CVC Insights Project – Summary Findings & Analysis

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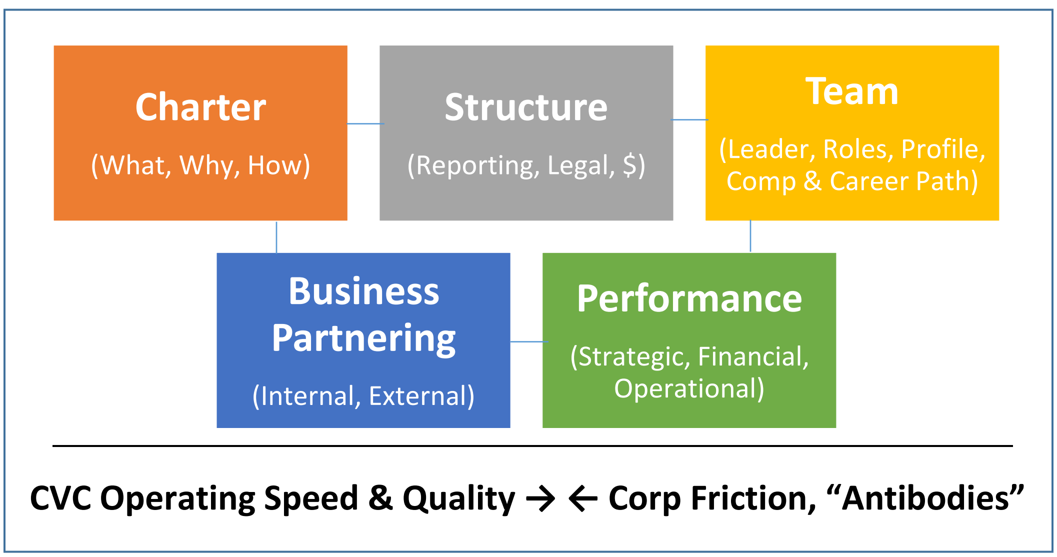
Introduction: The CVC Insights Project came out of an end-of-year (2016) GCV-BMG conversation about how the last 3-5 years of corporate venture capital (CVC) have been noteworthy for remarkable changes in corporate venturing strategies, approaches and the professionalization of practices.

CVC programs are now at the highest volume in their long history, established in virtually every sector and industry, and finally being acknowledged as vital, mainstream tools in the portfolio of corporate innovation and transformational growth initiatives.

We thought it would be useful to get 'in front of the data,' and to qualitatively capture some of the key trends and implications through a series of confidential BMG discussions with a select group of ~ 30 venturing professionals, representative of the community, and grouped according to the maturity of their units (1-2 years, 3-5 years, and 6-9 + years).

These conversations covered market trends, operational agility and innovation, new opportunities and challenges, as well as best practices and program strategies for overcoming the corporate "antibodies" that inhibit successful program development and sustainability.

We have organized our analysis of these conversations into a summary that includes some high level trends which apply to all groups, followed by "drill-down" commentary by age of unit (1-2 years, 3-5 years, 6-9+ years), across 5 dimensions (Charter, Structure, Team, Business Partnering, and Performance). We have also highlighted common CVC-Corporate Parent friction points/corporate antibodies per group.



Two additional categories included are:

- **CVC Spin-outs**: Comments on CVC program "spin-outs" are included due to the frequency with which the topic is currently being raised in conversations, especially among those in 3-5 year programs. Spin-outs are more frequently being considered as an option when planning for program scale and sustainability, and for team retention.

- **CVC Tools and Resources**: Sampling of participant comments about tools and resources are also included, as they relate to efforts to increase operational efficiency and enhance deal flow/investing effectiveness.

Top-Level CVC Market Trends & Threats

- **Corporate Parent** – Corporate boards and leadership are feeling intense pressure to respond to new market realities -- the speed of changing landscapes, digital/emerging technology ubiquity, increasing competitive urgencies. Corporates across industry sectors are finally, broadly acknowledging CVC as a mainstream corporate innovation tool; along with other players/stakeholders in the innovation investment ecosystem who are recognizing the value that professionally-managed CVC programs can deliver
- **CVC Professionalization at new level** – Formalization of unique CVC practice specialty with adaptations and practice innovation focused on 'end to end' investing for accelerated and integrated (strategic + financial) performance delivery. Program charters and CVC investing platforms (team, structure, processes, partnerships…) have been honed to deliver strategic innovation leverage, 'market maker' opportunities and accelerated proof points for commercial traction
- **Threats to CVC program success, within the parent company environment -** Parent company cultural, organizational and operational 'antibodies' tend to become more pronounced as CVC programs grow and scale, and visibility increases both inside and outside the corporation. Key challenges include:
    - High degree of internal 'time sink' for CVC leader/team in corporate executive staff and business unit relationship management, and ongoing CVC education
    - Recruiting and retaining quality professional team while maintaining alignment within parent culture (professional CVC career path/comp – rewarding for staying in place)
    - Making 'end to end' portfolio company, parent company and business partnering work effectively

