

Corporate Venture Capital Investments as a Tool for Implementing Open Innovation

An executive summary of findings regarding the strategic use of CVC

by Johann Jakob Napp

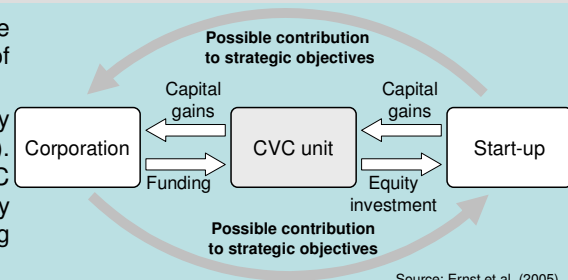
Introduction to this Report

What is the origin of this report?

- This report summarises research conducted at the Centre for Technology Management (Institute for Manufacturing, University of Cambridge) from January 2007 to March 2010.
- Embedded in a broader project on *how to implement open innovation*, the research aimed at understanding *how companies capture and measure strategic value* from corporate venture capital investments.
- The findings are based on *case studies of 9 multinational technology companies*. In total, more than 35 managers of CVC units, involved start-up companies and the parent firm's business units as well as external industry experts and consultants have been interviewed. Nonetheless it should be noted that *the results are of very exploratory nature* and have not been tested in further depth yet. As a result, this report should be seen as a *summary of observations* and not as a provider of strict guidelines.

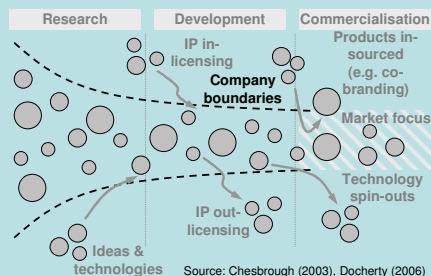
What is 'Corporate Venture Capital' (CVC)?

- The study research is focussed on Corporate Venture Capital (CVC) investments, which is a specific form of direct, external corporate venturing.
- In the CVC model, a corporation makes strategic equity investments in start-ups (which originated externally). Investments are typically managed via a dedicated CVC unit, which can be either a legally independent subsidiary or an integral part of the corporation. The underlying structure is illustrated in the figure on the right.



Source: Ernst et al. (2005)

What is 'Open Innovation'?



- 'Open innovation' describes a technology and innovation management strategy conceptualised by Henry Chesbrough in 2003
- Open innovation activities comprise the use of purposive inflows and outflows of knowledge to accelerate internal innovation, and expand the market for external use of innovation respectively (as illustrated in the figure on the left).
- CVC investments are one of many tools that can be used as one aspect for implementing an open innovation strategy

Topics Covered by this Briefing

This report aims at providing a mapping of options for structuring and measuring CVC programmes by covering the following aspects:

A. Why to do CVC investments?

- The strategic view: key dimensions of strategic value of CVC investments
- Related challenges & observed solutions

B. How to capture value from CVC operationally?

- The operational view: linkages for capturing strategic value
- Related challenges & observed solutions

C. How to measure strategic value?

- The evaluative view: metrics for measuring strategic value
- Related challenges & observed solutions

Further Information

For further information about results of the research and for a list of related academic publications, please contact:

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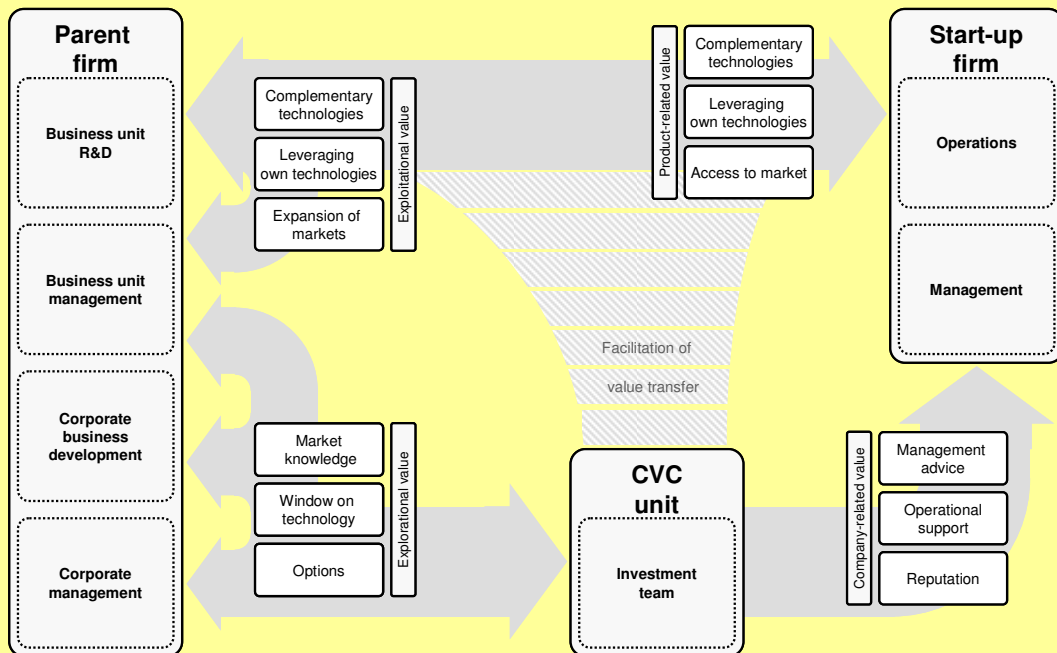
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Section A:

Why to Do CVC Investments?

The Strategic View: Key Dimension of Strategic Value



What to take away from the figure?

- The figure illustrates a) what *key dimensions of strategic value* can be generated through CVC investment activities; and b) through which *channels between parties* within the CVC environment the value is captured
- CVC investments can be done for a range of different strategic reasons, as it can provide:
 - a) *explorational value* (i.e. providing general understanding of markets + technologies for the parent firm)
 - b) *exploitative value* (i.e. enabling a specific combination of new technologies for the parent firm)
 - c) *company-related value* (i.e. adding general value to running the start-up's business)
 - d) *product-related value* (i.e. enabling a specific combination of new technologies for the start-ups)
- CVC units typically are only responsible for transferring explorational value to the parent firm and company-related value to the start-up
- Exploitative and product-related value is typically exchanged directly between the parent firm and start-ups
- The CVC unit typically has to act as a *matchmaker* to facilitate value capture between the parent firm and the start-ups

Related Challenges

a. Finding the right mixture of objectives

- Balancing financial vs. strategic objectives
- Balancing explorational as well as exploitative value

b. Sustaining long-term CVC commitment

- Getting commitment from senior management to long-term strategic objectives
- Getting buy-in from the BUs

Observed (+ Future) Solutions

a. CVC = C + VC

- "VC" for Venture Capital: use financial targets (as VC's do) as "base line" to identify commercially solid start-ups which can develop into reliable business partners
- "C" for Corporate: clearly define + communicate additional strategic objectives for the corporation internally + externally

