky and Lenox, 2006). From the mad dash to invest in new ventures in the late 1990s due to the Internet bubble (Chesbrough, 2002) to the collapse of the financial markets in 2008, the past 50 years have witnessed dramatic shifts in interest and investment from corporations seeking growth and innovation through CVCs.

A glimpse at the total dollar volume of rounds by year of CVCs versus IVCs (Figure 3.3) (Dushnitsky and Lenox, 2006) reveals an expected correlation between the levels of investment from CVCs and IVCs. However, what seems striking is just
how CVCs are slightly more volatile than IVCs. During the Internet boom of the late 1990s, for example, the growth change of CVC Rounds was more pronounced than that exhibited by IVCs. Inversely, the decline of CVC investment following the Internet collapse in the early 2000s was just as prominent and marked.

Figure 3.3 CVC vs. IVC History of Investment: Total Dollar Volume of Rounds Per Year. (Dushnitsky and Lenox, 2006)

What is the historical context behind these spurts of CVC activity over the past half-century? What has caused corporations and their investment arms to follow the bandwagon during certain points of history and invest heavily in start-ups? What forced them to withdraw their investment, support, and interest during times of doom.
and gloom? To fully understand the cyclical nature of CVC investment, a brief overview of CVC’s history would shed light on its volatility and how it has impacted its reputation in the start-up and investment markets.

Corporate Venture Capital traces its history back to the mid-1960s when US corporations started to establish internal venture capital funds, about two decades after the establishment of the venture capital industry (Gompers, 2000, Fast, 1978, Gee, 1994, Venture Economics, 1986). By 1970, due to the wide popularity of CVCs, over 25% of Fortune 500 companies boasted a corporate venturing program (Gompers, 2000). However, as the global economy plunged into recession in 1973, most corporate venture capital units were closed down (Birkinshaw and Hill, 2005). As the stock market deteriorated and the market for new public offerings became unattractive – CVC’s primary avenue of exiting successful investments – corporations scaled back their venturing initiatives, less than a decade after they were first established (Gompers, 2000). The first wave of Corporate Venture Capital came and went, and following their demise in 1973, CVCs were considered a mere blip and a fad.

Following a recovery of the stock market, and favorable government programs and legislation promoting investment in the late 1970s, the second wave of CVC activity sputtered back to life (Gompers, 2000). In 1978, capital gains tax rates were lowered, followed by a 1979 amendment to the “prudent man” rule allowing pension managers to invest in high-risk assets, including venture capital. As a result,
conditions for investments started to look favorable once again, as corporations were lured back by the opportunities promised by having their own investment venture arms (Gompers, 2000). Along with substantial growth in the computer and electronics sectors (Birkinshaw, 2005), interest in CVCs rose once again, peaking in 1986 when funds managed by CVCs topped $2 billion, or 12% of total venture capital invested that year (Gompers, 2000).

However, the stock market crash of 1987 once again sent new public offerings into a tailspin. Financial returns from CVCs and their investment partnerships started to decline, as corporations, almost predictably, started to once again scale back their CVC commitment (Gompers, 2000). In just five years, by 1992, the number of CVC programs still in operation fell by one-third, as their capital under management represented only 5 percent of all venture investments. The second wave of CVC ended as it did in the 1970s, questioning the value of CVCs and their future viability.

Lured by the dot com surge in the mid- to late-1990s, corporations once again sought investment partnership ventures with start-ups, seeking both strategic and financial returns, giving rise to the third wave of CVCs. However, what seemed to distinguish this wave from the two previous waves was how corporations attempted to replicate the model of IVCs as a template for their own operations (Birkinshaw and Hill, 2005). A wide range of companies including Intel, Lucent Technologies Inc., Nokia, Roche, Unilever, and Xerox sought to mimic the IVC model by using staged investments, syndicated investment deals, and general partner equity stakes,
believing that with this model, the problems faced by earlier CVC waves would be avoided (Birkinshaw and Hill, 2005). As a result of what Chesbrough (2002) calls a "mad dash to invest" in the late 1990s, corporate investors accounted for 30 percent of the venture funds by 1997, up from an average of 5 percent in 1992 (Venture Economics, 1997).

As the Internet bubble started to grow in the late 1990s, interest in and activity of CVCs continued to rise exponentially. In 2000, over 300 large corporations had invested over $16 billion of venture capital to start-ups (Chesbrough, 2002). The third wave of CVC had achieved a magnitude never before witnessed.

However, as it was in the first and second waves, interest in CVCs tumbled significantly as the dot com bubble burst in 2001. Venture investments from the same 300 large corporations described above dropped from $16 billion (2000) to just slightly over $1 billion in 2003 (Knowledge@Wharton, 2005). As Figure 3.4 displays, CVCs’ share of all venture capital investments declined from 16% in 2000 to 6-8%, less than 24 months later (MacMillan et al, 2008). It is estimated that nearly one-third of actively investing venture funds stopped activity in September 2001, just 12 months after the start of the dot com crash.
The fourth and most recent wave, spurred by a burgeoning stock market in the mid-2000s, inspired corporations to once again seek strategic or financial opportunities through the establishment of CVCs. According to the National Venture Capital Association, during the first six months of 2007, total CVC investments reached $1.3 billion in 390 deals, its highest level since 2001 (Chemmanur, 2010). However, with the onset of the global financial crisis in 2008, CVC activity once again declined as corporations scaled back their investment efforts, allocating their budgets instead to internal businesses, as they struggled to stay afloat in trying circumstances (Shane, 2010). The impact of the global financial crisis on CVC activity is, to date, unknown as corporate investments on start-ups, particularly in biotechnology, have continued to decline. However, what is known is the almost predictable cyclical nature of CVC activity, as a direct function of stock market volatility.
The highly volatile and cyclical nature of CVC activity places into question the commitment and the long-term outlook of corporations on venturing. According to Birkinshaw and Hill (2005), this pattern of CVC behavior signals “short-term thinking that is often seen in corporate headquarters, especially when the economy is in bad shape.” Further, it shows that corporations and their venture capital arms are “unreliable partners” for start-ups who are seeking a long-term commitment from their larger, more established capital sponsors (Duray, 2010). Therefore, in seeking a capital investor, start-ups may well be more hesitant to associate themselves with a CVC. Certainly, CVC-start-up relationships are tenuous, at best.