PROGRAMS AT 1-2 YEARS

Description	Trends	High Performers
• Fundamental CVC program formation period • Sets the competitive 'clock' for speed of development and roadmap for early traction and performance	• Board-level recognition of CVC as legitimate, mainstream corporate tool for innovation and growth • Executive management more receptive to rapid CVC program formation to address competitive and growth 'urgencies'	Bar raised on the quality of CVC programs now being formed, as reflected in: • External CVC program & compensation benchmarking • Clarity in strategic intent/program chartering with appropriate fusion of financial & strategic goals • New end-to-end investing tools (CVC, BD, M&A…) • Initial mix of experienced team hires • Leaner decision-making/end to end investing processes • Business partnering skills (Parent, syndicate partners, startups…)

Highlights

Charter:

- Accelerated CVC programs benefit from parent clarity on goals for 'end-to-end' strategic investing (i.e. from sourcing through to 'landing spots'). Primary investing objectives include intelligence on position with future trends and technologies, identification of new business models and desirable adjacent markets access/fastest routes to by which to achieve
- End-to-end investing/partnering emphasis and speed is driving proposed use of broader set of CV program investing models and adaptations (CVC + BD/Partnering + M&A – i.e., *'market maker tool kit'*)
- Increased corporate "openness" to more agile/lean CVC investment and partnering decision-making processes reflecting greater parent understanding of specialized nature of CVC practice and experience base of CVC leader/team…in some cases, with higher levels of leader signatory authority than in the past

Structure:

- Consistent 'up-leveling' of reporting to CXO/EVP (no more than 2 levels below CEO) with CEO as active supporter
- Reporting structure ('Transactional Innovation') -- Shift of internal CVC program reporting to business commercial/transactional side, i.e., Corporate Strategy, Business Development, and M&A side of corporation. NOTE: Even those with strong technology/digital transformation

investment charter who still report through R&D often have matrixed reporting and performance assessment in business commercial/transactional exec management

- More common use of legal entities such as LLCs to simplify internal corporate financial reporting, reduce operating friction of 'on balance sheet' reporting, as well as provide downstream vehicle for potential CVC program expansion/growth path and team retention
- Now typical: Corporate multi-year CVC program funding commitments to support active investing/follow-ons (5+/year minimum; experienced team of professionals can increase that ramp to 10+annual investments/commercial deals, with team of 5-6.). Typical viable first fund commitment: $100M-$150M
- Emerging use of 'leverage funds,' designated budgets to facilitate startup/parent company collaborations (trials, pilots, etc.) and to incent parent 'catchers of opportunities'

Team:

- CVC program teams strategically designed to pair trusted insiders (senior people fluent in parent language, culture, business and strategy with trusted internal networks) and specialist outsiders (senior investment professionals with experience building CVC programs or VC/Private equity and/or start-up co. experience). Requires sophistication on part of CVC leader to assemble, integrate, and manage complexity; but can accelerate quality program development and end-to-end performance, and reduce internal friction
- Corporates new to CVC as well as those forming 'restarts' are showing new respect for experienced CVC professionals who are recruited to fill parent capability gaps, and who act to accelerate and improve the quality of program operations and performance
- Recognized 'need to compete' for these experienced CVC investment professionals in the innovation investment ecosystem talent pool (CVC, VC, Private Company), at program formation and over time. Broad ecosystem and sector compensation package benchmarks are now available and continuing to evolve, as practice continues to professionalize and formal roles/job descriptions become industry-standard

Business Partnering:

- Starting point investment theses are more likely to reflect corporate desire for emerging market ecosystem technology/business insight, as well as identification of parent's 'market-maker' potential and means by which to effectively partner to achieve
- CVC Team evolution: Emergence of new senior level BD position, focused on strategic internal/external partnering and parent relationship management. Ultimately, senior professional in this role is frequently recruited from within parent, but BD responsibilities may initially be part of investment professional job description when portfolio is small and the external investment professional needs to understand internal corporate stakeholder relationships as key element in making 'end to end' investing work, and to establish initial credibility

