November 2012 • Global Corporate Venturing

Building a Corporate Venturing Unit: A Best Practices Approach

Patty Burke
Partner,
Bell Mason Group

!

According to recent GCV statistics there are now more than 750 active corporate venturing and innovation (CV&I) programs, with more than $100 billion in assets under management. CV&I programs are now viewed as a vital addition to traditional corporate innovation sources—R&D, M&A, strategic alliances, licensing and joint ventures. And companies are taking a keen interest in best practices guidelines for establishing new programs, or fine-tuning strategies and operations of existing groups. In a recent Bell Mason Group survey that explored this trend we found a great deal of optimism for the promise of corporate innovation groups, tempered, of course, by concerns about internal and external barriers to success.

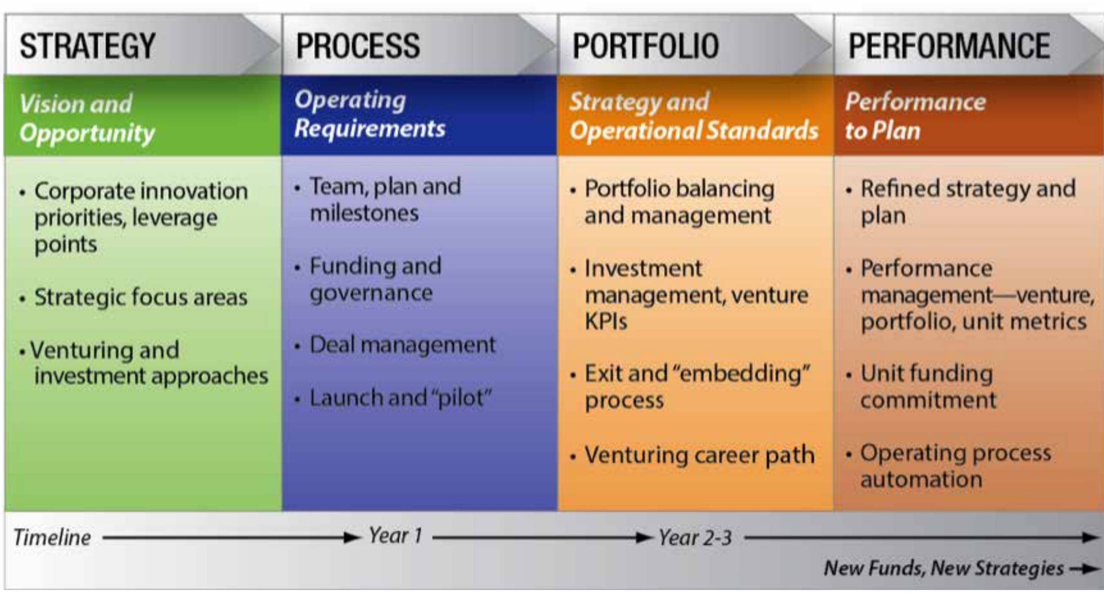
Corporate Venturing and Innovation Models

Today, a CV&I portfolio frequently includes several types of venturing models designed to accomplish different but complementary objectives.

The **Integrated Innovation** function is a growing trend as companies seek to consolidate and leverage their innovation initiatives. Often led by a Chief Innovation Officer (CIO), these groups oversee all innovation teams, integrating the objectives and operations of Incubation, Commercial Piloting, CVC, Venturing Center of Excellence (CoE), partnering initiatives, and frequently, IP and licensing. It may be managed as a P&L unit with financial as well as strategic objectives.

Corporate Venture Capital (CVC): Whether they are part of an integrated Innovation function or a standalone unit, these groups make direct external investments. They are often established and funded with a box budget, as an LLC, or as limited partnerships with external VC funds. They have established investment strategies and parameters, and are measured on achievement of both financial

Bell Mason 4 Phase Model for CVC Unit Development



and strategic objectives.

Building a sustainable CVC initiative: The four phases of development

At Bell Mason Group we've analyzed hundreds of corporate innovation programs—both successful and unsuccessful—and have used that data to develop a four-phase framework for CV&I unit development that can be customized for innovation models (incubation or CVC, for example) and for specific corporate requirements.