Ackerman (2008) argues that CVCs “jump in and out of investing because they pay too much attention to short-term considerations, consumer trends, and the general state of the economy.” Compared to IVCs, CVCs are at a disadvantage when seeking promising start-ups wishing to be their investment partners. With a spotty track record, a questionable history, and a seeming lack of commitment, it is then unsurprising that CVCs are questioned about the value they provide.

3.4 Unclear Roles and Obligations

Since resources, both financial and human, are finite, corporations inevitably must balance how much of their focus should be maintained on in-house capabilities – their core competencies and functions – versus external innovations that may promise the next breakthrough. A politically charged situation arises, where internal business units compete over scarce resources versus external ventures (Dushnitsky
and Lenox, 2005). For every dollar invested in CVC investments by the corporation, the same dollar is often times demanded by the in-house R&D team (Gompers and Lerner, 2000). For every investment made on a start-up, in-house product teams question their value and wish that the capital is instead utilized on more “worthwhile” projects internally that need attention. As a result, the CVC unit is seen as adversarial to some in the organization, an internal nemesis to in-house teams.

Undue pressure is placed on the CVC: What is expected of the CVC? Can it replace the corporation’s R&D function? What is its obligation and role in the larger corporate infrastructure? By setting unreasonable expectations on the CVC, its fate is almost sealed. When CVCs do not perform up to expectations, or fail to reproduce, if not surpass, the output of its in house R&D function, top management may then be quick to retract its support from the CVC, consequently exiting the venture capital market (Dushnitsky and Lenox, 2005).

By not setting a reasonable set of goals and obligations for the CVC, they are essentially placing their fledgling investment arm in a precarious position. Data from Gompers and Lerner (2000) suggests that newly appointed senior management teams typically terminate CVC programs established by their predecessors, viewing them as expendable “pet projects”. Because these CVC programs lacked a clear remit of their role and obligation in the organization, they lack an equally clear set of objectives and goals. This, inevitably, sets them up for an imminent failure.
3.5 Lack of Organizational Identity

Several academics have questioned the viability of and the value inherent in CVCs due to “structural deficiencies” arising from the question: Are CVCs more “corporate” than “venture capital” (Dushnitsky and Lenox, 2006, Shane, 2010, Henley, 2005, Birkinshaw and Hill, 2005, Ackerman, 2008, Henderson, 2007)?

According to Birkinshaw and Hill (2005), CVCs and their sponsoring corporations are “strange bedfellows”. Whilst start-ups and venture investments seek long-term financial and operational support, public parent companies want to report short-term results to shareholders; whilst venturing requires quick decision making, large corporations are typically mired in layers of bureaucracy and red tape; whilst start-ups are oftentimes grounded on uncertainty and risk, large corporations are typically risk-averse (Birkinshaw and Hill, 2005). Therefore, the culture of a large corporation may well be in conflict with the requirements demanded of a start-up - an “impedance mismatch” occurs (Ackerman, 2008).

A number of questions then arise. Should a CVC be shaped into yet another division or department in a corporation’s structure? Should it take the form of a completely independent venturing vehicle, similar, in many ways, to an IVC? In the first case, the CVC risks being lost in the dense structure of the large corporation (Shane, 2010), slowing down its operations and limiting its purview solely on opportunities that fit exactly the company’s strategic objectives – whilst neglecting potential breakthroughs that may provide the corporation a real competitive advantage (as
discussed in Chapter 3.2). In such a situation, the CVC suffers from a “liability of largeness” (Henley, 2005).

To avoid this predicament and to shield the CVC from the inefficiencies of the large corporation, several companies have attempted to create venturing arms modeled after IVCs. With a dedicated fund and a unique governance structure that reports to a separate board of directors, these companies have recognized the challenges inherent in creating a fully functioning CVC, within a corporate entity. However, the long-term effectiveness of such CVCs is still in question. Due to their independence from the larger organization, critics argue that they lose the capacity to draw on the scale and strength of the corporation and fail to gain the benefits generated from a close collaborative relationship between the CVC and the other departments in the company, especially R&D (Gompers and Lerner, 2000). Silos and divisions inevitably form between the CVC and the corporation at large, causing even more animosity and distrust about an investment vehicle taking scarce resources away from in-house operations.

Further, compensation schemes in these independent CVCs have also been patterned after those found in IVCs. For example, Unilever Corporate Ventures believe that employees involved in their CVC arm should bear similar reward-risk terms as they would in the IVC firm. Birkinshaw and Hill (2007) argue that any compensation unlinked to investment performance creates an agency problem for the CVC, since no accountability is in place. Further, they emphasize that by basing compensation
on the success or failure of investments, at par with other IVC firms, they are able to attract top talent from other venture firms (see, also, Gompers and Lerner, 2000). However, the disparity of compensation between regular corporate employees (typically on a set base salary) and CVC employees may produce a major rift (Dushnitsky and Lenox, 2006).