Performance:

- Clarity and concreteness in charters laid out in better understood and more appropriate fusion of strategic (Commercial traction/other impact) and financial (don't lose $, institutional VC & syndicate partner metrics) goals and performance metrics

- External ecosystem interest in CVC deal participation and partner relationships has also exploded over last 3-5 years ("phone ringing off hook; never problem in getting meeting")
- Growing corporate acceptance of CVC as a necessary and professional, specialized senior level practice speeds effective CVC operating platform development and clears way for initial CVC program performance. Program development for quality deal flow, investment management, portfolio management now occurs at more accelerated rate, in first 12 vs 24 mos., effectively beating the 'Corporate Patience Cycle' (i.e. corporate tolerance of CVC program risk, exceptional process/governance relative to future value delivery starts to wear thinner at year 3, with greater insistence of need to see early 'wins' as indicators of program performance)

Top Friction Points/Corporate Antibodies:

- Most early friction occurs in defining and corralling internal executive management and operational support for CVC program charter/structures, building alignment for funding, performance criteria and 12-18 month roadmap
  Note: CVC program leader can spend 60-75% of time on internal alignment, education and stakeholder relationship management…not sustainable at this level on ongoing basis, as program moves to next phase of development and complexity
- Another prime area of friction (especially for 'first-time' corporates) is external recruitment of seasoned CVC team members, and the ability to be competitive with compensation and career path potential (in line with CVC program/portfolio strategy and desired speed to program traction and performance). This requires corporate acknowledgement of external senior level, specialty compensation package benchmarks and willingness to rationalize new types of roles and comp packages internally within corporate HR structure (often a 'work in progress').
- Equally big issue can be internal/external team chemistry and corporate/cultural fit. Ideally, internal understanding and 'outline' are in place re: expectations for performance (what/when), as well as trajectory for career path and potential to expand compensation parameters in the future, based on individual and team MBOs

PROGRAMS AT 3-5 YEARS

Description	Trends	High Performers
• Critical execution period which tests performance expectations and lays foundation for 'turbo-charged' CVC program scalability and sustainability • Demonstration of agility in refining strategic investment theses & portfolio focus, while showing path to CVC portfolio value/impact with early 'wins' • Institutionalization of the CVC operating 'platform' (team/comp, process, governance, funding…) to weather subsequent and inevitable management changes, reorgs, corporate strategy shifts	• 3-5 years is 'pivot point' for the future of the CVC program, whether it: - Survives management and corporate shifts intact - Continues/expands within the parent corporation - Moves outside as a means to reduce corporate friction and CVC program growth inhibitors - Winds down, cuts back on investing or focuses on management of existing portfolio • Early wins raise program visibility and exposure, requiring CVC leader/team experience and strategic prowess to educate and align key stakeholders (CVC program/team, start-ups & other syndicate partners, corporate execs/BUs)	• Demonstrate deal/portfolio strategy & execution: - Fast 'wins' with clear, visible impact for ALL stakeholders, as early proof points of capabilities and risk reduction - Roadmap and options for program expansion • CVC teams include both high-performance senior investment and BD professionals with increased operating autonomy • Move to next phase of CVC team retention strategy and career path development • Formalized internal linkages for repeatability of value delivery from and to portfolio companies • Effectively use strategic communications to highlight CVC performance and value

Highlights

Charter:

- Parent and CVC team see Charter as 'living' strategy/document to be continuously refined and improved (try it, fix it) in order to preserve strategic alignment with parent/stakeholders and to enable efficient replication/customization for geographic or new domain expansion
- 'Market maker' strategies and tools increasingly employed by experienced CVC teams to hasten delivery of impact that matters to parent. Emphasis on portfolio vision with refined strategic focus area investment/partnering targets and broadened investment toolkit including M&A/Growth PE – also, ability to make bigger bets for greater impact in smaller number of areas
- Expansion option exploration through fund collaborations with complementary CVCs; and LP positions in geographic and/or domain-specific funds that align with portfolio strategy