The BMG 4-Phase Model pictured shows high-level elements Phase, the full BMG Framework includes multiple levels of execution guidelines and tools within each Phase

Phase I—Strategy: Vision and Opportunity (Year 1)
Most CVC groups start with ad hoc activities, such as direct investments in just a few strategic companies, or with a 'fund of funds' that has a complementary market or technology focus. Fund of fund investments often provide an easier way to learn about the market, build relationships, and introduce the company into the venturing ecosystem.

Investment Strategy is a key deliverable of Phase 1, including a charter that explicitly states the CVC group's focus, objectives, investment models. The CVC team's job is to match current and projected corporate priorities to new markets and innovation growth areas that can achieve the corporate vision.

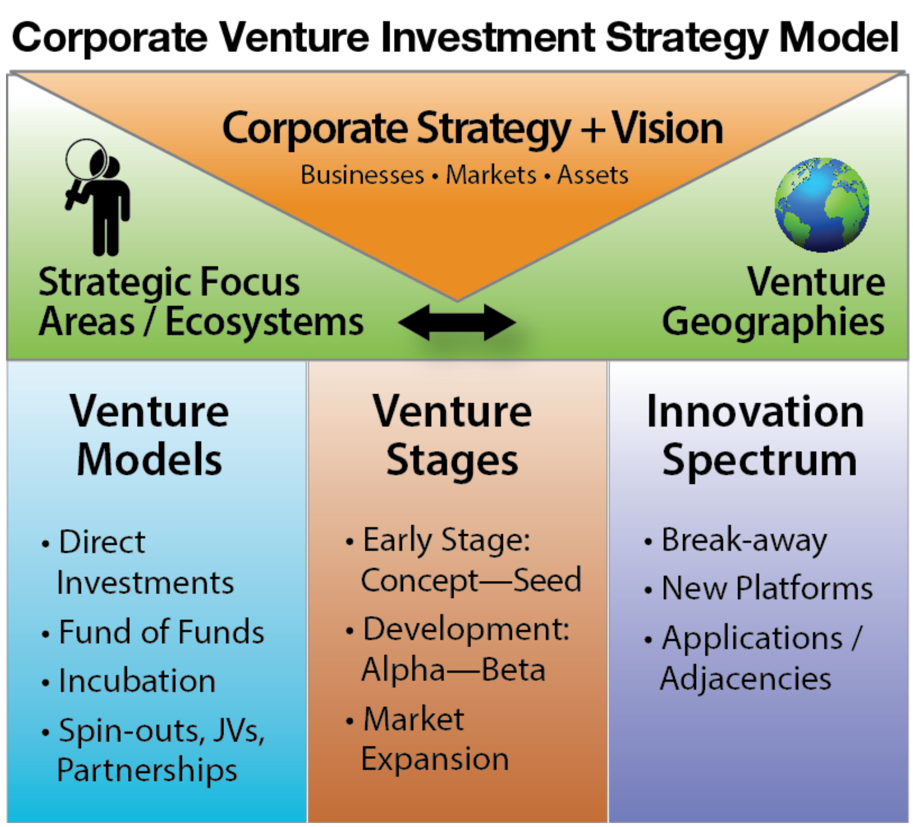
The CVC group's board and sponsors must also buy in to the charter, and be aligned with its support of corporate objectives and success metrics. Identifying and partnering with BU executive 'champions' to explore venture focus areas ensures that objectives are aligned. Venturing groups often choose to work with a limited number of BUs and regions to start, usually choosing units that may be challenged by innovative competitors or have opportunities to leverage 'hot' new technologies, regions or market trends. Once a successful CVC-BU relationship and model is established, it can be duplicated and adapted for other BUs.

Phase II—Process: Operating Requirements (Year 1-2)
With strategy set and direction clear, the next phase is to establish the operating requirements for the CVC group by developing an annual plan and outline of key milestones for years 2-3. This is a 'trigger' phase that sets up the foundation required for the successful development of the unit over time.