Thus, whether a CVC is more “corporate” or more “venture capital” cannot be answered generally. It depends on how the organization is structured, managed, measured, and rewarded. If it is shaped as “too corporate”, it may risk losing its venturing edge. On the other hand, if it is made “too venture capital”, it may lose the advantages conferred by the scale and size of the sponsoring organization and may become alienated from other departments in an already politically charged environment.

3.6 Conclusion: The Case against CVCs

The case against CVCs and the value they bring to the corporation is outlined above in four dimensions: (1) Lack of a clear objective, (2) Short-term outlook, (3) Unclear roles and obligations, and (4) Lack of organizational identity. With such challenges to overcome, do CVCs then have any hope of proving their worth and achieving growth and innovation for their parent organizations? Considering their challenges, can CVCs be shaped and structured in a way that enables them to deliver long-term and concrete value to the corporation?
The next chapter addresses each of the four critical points made in this chapter as I propose a framework, the 4 O’s, to describe how CVCs might be better structured to provide the most long-lasting value to their sponsoring company. Despite the problems CVCs have experienced over the past half-century, I believe there is genuine value to their existence, and as a result, corporations should consider utilizing them as an effective corporative strategic tool for seeking growth and innovation in the 21st century.
4.1 The Value of CVCs

For over half a century, as I have mentioned previously, CVCs have experienced a turbulent history marked by exponential growth, followed by sudden contraction as markets deteriorate. Over a span of four short-lived spurts, CVCs, since the 1960s, have behaved cyclically, giving the impression to investors, start-ups, and pundits alike that CVCs are nothing more than a constantly repeating tragedy where the protagonist fails to learn from past mistakes. As a result, academic literature over the
past few decades, as outlined in Chapter 3, has derided the value of CVCs and has questioned their viability versus their IVC counterparts.

Considering the history of CVCs and the challenges and pitfalls they face, several questions arise. Is there, truly, value that can be extracted from the work of CVCs? Is there a justifiable reason for their existence, or are they merely frivolous investment vehicles for corporations to spend their excess capital whilst financial markets are favorable? Are the hurdles faced by CVCs far too substantial to overcome, or can they be resolved with fundamental changes to how CVCs are shaped and managed? Why haven’t CVCs been able to capitalize on their competitive advantages over IVCs, including in-depth market knowledge and robust financial backing, to extract greater returns for the corporation? In short, how do CVCs, if at all, provide value?

Several studies suggest that CVCs, indeed, provide value. Gompers and Lerner (2000), based on empirical evidence, determined that far from being “outright failures,” CVC-backed investments appear to be just as successful and profitable, if not more so, than those supported by IVCs. Further, according to Knowledge@Wharton (2005), following an analysis of databases of hundreds of companies, researchers concluded that there was a clear and direct correlation between the level of CVC investment a corporation makes and its innovation rate, as measured by the number of patents generated or by citation weighted patents output. Noteworthy examples of this innovation benefit conferred by CVCs to their parent
organizations include Sony and Nortel where innovation rates, as measured by patents, increased following the establishment of CVCs (Knowledge@Wharton, 2005).

In addition, Block and MacMillan (1993) and Chesbrough (2000) provide evidence that CVCs supply valuable and complementary resources and capabilities to their ventures, translating into higher valuations at IPO for CVC-backed ventures, when compared against ventures supported solely by IVCs (Ginsberg et al, 2003; Maula and Murray, 2001).

Finally, the value of CVCs is further reiterated by Chemmanur et al (2010), who, based on empirical evidence, established that CVCs provide a pivotal strategic and financial value to sponsoring organizations and ventures alike. By investing significant amounts of capital to younger, riskier and R&D intensive ventures, CVCs have helped foster innovation and create “higher growth option values for their portfolio firms” (Chemmanur et al, 2010). This strategic value is then translated into tangible financial value as these ventures are spun out, sold, or made public at a higher valuation, than their IVC backed counterparts.

Compared to empirical data discussed in Chapter 3 noting the lack of value generated by CVCs, the academic literature discussed above seems to hold a contrarian and a more optimistic perspective of CVCs. Whilst Dushnitsky and Lenox (2006) discuss the lack of “systematic evidence” to show that CVCs provide value to their
sponsoring companies, others, including Chemmanur et al (2010) believe that CVCs confer strategic advantages to the corporation. This disparity between academics exhibits the lack of agreement in literature about CVCs and the benefits they confer.

However, assuming that CVCs do provide value, both strategic and financial, to the sponsoring corporation, to start-ups, to the market, and to the CVC itself, then what are the key success factors in CVCs that actually generate value? What are the elements that propagate success in CVCs, and what are those that diminish it? What structural components in CVCs must one develop and maintain to ensure that they yield the most benefit to their sponsoring organizations? How does one transform these investment vehicles, which have faced at least four tumultuous cycles in its history, into a new and improved version, one that can be an effective corporate strategic tool for seeking innovation and growth in the 21st century?

4.2 The Four O’s Framework: An Overview

The Four O’s is a framework I am proposing that is designed to guide organizations in developing effective and efficient CVCs that will create both innovation and growth for the organization. The framework, based on what I take to be four key elements critical to the success of a CVC, enables corporations to focus on the most pivotal aspects of the CVC infrastructure, and establish a CVC that yields value for the corporation, the start-up, and the market in general. Whilst there are a multitude of factors that contribute to the success or demise of a CVC, these four O’s are, I
believe, imperatives to the success of the CVC, and as such, must be considered by any company wishing to venture into the CVC arena.

The elements of the Four O’s framework are: Objective, Outlook, Obligation, and Organization. As shown in Figure 4.1, the four elements are linked to each other, and changes to one will affect the make up and structure of the entire diamond. The challenge for the corporation is to strike a balance amongst all four factors, to create a CVC that is both effective and generates value.