- Streamlined governance/operations: trend for increased CVC leader/team signatory authority and operational autonomy to reduce friction and speed progress, particularly with a trusted, experienced team that can demonstrate early program successes
- Investment committees and decision makers: trend is for smaller size, shorter decision-making process/cycle time, tuned to CVC investment requirements. More experienced CVC teams are better able to manage IC process and outcomes; have important, respected vote. Quorums are typical for approving investments; veto power is constrained. Typical part of investment proposal is its preparatory socialization among decision makers
- Board vs. Observer seats: at minimum, Observer seats seen by many CVC teams as essential in 'end to end' investing/partnering. Many corporates prefer Observer vs. Board seats to avoid increased risk and exposure that comes with Board position legal and fiduciary responsibilities. Some scenarios in which board seats are taken: investment is very large; portfolio co. is critical to 'market maker' strategy; portfolio co. is strong candidate for M&A

Structure:

- Reporting/sponsor transitions: by year 3-5 of CVC program, there has probably been at least one change in reporting structure, corporate strategy shift or corporate reorganization/M&A – e.g. shift of internal CVC program reporting to business commercial/ transactional side. Transitions are test for CVC program effectiveness, adaptability and maintenance of external momentum
- Current high growth environment and rising desirability of top CVCs as syndicate partners leading to increase in 'traffic' that puts foundational CVC platform/operational throughput to the test
- Increasing connection to and leverage of existing corporate lab/innovation center environments for outside-in CVC commercial development and piloting (another effective corporate vehicle for CVC end to end investing and partnering)
- By end of year 4 to 5, initial allocation (Fund #1) largely invested with strategic and financial value demonstrated and effectively communicated. Basis for raising (increasing?) annual allocations including discussion of expansion funding and legal structure optionality

Team:

- Corporate and CVC sector recognition that high-performance CVC teams integrate specialized, blended skill sets and that retention of high performance professionals /team is as important as their recruitment. CVC team in year 3-5: now vulnerable to attrition, given competitive external environment and increase in poaching
- Recognition that corporates must competitively position CVC specialist roles and compensation packages relative to other players in the ecosystem talent pool (VCs, Growth PE and private company professionals)
    - Understanding of cross-ecosystem compensation benchmarks and potential risk/reward trade-offs (e.g., potential VC/private co upside vs reduction of individual risk and consistent rewards for CVCs - stable salaries, annual bonuses, RSUs in successful, brand name parent companies)
    - Exploration of career paths/development programs for entry/mid-level team members
- Especially within last 3 to 5 years, there is increasing corporate awareness and willingness to competitively reward high performing individuals and, more recently, consider 'upside' options

for team performance pools (i.e., ‘pay for performance’ in line with venturing risk/reward profile)
  - Restricted Stock Units (RSUs) are progressively the most common vehicle for this in the corporate environment, with equity in parent corporate seen as the closest equivalent to external VC equity interest (‘carry’)
  - Direct and dedicated equity interest in individual investments or portfolio as whole is least common for CVC individuals and team, given degree of complexity in structuring /friction in implementing in the corporate environment – as well as cultural antibodies it unleashes
- With team expansion: Potential for growing misalignment and discontinuities with corporate HR and core business banding. (e.g., MD equivalent to CEO of multimillion dollar biz? BD vs investment professional comp?)

Business Partnering:

- Recognition that partnering and BD skills are critical for ‘securing’ corporate position as innovator, hastening commercial traction/building beachheads in new markets, applications, etc
- More systematic, senior level approaches to partnering for accelerated portfolio development and value delivery for parent corporate:
  - Formalization of internal linkages for repeatability of value delivery from and to portfolio companies (LOIs, stakeholder relationships/resource commitments) – account management/sales, product, platform, supply chain, etc
  - Senior BD professionals building and maintaining meaningful and productive internal/external relationships to speed delivery of commercial traction and strategic impact in innovation areas deemed critical to parent’s overall growth
  - External ‘portfolio partnerships’ (among VCs & CVCs) a common accelerator of program performance. Note: CVCs are increasingly co-investing with other CVCs for horizontal technology, application, services or platform development, even though their parent companies may view each other as competitors
- CVC professionals are typically very conscious of potential conflicts of interest and ethics re: information sharing within and across their global parent companies
- Power of good external syndicates: sitting side by side with experienced Board/Observers – key to reduction of learning curve, learning by example. Result: increase of value delivery for all stakeholders

Performance:

3-5 year period is test of CVC program: meet portfolio strategy and execution goals, recruit/retain high performance team, and establish streamlined operating platform

- ‘Fund #1’ equivalent invested, with strategic and financial value demonstrated
  - Proof of refined investment strategy with deals and partnerships that highlight CVC team proficiencies and strategic value delivery to corporate parent and all other stakeholders
  - IRR exceeding corporate parent hurdle rate, ‘exits’