BMG has defined 10 Operating Requirements for the Phase II CVC group plan. Among the most important are governance, deal management, and 'marketing' the fund through systematic outreach to targeted industry and VC partners.

Governance policies are always challenging for CVC units, but efficient operations are critical to ensuring that the unit can compete for the best deals and earn the respect of potential VC partners and target entrepreneurs. The investment board should include senior level venturing and domain experts and must be entrepreneurial and empowered—not just a collection of executives representing major corporate functions. Good investment boards have the time, industry knowledge, and passion to help shape and tune the investment strategy.

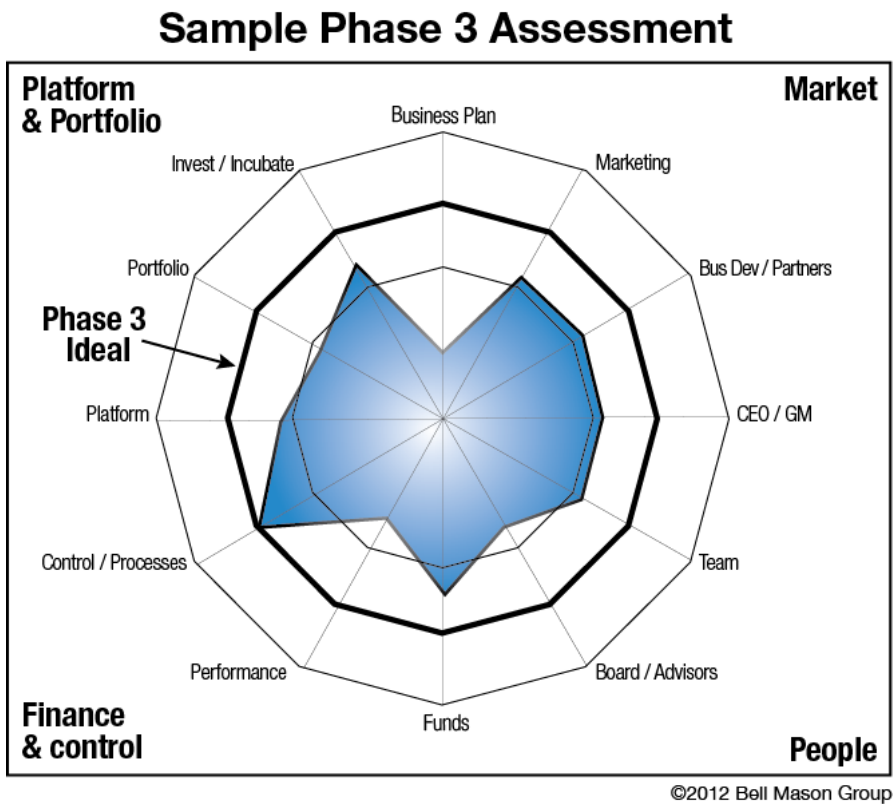
Reporting to a corporate unit (innovation, strategy, finance or corporate development, for example), rather than a business or product unit, is often the best choice to protect CVC investments from the



quarterly focus of revenue-driven BUs. New product and service categories may be unfamiliar territory for existing BUs, and adapting to new revenue sources, ecosystems, channels, and partners can be a challenge. Because BUs are incented to bring in revenue fast, they may also move too quickly to attack larger, highly visible markets, sometimes skipping the important validation and iteration steps that a new concept requires, and risking reputation damage as a result.

Deal management—with explicit processes within each phase of the 'pipeline'—is one of the best ways to accelerate the often-lengthy approval process. Well-defined investment criteria, and a phased due-diligence process that brings in corporate resources and reviewers at appropriate points can accelerate the process and make it more competitive with traditional VCs. Using investment criteria as a pre-qualification tool is critical: many CVC teams waste valuable time responding to and vetting internally generated ideas and referrals, especially 'pet' projects from executives and board members. A clear investment strategy and process empowers the CVC group to reject these 'time-sink' projects.