Figure 4.1 The Four O’s Framework: A Guide to Transforming CVC into an Effective Corporate Strategic Tool for Seeking Innovation and Growth in the 21st Century.
Whilst the success or failure of CVCs is multi-factorial and goes beyond these four factors, by using the Four O’s Framework, relevant decision makers in an organization will be best equipped to properly evaluate its CVC’s mission, values, and structure, and determine whether or not it is best positioned to extract as much value as it can. In doing so, the corporation will be able to capitalize on its own strategic advantages (versus IVCs) and maximize any potential benefits that CVCs can provide.

The following sections will breakdown the 4 O’s framework into its individual components, explain each factor in detail, and describe how corporations might best optimize the operations and output of their CVC to deliver maximum value.

4.3 Objective: Prioritizing the Strategic Objectives of CVCs

According to Chesbrough (2002), CVCs can be defined by its “dual dimensions”: (1) its objective, and (2) the degree to which start-ups operations are linked with the corporate sponsor. As discussed in 3.2, the objective of the CVC could be purely financial, that is, seeking attractive returns for each investment made. Alternatively, the objective could be strategic - the search for innovation to gain new technologies.

In addition, CVCs could also be defined by the operational link between the start-up and the corporation – how much of the sponsoring company’s current resources, capabilities, and competencies are shared by the venture (Chesbrough, 2002). Whilst some partnerships are inherently “tight”, where the start-up utilizes most of the
resources of the corporation (as found in Lucent Technologies), other tie-ins are “looser” in nature, or may not draw on corporate resources at all.

Using this “dual-dimension” definition of CVCs, a 2x2 matrix can then be created to illustrate four potential ways of investing by CVCs. Figure 4.2 illustrates these types of investments.

Figure 4.2 Four Types of CVC Investments. (Chesbrough, 2002)

With a strong strategic objective and a tight link between the start-up and the operations of the corporation, a Driving investment advances the strategy of the current business and promotes the use of current technologies, capabilities, and resources to seek out new innovations that perpetuate current standards (Chesbrough,
This ensures that the strategy in place is further strengthened and any new discoveries made are aligned with the vision for and the expected trajectory of the corporation.

An example of a driving investment is Microsoft’s $1.0 billion investment in start-up companies working on its Internet services architecture “.Net”. Microsoft’s primary objective in this investment was not to extract financial rewards. Rather, Microsoft was seeking to establish “.Net” as the dominant Internet services standard, over its competitors IBM and Sun Microsystems. By investing based on its underlying corporate strategy, and by sharing its operational capabilities and resources with start-ups, Microsoft, with its investments, propelled “.Net” to commercial success (Chesbrough, 2002).

Enabling investments, on the other hand, whilst also based on strategic rationale, do not tightly link the corporation’s operations with the start-up (Chesbrough, 2002). What results from these types of investments are innovations that are typically designed to complement, rather than advance, the current strategy. By promoting an “ecosystem”, the corporation, through its investment, can stimulate demand for its own products or services (Brandenburger and Nalebuff, 1996). Thus, the strategy of the corporation is supported and strengthened by the investment. In the early 1990s, for example, Intel Capital invested in hundreds of companies whose products used increasingly powerful microprocessors (Chesbrough, 2002). With its investments, Intel Capital was able to indirectly promote sales of its own microprocessors by
boosting demand. Despite financial losses from its investments, Intel was able to capture value by creating demand in the marketplace, positively impacting its own topline (Gawer and Cusumano, 2001).

The third type of investment, according to Chesbrough (2002), is *Emergent* — investments that are made with a focus on yielding favorable financial returns (versus strategic), whilst tightly linking the operations of the firm with the start-up. These investments may not promote the current strategy or established standards, but may provide the organization breakthrough or next generation technologies that will prepare the corporation in the event the market shifts. The intention is that these investments will open new markets and introduce new customers to the organization, without risking the entire organization. Emergent investments allow the firm to experiment with new products, technologies, or fields, which may disrupt and potentially replace the organization’s current set of competencies. As such, in contrast to Driving investments that perpetuate the current strategy, emerging investments provide the corporation an option-like upside in the event the current technologies or products are no longer viable. Lucent’s New Ventures Group makes such investments, mainly looking for a profitable financial return, but may parlay those investments into significant strategic returns in the future if the new technologies in which they invest prove to be significant.

Finally, *Passive* investments are those where the focus is on financial reward, and there are no operational links between the corporation and the start-up (Chesbrough,
In this regard, passive investments turn the CVC into a regular financial investor or IVC. No synergies are imagined between two entities (corporation and start-up). The relationship is based purely on whether or not the start-up increases its valuation for a potential sale or spin out or public offering in the short term. Dell Ventures is known to make such investments, focusing on building a portfolio that is, at best, tangential to Dell’s corporate strategy.

The question now is, how should a CVC, seeking to provide value to its corporation, position itself in this investment matrix? What objective, strategic or financial, is more beneficial for the CVC? What approach will provide the organization greater leverage in achieving growth and success in the long term?

Yates and Roberts (1991) argue that a strategic objective is imperative for the success of a CVC. Based on empirical data, they concluded that firms with a focused strategy were found to yield better financial performance than firms without any strategic objectives. Further, Dushnitsky and Lenox (2005) argue that in the event CVCs do generate poor financial returns, they should be judged not solely on financial metrics but on the indirect strategic benefits of CVCs to the corporation and the start-up. According to several sources (Argote, 1999; Gompers and Lerner, 2000; Dushnitsky and Lenox, 2005; Alter and Buchsbaum, 2000; Siegel et al., 1988; Yost and Devlin, 1993), a strategic objective (versus financial) provides the corporation a unique opportunity to tap into technologies in the external world that it otherwise would not have done. Chesbrough (2002) argues that CVCs should be
seen as an important way to fuel growth and innovation in a business by tapping into other sources of technologies.