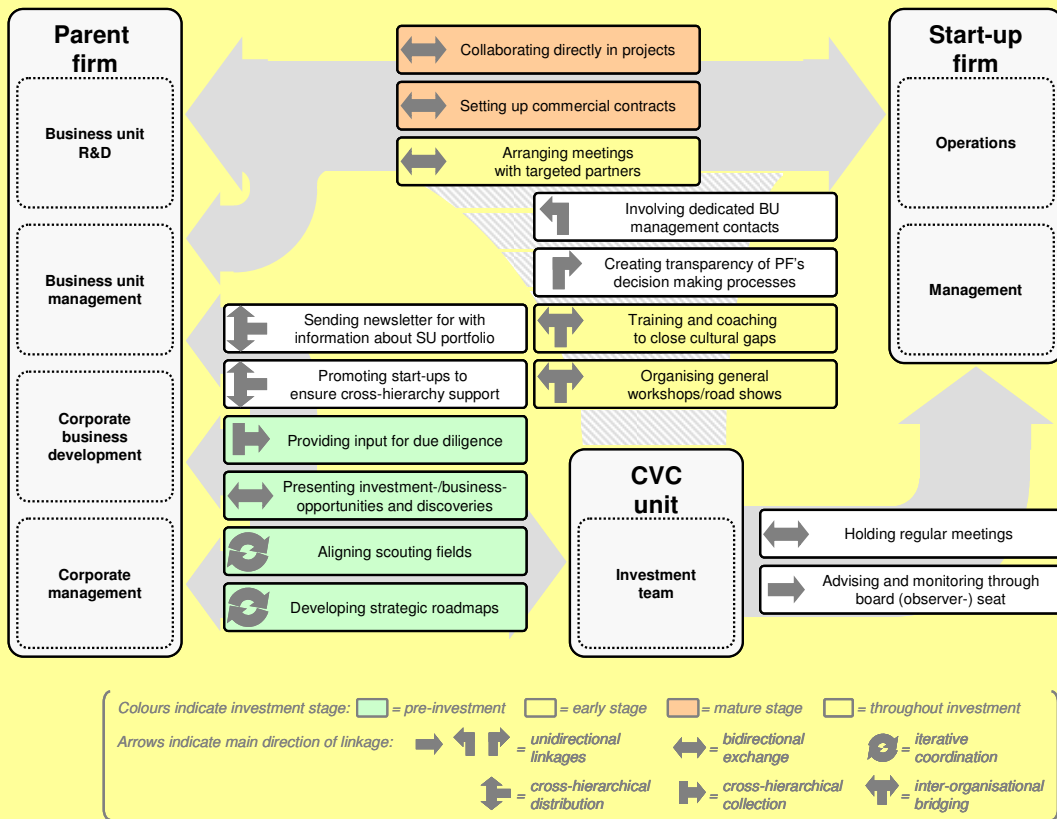
b. Setting up an internal fund structure

- Set up dedicated funds for individual business units (→ target funds at interests of individual BUs)
- Do the fund-raising for each fund at BU level (→ more independence from shifts in senior mgmt.)
- Share financial return with BUs (→ aligning incentives for working with SUs)

Section B:

How to Capture Value from CVC Operationally?

The Operational View: Linkages for Capturing Strategic Value



What to take away from the figure?

- The figure illustrates what *operational linkages* can be put in place between the CVC unit, the parent firm and the start-ups to *capture the strategic value* outlined in section A of this report
- The linkages are active at *different investment stages* (see color code): in early stages, in particular explorational value is captured between the parent firm and the CVC unit. Later in the process independent links develop to connect the start-up directly to BUs. Those links are strongly facilitated by the CVC unit.
- To perform its *matchmaker-role*, the CVC unit has to *bridge inter- and intra-organisational gaps*. The arrows illustrate the dynamic tasks of the CVC managers of distributing and collecting information across a wide variety of parties involved in the parent firm and the start-ups.

Related Challenges

a. Bridging inter-organisational gaps

- Connecting the start-ups to relevant BUs
- Overcoming cultural differences between start-ups and large companies
- Building trust between involved parties

b. Bridging intra-organisational gaps

- Connecting the investment strategy to the corporate strategy
- Making the potential for collaboration with start-ups visible across the whole corporation

c. Creating ownership for collaboration within BUs

- Making an 'independent' collaboration between BUs and start-ups happen
- Handing over responsibilities to BU

Observed (+ Future) Solutions

a. Building a competent interdisciplinary CVC team

- Setting up the CVC management team as a mixture of managers with internal corporate experience and external VC experts
- Provision of training + coaching for BUs and start-ups to prepare them for collaboration