Bell Mason CVC Assessment – A Best Practices 'Gap Analysis'



The Bell Mason Assessment can be used at any phase of the development of a corporate venturing unit—CVC, Incubation or other. This 'spidergraph' is a visual 'gap analysis' showing how the unit compares to the ideal at its Phase of Development, across 12 Dimensions of development. The Dimensions are a part of Bell Mason rules-based system that describe detailed strategy and execution elements and milestones that must be accomplished at each of the 4 Phases. This analysis provides the prescriptive roadmap to establish CVC unit plans in the early phase and evaluate and tune them in later phases. It is often used as the basis to kick-off a planning process, with teams working together to determine actions required to address the gaps.

Marketing and communicating a clear investment strategy sends a message to the external innovation ecosystem—VC partners, academic institutions and market influencers—that ensures a pre-qualified deal flow and strategic fit. This ecosystem also serves as the group's eyes and ears in identifying early stage innovations and competitive and trend information, while complementing its internal champions and 'scouts' from R&D, sales and product groups, worldwide.

Phase III—Strategy and Operational Standards (Year 2-3)

With operational plans in place and a critical mass of investments, it's time to test and refine the portfolio strategy and standardize operating processes.

Portfolio Balance is assessed at year two or three to determine whether the portfolio is meeting the objectives of the original investment strategy. This assessment should evaluate the mix of ventures in terms of focus areas, venture types, stages, regions, and distribution across the Innovation Spectrum, with the goal of identifying misalignments and determining causes and implications. How has corporate strategy evolved? Have market and competitive dynamics changed? Should focus areas be changed or expanded? In addition to portfolio analysis, a candid assessment of the group's management, operations and processes should also be done. The goal of these assessments is to define data and information needed to make investment strategy changes and for fine-tuning unit staffing and operations in Phase IV.

Investment Management systems should also be in place to track progress and metrics as ventures move towards 'exit'—spin-in to a BU, spin-out, IPO or trade sale. Development milestones are tracked across multiple areas—from product to marketing to management team composition—addressing key performance indicators by venture stage. The Bell Mason Framework for Venture Development is one way to manage the progress of venture investments, providing input for management 'dashboards' that give an investment board a consolidated view of CVC investments in relation to each other, to incubated investments, and to other corporate innovation initiatives.

Phase IV—Performance to Plan (Year 3)
Building a CVC unit is like building a start-up—a continuous process of action, analysis and iteration. Phase IV, in Year 3, is the time to step back and take a critical look at performance to plan. Issues and market dynamics identified in Phase III should feed into an update of the investment strategy, plan, and funding needs. Operational processes—both internal and external—should be evaluated to ensure that the group is functioning like a well-oiled machine

Performance management is a key element of this phase. All CVC units monitor financial metrics, but in reality, returns are rarely material to the company's overall performance. Even then, the returns aren't likely to be achieved in less than five years.

Setting, monitoring and achieving strategic milestones provides management with near-term ways to measure the success of the CVC group, and to help refine its objectives and strategies. For example, the ability to pre-empt competitors or be first to market in a high-growth category are strategic metrics that can be identified and tracked prior to any significant financial results.

Establishing a system for tracking and reporting strategic objectives makes it possible to assess the portfolio's financial and strategic value, analyze the various elements against the original strategy model and portfolio mix, and determine appropriate changes.

Standard dashboard views that illustrate metrics at the venture, portfolio, and corporate level can then be provided to the investment board and executive team as it assesses the value of its overall CV&I initiatives, and aggregates the performance of different innovation models across the company.

Corporate Venturing: A Growth Engine

In today's dynamic, technology-driven environment, innovation is a critical topic for every corporate board, with high visibility and even higher expectations. Corporate venturing has the potential to deliver real results that can transform the trajectory of even the most traditional corporations—the opportunities are certainly there.

Innovation groups that set clear objectives and develop sound processes and metrics can build a solid foundation to leverage these opportunities. The result will be innovation strategies and teams that can survive and thrive through management and market cycles, bringing innovative products and services to market, and fueling an important engine for corporate growth.