According to Henley (2005), CVCs focusing solely on a financial objective “miss the point”. He argues that start-ups provide an undeniable source of innovation for the corporation, as they are oftentimes more agile in seeking opportunities and unhampered by the pitfalls of corporate bureaucracy. Also, based on his study, a significant amount of innovation has been created from the collaboration and partnership of start-ups and corporations over the past few decades. Unlike IVCs which are dependent on a financial set of objectives and, hence, limited to the financial rewards they can offer, CVCs have the potential to deliver valuable strategic benefits to the corporation by providing a pragmatic, cost-efficient and focused means of identifying new business opportunities (Birkinshaw and Hill, 2005).

Chesbrough (2002) concludes that CVCs “need to manage its investments to capture the latent strategic benefits in its portfolio rather than chasing the evanescent promise of high financial returns in the venture capital market.” A CVC is not the same as a traditional venture capital. Rather, it can deliver strategic value to the sponsoring organization, above and beyond any incremental financial surplus it might achieve. By using Driving investments to promote a standard, and Enabling investments to stimulate demand through the creation of an ecosystem or complements, the corporation, with a keen eye on its strategy, will be able to yield value that may be
much more than its financial returns. Both types of investments will enable the 
corporation and the CVC to enhance their own business objectives whilst exploiting 
open innovation occurring outside their borders.

Despite not having a strong strategic objective, *Emergent* investments may also have 
a role in CVCs’ portfolios. They may complement a CVC’s Driving and Enabling 
investments. Emergent investments become especially attractive in booming 
economies when “solid financial returns offset the uncertainty of any strategic 
benefit” (Chesbrough, 2002). By ensuring a tight link to operational capabilities, the 
corporation may be able to translate any new blockbuster technologies into an 
entirely new strategy that can then carry the corporation through a technological 
change.

Finally, *Passive* investments, according to Chesbrough (2002) are “arguably a 
misuse of shareholders’ funds,” since he believes they are subject to the follies and 
vagaries of a turbulent private equity market. Further, if a CVC focuses solely on 
financial returns, it is essentially risking its portfolio in a sphere outside of its own 
core competency (i.e., deep market knowledge) and playing into the hands of IVCs 
whose key strengths lie on investing purely for financial returns.

Overall, a strategic objective has been identified as a key attribute of successful 
CVCs. By having a clear and focused strategy, the CVC is able to successfully 
provide its sponsoring corporation an invaluable window to new technologies and a
place at the table of open innovation. By prioritizing its strategy over its financial objectives, a corporation will not be swayed by turbulence in the markets. Rather, it can remain steadfast on executing its strategy and, ultimately, provide value to the organization.

### 4.4 Outlook: Looking toward a Long-Term Future

Strategic objectives, as discussed above, are imperative to the success of the CVC. These strategic objectives influence and shape a CVC's mindset as it exploits the corporation's core competencies to bring value to itself, its ventures, and the market in general. By focusing on a strategic set of goals, CVCs avoid being enamored by the allure of short-term gains--oftentimes leading to disappointing results.

Empirical data suggests that CVC programs often fail when they prioritize financial returns over strategic aims, and attempt to mimic the philosophy and structure of IVCs (Brody and Ehrlich, 1998). By following IVCs, CVCs tend to lag behind when choosing investments in new ventures--once investment decisions are made, the market has oftentimes already recognized the inherent value of the start-up, thus raising its valuation (Henderson, 2007). In essence, because venture capital is not the corporation's core competency, it will fail to equal, much less surpass, the success of IVCs if it continuously patterns itself to the IVC model.

As such, it is imperative that a clear strategic set of objectives is prioritized in CVC organizations, to ensure that its own core competencies are brought to the forefront
(Chesbrough, 2002). Further, as strategies go beyond the short-term and enable corporations to create a vision for the future, such strategic objectives should be grounded in a long-term outlook that ensures the CVC is not merely investing in ventures simply to capture short-term rewards. According to Henderson (2007), a long-term outlook to CVCs is an “absolute must” to ensure that any innovations from start-up ventures benefit the corporation in general.

According to Benson and Ziedonis (2009), CVCs with a long-term outlook and continuously invest in ventures have been shown to earn greater financial returns than those CVCs who have had more “sporadic patterns of investing.” Whilst this phenomenon may be explained by a variety of factors, Sorenson and Stuart (2001) attribute this observation to “reputation effects,” the impact of reputation or image, in the venture capital community. Considering the tight-knit nature of the VC community, the reputation of the CVC, either as a stable, dependable partner or as an unpredictable, temporary drifter, influences the image of the CVC and the degree of risk they carry along with them (Benson and Ziedonis, 2009). Further, by becoming stable investors with a long-term outlook, CVCs are better equipped to exploit their strategic advantages of tapping into innovative technologies from start-ups. Innovation rates and financial returns from successful CVCs provide evidence as to why a long-term outlook is imperative. Intel and Microsoft have, over the past several decades, continuously committed high levels of investment to the venture community, even during financial crises. Similarly, pharmaceutical giants Merck, Eli Lilly, and Millennium have actually entered the CVC industry, as others
attempted to exit, thus raising their reputations as dependable partners (Chesbrough, 2002).