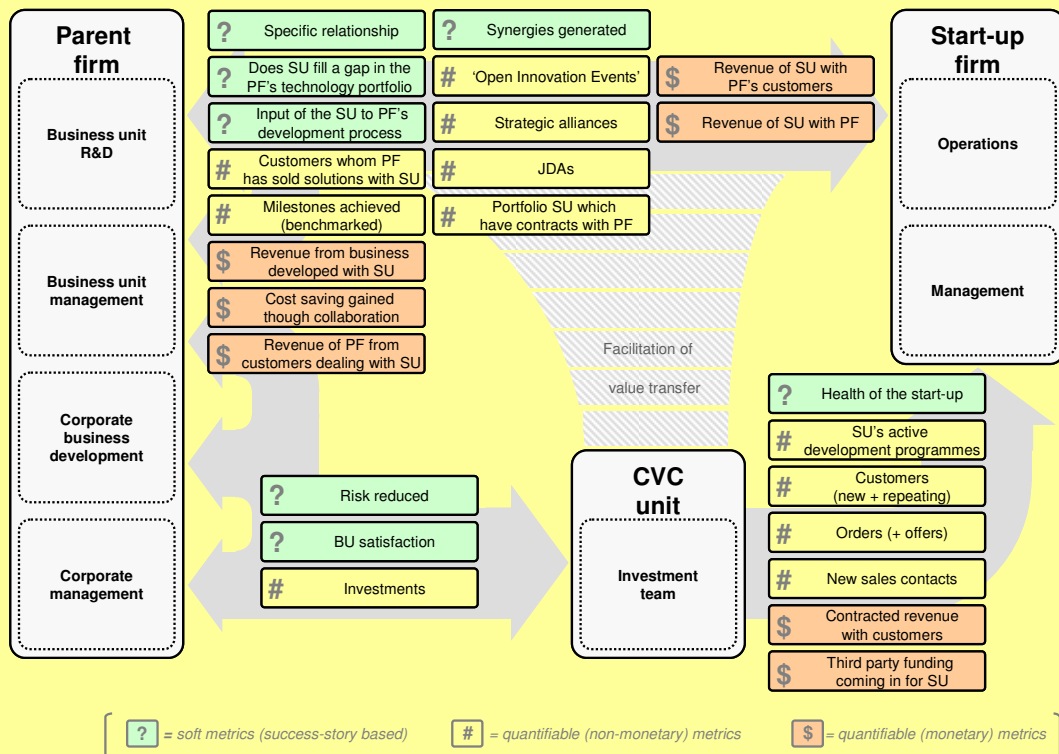
b. Establishing strong links into all hierarchies

- Close involvement of corporate management when forming a scouting/investment strategy
- Early involvement of BU management + R&D
- Organisation of roadshows and newsletters to promote start-up technologies internally

c. Establishing dedicated BU 'Catalysts'

- Commit + involve dedicated BU managers early
- Formally hand over responsibility for collaboration from CVC unit after the investment is made

The Evaluative View: Metrics for Measuring Strategic Value



What to take away from the figure?

- The figure illustrates what *metrics* can be put in place to *monitor the captured strategic value* outlined in section A of this report
- *Soft metrics* (i.e. case-based success stories and examples), *quantifiable, non-monetary metrics* (i.e. numbers which refers to a frequency of events or activities) and *quantifiable, monetary metrics* (i.e. monetary sums which indicate value creation) can be used for the evaluation of CVC programmes
- Most metrics focus on measuring the exploitative and product-related value creation, which are representing the most applied and thus most measurable value dimensions
- Fewer metrics are observed for capturing company-related value for the start-up and for capturing explorative value for the company
- Surprisingly CVC units currently do not measure the activity of their CVC units regarding the matchmaking + facilitation process (even though this process seems to be crucial for the future success of a CVC project)

Related Challenges

a. Balancing short- and long-term metrics

- Metrics tend to reflect short-term achievements rather than long-term strategic goals
- Objectives might not necessarily be completely coverable by metrics

b. Alignment of objectives through metrics

- Setting the right incentives for the start-up, the BUs and the CVC unit to align interests

Observed (+ Future) Solutions

a. Mix of different measures

- Do not limit the evaluation to revenue-based metrics, as they only represent a small percentage of the strategic value
- Use the power of convincing success stories to generate buy-in from management and BUs
- Generate case-specific targets and milestones depending on the objectives of each investment

b. Use of performance warrants

- Use of performance warrants with clearly defined performance conditions as 'trigger points' for next investment in shares
 - allows large corporation to convert warrants into shares based upon performance of the start-up
 - aligns incentive to maximise start-up performance
 - sets clear benchmarks to measure against