Finally, there is a clear and strong relationship between the first two elements of the 4 O’s framework: Objective and Outlook. According to Knowledge@Wharton (2005), CVCs that are more likely to prioritize strategic objectives are also more likely to have a long-term outlook. By setting their sights on the strategy and how their partnerships and synergies with the venture can also benefit themselves, the corporation is able to expand their time horizon further, and seek a more long-lasting commitment with their portfolio of ventures. This robust corporate-venture relationship can provide the sponsoring organization a better understanding of the investment process and what it entails to succeed, potentially translating this knowledge into financial gains (Knowledge@Wharton, 2005).

Companies who have been successful at corporate venturing, including DuPont, Johnson & Johnson, and IBM, have been adept at both prioritizing strategic objectives over financial rewards, and ensuring a long-term outlook and perspective on their investments (Knowledge@Wharton, 2005). By ensuring that the first two elements of the 4 O’s framework -- Objective and Outlook -- are both strategic and long-term, the corporation will be better equipped to withstand the vagaries of the financial markets, whilst enhancing their own competencies from innovation absorbed from their start-ups.
4.5 Obligation: Understanding and Setting the Complementary Role of CVCs

As I have argued, the decline of innovation across several industries in recent decades has prompted corporations to seek alternative ways of seeking new technologies. From collaborations with universities to the establishment of CVCs, corporations have sought to tap into open innovation, and any other means that will enable it to remain competitive. However, as financial markets started to deteriorate, and as resources, both human and financial, have become scarcer, corporations have had to make difficult decisions on resource allocation. As a result, as some corporations sought new sources of innovation, collaborations with universities rose, CVCs were founded, and acquisitions were executed – oftentimes at the expense of in-house functions, particularly R&D. In the process, unrealistically high expectations on CVCs and other open innovation streams were made, as corporations replaced seemingly expensive in-house R&D investment with relatively cheap, and less risky alternatives.

However, even if CVCs set long-term strategic objectives, it is also important that CVCs have a clear understanding of their obligation to the corporation. By understanding this obligation, the third O in my 4 O’s framework, the parent company will have clarity on expectations imposed on the CVC.

According to Knowledge@Wharton (2005), corporate venture capital is one leg of a three-legged stool, whose other two legs include collaborations with universities and
government, and a strong in-house R&D capability. Therefore, by no means should CVCs replace R&D departments. Rather, all three are complementary, and their potential synergies must be exploited to extract the most value.

Dushnitsky and Lenox (2005) empirically support this view and shows that those corporations that gain the most innovation from their CVCs, also have strong internal R&D capabilities. Further, Benson and Ziedonis (2009) find that amongst successful CVCs, there was a strong and positive correlation between CVC investing and R&D expenditure. Therefore, as investments on start-ups increased, so did investments on internal R&D. Instead of sacrificing resources devoted to in-house functions, parent corporations of successful CVCs continued to ensure the strength of their R&D units.

Benson and Ziedonis (2009) describes the “absorptive capacity of firms” to help explain the important role of in-house R&D in the success or failure of CVCs. Corporations have an “absorptive capacity” or the ability to “successfully identify, value, assimilate, and commercialize innovative discoveries made by outside parties (Benson and Ziedonis, 2009). As a CVC seeks, partners with, and acquires ventures, it needs capabilities within the organization to help it evaluate new technologies as they arise. By assisting the CVC in assessing new opportunities, the in-house R&D function is essentially providing an important strategic advisory role to the CVC in sifting through a large amount of information, that may oftentimes be conflicting or confusing. This enables the CVC to properly evaluate potential investments, and
identify which opportunities prove to be promising, whilst discounting those that do not have merit.

The absorptive capacity of firms and the complementarity between CVCs and in-house R&D functions are further reiterated by several studies by Cohen and Levinthal (1989, 1990, 1994). They maintain that the ability of firms to successfully use new technologies is based on two factors: (1) their ability to seek out those resources, and (2) their ability to absorb, assimilate, and integrate new technologies into the organization. Therefore, whilst CVCs, along with the internal Business Development functions, seek out new opportunities and investments in the marketplace, they lack the core competency of absorbing and assimilating the information into the organization. This role is, instead, held by in-house R&D functions, who may have the required knowledge and understanding needed to successfully assess and potentially, integrate, the new innovation into the corporation.
The complementary relationship between CVCs and other in-house functions is also illustrated in MacMillan et al’s survey of CVC firms (2008) (Figure 4.2). According to survey results, majority of CVCs used their parent company personnel for due diligence on investment proposals to “a large extent”. Further, over four-fifths used their in-house functions to screen investment proposals to a “large and moderate” extent. This data shows the need for robust in-house capabilities to support the activities and the objectives of CVCs. Without the capabilities and assistance of these internal functions, CVCs will be unable to tap into the corporation’s strategic advantage of an in-depth knowledge of the marketplace – thus relegating it to yet another IVC, purely focused on financial gains.

As corporations establish and develop their CVC arms, it is imperative that they not only have a strategic objective, or a long-term outlook. A clear understanding of the CVC’s obligation or role is also necessary to ensure its success in a highly competitive marketplace. By realizing that the obligation of CVCs is not to replace in-house functions, but rather, to complement existing capabilities, more reasonable expectations and metrics are made on the CVC. Further, by ensuring strong support within the organization from highly capable in-house functions, the CVC is better
equipped to seek out new opportunities and technologies – thus benefitting the organization in the long-term.

4.6 Organization: Developing an Effective Organizational Structure for CVCs

A robust strategic objective, a long-term outlook, and a clear understanding of its obligation to the corporation are critical strategic imperatives to the success of CVCs. These attributes, forming the first three components of my 4 O’s framework constitute key elements of a successful CVC. However, without a strong and effective organizational structure, CVCs risk confronting considerable challenges and hurdles. As discussed in the previous chapter, CVCs face an organizational dilemma, as it struggles to seek its identity between two seemingly conflicting roles: Is it corporate? Or is it venture capital?

As these two roles are, according to Birkinshaw and Hill (2005), “strange bedfellows”, attempting to amalgamate “corporate” with “venture capital” is a considerable challenge. As I have previously noted, if a CVC patterns itself far too much as a corporate function, it may be hampered by the inefficiencies and the bureaucracy of a large, slow corporation. On the other hand, if it distances itself far away from the corporation and positions itself more as an IVC, it risks losing the benefits of synergy with the corporation, and all of the benefits and competitive advantages it can provide.
Whilst there are a multitude of organizational features that need to be considered when shaping the “ideal CVC”, there are three critical and fundamental elements that need particular attention: (1) autonomy, (2) compensation, and (3) career development. Each of these elements is discussed below and concludes the chapter.

4.6.1. Autonomy

According to Birkinshaw and Hill (2005), autonomy within CVCs is defined along two dimensions. First, the autonomy of a CVC from its parent organization can be defined by its type of capitalization - that is, whether or not the CVC receives a dedicated fund or a discretionary fund (as shown in Figure 2.3). As discussed in Chapter 2.3, an autonomous firm would typically receive a discrete and separate pot of capital from the corporation, as opposed to a discretionary fund, which would force the CVC to ask for funds from the corporation every time opportunities arise. Second, autonomy can also be defined by the degree to which the CVC has decision rights over investment and management matters. In this respect, an autonomous firm would have the freedom to create and manage its portfolio and run its day-to-day operations as it chooses.

Birkinshaw and Hill (2005) discovered that CVCs with a higher degree of autonomy performed significantly better than their counterparts. Further, especially evident in the early years of the CVC, interference by top corporate management on day-to-day CVC business matters proved to be a significant cause for conflict between the corporation and the CVC and a cause for failure for the enterprise. Birkinshaw and
Hill (2005) cautioned corporations to ensure sufficient autonomy for the CVC, by providing a dedicated fund and managerial freedom.

That said, high degrees of autonomy do not imply that the CVC should have zero accountability to the parent company or that the CVC should avoid interaction with other business units in the firm (Birkinshaw and Hill, 2005). On the contrary, the CVC should be fully accountable to the strategic objectives set by the corporation and encouraged to form strong relationships with other business. Autonomy of the CVC from its parent organization on day-to-day, operational matters is an important and fundamental element to the organizational success of a CVC. By providing the CVC sufficient autonomy to manage its own operations, it can avoid falling victim to the red tape and bureaucracy of large corporations, whilst still benefiting from resources available within the company through collaborations with other business units.

4.6.2 Compensation

Employee compensation has historically been one of the most contentious organizational elements between CVCs and IVCs. Whilst CVCs within established corporations have typically provided a standard base salary and bonus as compensation to its personnel, senior managers at IVCs typically receive “carried interest” or a percentage on the capital gains of their investments (Henderson, 2007). This lucrative scheme, which has historically attracted top talent to IVCs, runs contrary to the prevailing compensation schemes found in corporations.
Should CVCs adapt a results-based compensation scheme found in IVCs or should it keep compensation schemes that are standard with the rest of the corporation? Views on this controversial issue vary.

Unilever Corporate Ventures, using an IVC compensation approach, argues that by using a carried interest scheme, they are able to attract top talent, and ensure that their senior managers are compensated commensurately to their investments’ success or failure. Any other schemes, they argue, would simply distort the risk/reward nature of the investment market, and diminish the link between performance and compensation (Birkinshaw and Hill, 2005).

On the other hand, other CVCs, including Lloyds TSB Strategic Ventures and Shell GameChanger, utilize a standard salary and bonus compensation scheme. They argue that the “intrinsic satisfaction” of new venture work is “sufficiently motivating to employees” (Birkinshaw and Hill, 2005). Further, they argue that creating a compensation system severely disparate from the rest of the organization (i.e., the “carried interest” scheme) would create animosity in the organization, alienating the CVC from other in-house functions.

Which argument is stronger? Which compensation scheme is more appropriate for CVCs, as it seeks innovation and growth to its parent organization? Which scheme is more effective in allowing the CVC to develop and support a strategic objective
with a long-term outlook and a complementary obligation/role to the rest of the organization?

Birkinshaw and Hill (2005) found “no link between the substantial use of equity-lined or highly leveraged financial incentives and venture unit performance.” Therefore, despite claims that the “carried interest” compensation scheme attracts top talent and motivates investment managers to perform better (as compensation is linked to performance), studies suggest that there is no benefit to the IVC scheme. This observation can be explained by the fact that most successful CVCs do not base their investments purely on financial objectives. Rather, as discussed earlier in the chapter, strategic, long-term objectives are much more critical to the success of a CVC.

Further, according to Birkinshaw and Hill (2005), high-powered compensation schemes, such as “carried interest”, may be a distraction to employees, as employees may instead seek out short-term financial rewards, ignoring a long-term strategic outlook. By dangling such a lucrative financial incentive, strategic priorities may be overlooked in light of a desire for financial returns.

4.6.3 Career Development

As discussed earlier, CVCs have a dual purpose. First, they must look externally, seeking to build strong relationships with the venture community and other investors wishing to form partnerships. Second, they must look internally, ensuring
collaboration with other in-house functions and utilizing competencies the corporation already possesses.

According to MacMillan et al (2008), most successful CVC personnel have prior experience of working in one or more of the sponsoring corporation’s business units. This invaluable experience provides the employee a unique advantage in “speaking the language” and in understanding the culture and intricacies of the parent company. With this, the CVC manager is better equipped to collaborate more closely with his or her business units or R&D counterparts, and is better able to extract value from such relationships.

Career development is a critical organizational component of successful CVCs. Ackerman (2008) argues that CVCs should be part of the career development or path of the corporation’s best performers. Instead of treating the CVC unit as an extraneous part of the organization, organizations should put the CVC on the career development pathway for talented managers. MacMillan et al (2008) advocate the use of personnel secondments or temporary assignments to the CVC unit, lasting from 12-24 months, for “rising stars” in the organization. With such appointments, the appointee broadens his or her managerial and leadership perspective whilst the CVC benefits by having top talent.

Organizations and CVCs alike need to recognize the dual role of CVCs. Their objective is not simply to build relationships with the external venture community;
rather, they need to build robust and collaborative ties with other internal business units. By developing a strong and worthwhile career track within CVCs, both the organization and personnel gain from expanding their horizons, elevating their skills, and strengthening internal relationships that will undoubtedly yield dividends in the future.

4.7 Conclusion: The Four O’s Framework

In sum, my Four O’s Framework is a way to imagine how to develop a successful and effective CVC organization. I believe the four components -- Objective, Outlook, Obligation, and Organization -- are strategic imperatives to ensure that the CVC is appropriately developed, managed, and structured to generate strategic and financial benefits for the parent organization. By acknowledging these four attributes, and by taking steps towards their implementation, a corporation can create a new engine to discover innovation, and consequently, generate growth.
Chapter 5

Conclusion

The decline of innovation over the past few decades across several industries has prompted corporations to seek new sources of growth and creativity. As in-house R&D functions stagger to find the next paradigm-shifting technology, more companies have attempted to tap into open innovation. From collaborations with universities and governments to a series of high value acquisitions, corporations have sought innovation and growth from a variety of sources – hoping that their investments would yield significant benefits and rewards in the future.
For over half a century, Corporate Venture Capital has been used by corporations to invest in start-ups promising the next novel technology – hoping to extract as much strategic and/or financial rewards from venture partnerships. However, based on its turbulent, cyclical, and, to some, disappointing past, the performance of CVCs has been tepid, at best. Whilst CVCs, theoretically, possess the competitive advantage of having the corporation’s capabilities and support, there have been concerns about the viability and effectiveness of CVCs in delivering value to the parent organization.

As I have continually noted in this thesis, after four cycles of seemingly disappointing performance, scholars and practitioners are still asking whether or not CVCs can be transformed into effective and efficient investment vehicles, or if they are simply a waste of capital and resources. With ill-defined objectives, a highly cyclical short-term outlook, confused roles and obligation, and a dysfunctional organizational structure, the case against CVCs is strong.

But, as Chapter 4 outlines, I have put forth the “Four O’s framework” to help organizations in shaping and managing effective CVCs. Whilst the attributes necessary for CVC success are many, I believe four factors -- Objective, Outlook, Obligation, and Organization -- are essential. Based on empirical data, CVCs can deliver value.

Literature and empirical data on Corporate Venture Capital are, however, limited. There is a need to conduct substantially more research and analysis in this exciting
field. In particular, there are four topics that should be explored further. First, there is limited information on how strategic value is measured quantitatively. If we are to claim that setting strategic objectives are critical to the success of CVCs, then how does one measure success? How does one measure innovation? Currently, innovation is measured via number of patents registered. One can argue that whilst this system is the most practical, it can also be misleading and fails to capture the quality of the innovation generated. By understanding and quantifying “strategic value”, CVCs will be better equipped at setting metrics for success.

Second, there is limited information on the effectiveness of professional secondments into CVCs. Whilst several literature sources argue that there are career development schemes that provide benefit to both the CVC and the organization, few have been able to adequately assess their impact. Because this secondment or rotational practice of 12-24 months has been quite limited in CVCs to date, it is difficult to track and assess the value of this program. By exploring this further, one could identify the benefits of career development as a critical component of successful CVCs.

Third, further investigation must be made on what Sorensen and Stuart (2001) called “reputation effects,” the impact of cyclical investing on the CVC image and reputation in the investment community. CVCs have been tainted by five decades and four cycles of turbulent investing. It appears important, therefore, to assess the long-term damage this type of discontinuous commitment has had on the entire CVC
industry. Are entrepreneurs less keen to partner with fledgling CVCs for fear of losing their support once the market declines? Are CVCs wary of other CVCs who have had an undependable past? This investigation would shed light on the impact of CVC’s seemingly lack of commitment to the investment community over the past half century.

Finally, more research must be conducted on the Four O’s framework, and how it can be best implemented by corporations. Whilst all four strategic objectives are critical to the success of the CVC, more data is needed on their interrelatedness, and how each component affects the others. Also, how should companies prioritize the four elements, and are there elements that are more critical and important than others? By understanding how the Four O’s framework can be best utilized, the corporation will be better equipped in shaping and developing an effective CVC.

Corporate Venture Capital organizations, can, indeed, create value. CVCs provide a unique and invaluable opportunity to corporations to seek out new technologies in the marketplace and build robust relationships with those start-ups that are significantly more efficient at generating and nurturing breakthrough technologies. As a window to innovation, CVCs can provide the corporation a significant competitive advantage by opening up its horizon of possibilities beyond its own in-house R&D capabilities. With CVCs, companies can effectively tap into open innovation, and widen their perspective in a world that is increasingly becoming more competitive.
By creating and developing CVCs, based on the 4 O’s framework, corporations can gain an effective strategic tool for seeking innovation and growth in the 21st century.
Bibliography