- CVC platform institutionalization and syndicate formations speed follow-on deals and valued partner relationships
  - High quality deal flow from partners and prospective portfolio companies
  - CVC team: trusted position in ecosystem as valued, highly competent end-to-end player (understands VC investment operating rules/cycle times, can efficiently deliver parent resources and facilitate relationships)
- CVC program Communications acknowledged as critical business strategy tool for educating, conveying performance and value impact, maintaining 'touch' and productive connection to corporate parent and all other stakeholders

Top Friction Points/Corporate Antibodies

As CVC units/programs become more visible in year 3-5 with increased investments, strategic and financial exposure and heavier demands for internal/external relationship management; they lose the luxury of operating 'under the radar,' and must compete for corporate funds/incur more visible risks. Key challenges/friction points include:

- <u>Retention of high performance individuals and expansion of the team</u>; particularly when team as a unit meets early program performance goals…puts real pressure on compensation package value and career path definition
- <u>CVC program continuity/expansion in face of multiple executive rotations/corporate strategy shifts</u>…alignment of parent goals and relationships are often threatened via multiple corporate management changes or strategy shifts, particularly if foundational program elements (charter, team, structure & governance/ops, portfolio development & performance metrics) are not 'institutionalized'
  - CVC programs can lose momentum or stop completely as new reporting structures are created -- threatens ability of CVC team to compete on outside for deal flow, key investments for portfolio, partners and ecosystem positioning
  - CVC leader/team must often start over to build internal respect and relationships, and regain freedom to operate, funding and BD support, quality access to internal networks for 'end-to-end' landings

PROGRAMS AT 6-9+ YEARS

Description	Trends	High Performers
• CVC entrenched as an essential corporate innovation tool, contributing significant strategic value and financial stability • Continuity and scalability enabled by ability to adapt institutionalized teams, programs and incentives over time; and to manage changes in parent strategy and leadership without undermining professional investing credibility externally	• Broadening of CVC charters/ mandates to address larger 'market maker' opportunities by actively incorporating BD, M&A and growth equity tools • Substantial size and global reach with teams/processes to support up to 40-60 investments/year, along with aligned innovation infrastructure to manage pilots/business collaborations ('transactional innovation')	• Strong CVC leader and executive management support • Exceptional understanding of the corporate parent's core businesses, operations, organization and culture • Agile and creative in adapting to changing internal and external circumstances while maintaining corporate relevance and strategic alignment • Institutionalized CVC program structure and operations, investment process discipline, financial rigor, means of governance and reporting • Performance impact/significant investment portfolio 'wins' and clear program success metrics • Standard team specifications and performance framing with 'CVC track' (competitive comp and entry level career development) • Savvy communications capabilities (inside out – outside in) that have accelerated corporate 'education,' 'currency,' and awareness; earned respect and trust among external ecosystem players/partners

Highlights

Charter:

- Market maker roles: CVC teams provide expert view of emerging market structures around new technologies, products, platforms, services, apps, etc. Up-leveling of CVC effort to track and frame new, rapidly developing ecologies and 'marketectures' around business areas strategically important to parent:
    - Hypotheses on trigger points; curation of key elements/players to maximize CVC/corporate position.
    - Yield portfolio and partnering strategies for end to end investing, in multiple domains with dedicated, domain-specific MD's/teams
    - Utilize suite of investment tools and access to capital (investment, M&A, Growth PE/roll-ups, partnering & coincident commercial relationships)
- Current portfolio strategies reflect industry shift/focus on 'transactional innovation' and increased emphasis on business/BD and partnering strategies as part of CVC team competencies and performance. Many expect (and deliver on) 'landings' in 1-2 years
- Evolution of Investment Committee structures and processes to reflect parent respect for CVC team expertise and track record: Increasingly CVC team-driven investment decision-making to leverage full team experience and enhance horizontal perspective on market opportunities
- Outside-in corporate education and communications: increasingly significant part of CVC charter, given speed of technology commercialization and new market development. Vital enabler of successful stakeholder collaborations, partnering, and end-to-end investing

Structure:

- Reporting/sponsor transitions: Proven ability to weather multiple transitions in reporting structure, corporate strategy shifts or corporate reorganizations – e.g. change in CVC program reporting structure. Transitions continue to be test for CVC program effectiveness and maintenance of external momentum
- CVCs who have achieved sustainability in 6-9+ year range are stable, significant strategic value contributors with an established role in the parent innovation portfolio. CVC program structure and operations, investment process rigor, means of governance and reporting have been refined and institutionalized with the parent corporation:
    - Standard process for allocating annual investment funds and increases. Strategic, transformational impact is the ultimate goal, investment funds are one of the enablers, means to ends
    - 'Evergreen' goal - Fund returns may be poured back into CVC unit operation, self-funding
- For those whose strategic alignment with parent has 'drifted', and whose program performance and growth is being threatened by corporate strategy shifts, reorgs, and heightened operating frictions: candidates for spin-out discussions? (see Spin out section)

Team:

- Formalization of team structure: Most long term CVC programs have formalized their team structures/jobs, compensation bands and career paths. In addition to investment team, program may include senior BD, marketing and operations roles with increase in emphasis on end to end investing and 'landing spots' and partnering
- CVC Compensation: Most long term programs/teams still compensated on a spectrum with other employees, largely aligned within standard corporate HR structure and banding for base and bonus (RSUs, cash). Majority still do not/will not get equivalent of carry or portfolio equity interest (too difficult to rationalize within corporate structure, especially with large funds and size of portfolio; high friction/core company discontinuities)
    - Brand: Long term CVC programs and parent companies have powerful brands that are significant factor in attracting and retaining teams
    - More than $: Competitive compensation relative to all but top VCs, with some element of 'pay for performance' for retention. CVCs often also motivated by choice of lifestyle/intellectual stimulation vs desire for 'home run' (Note: CVCs may do better over time than many VCs, enjoying predictable compensation year over year with often significant value in established corporation's RSUs vs. VC base and carry, and realities of compensation unpredictability and lack of IPO 'windfall' exits for many VCs, as well as delay in receiving)
- Size and track record of top brand, long term CVC teams/programs bring some unique advantages, e.g. large enough in size to consider new thinking around how to grow more CVC professionals from within, starting with Associates (easiest to source), graduating to Manager to Director. Greatest amount of current 'churn' and external recruiting is at senior professional level. Possible to eventually offset that churn with internal training for qualifying and placing personnel?
- On the whole, attrition has been relatively low among these long term CVC teams, but trends and corporate shifts over last 3-5 years have brought new challenges and marked increase in competition for recruitment and retention of experienced, senior level CVC professionals. Currently, corporations source up to 50% of their CVC teams externally

Business Partnering:

- CVCs now becoming increasingly proficient at creating higher level market development hypotheses, architectures and frameworks, and then curating for solutions among ventures and partners that 'fit.' In parallel, CVCs also educate internal customers/partners, and teach them how to effectively curate for 'right fit' solutions among prospects/approaches/partners
- Long term, successful CVC programs have well established proficiencies and reputation for quality in portfolio level partnering, syndicate and investment collaboration, and experience with most key players in ecosystem (i.e., VC, CVC, Growth PE, etc.)
    - Understand what constitutes 'good investing behavior,' even in the face of strategic shifts
    - New types of CVC syndicates and higher level portfolio partnerships forming to better address emerging ecosystems and build 'market maker' positions

  - All note increasing instances of multiple CVCs teaming up with one another on venture investments– natural, even preferred, alignment of investors who share understanding of corporate environments, similar end to end investment process, strategic goals, complementary commercial traction accelerators, and shared, explicit view of how investment and commercial 'landing spots' fit together for venture and each corporate investor
  - Close attention to detail and high degree of care re: potential for conflicts and access issues (with other CVCs, with ventures); identifies potential areas ahead of time, quick to recuse
- Increasingly systematic approach to formalizing internal relationships for transitioning ventures to 'landing spots;' e.g., sharing risk and funding; rewarding those who 'catch' as well as those who invest – critical for aligning motivation, incenting right outcomes
  - Closer alignment and strategic collaboration with internal key 'customers' at outset of relationship. e.g., joint development of 'problem sets' which CVC uses to frame hunt for 'solutions' (more compelling than business 'shopping lists')
  - Maintaining currency of 'right' internal partnerships, business relationships/internal network intelligence: requires significant, dedicated CVC team effort, and progressively specialized BD development and relationship management skills
  - Planning for the core business rotations that occur, on average, every 2-3 years; business leaders, every 4. (a uniquely daunting challenge for delivering successful 'landing spots' for portfolio cos)

Performance:

- Consistency in meeting strategic and financial goals: hallmark of high performance team and enduring program; close, continuing adjustments for alignment with corporate strategy and parent organization
- Top quartile financial performance – respected player, seeing best deals, participating in top syndicates, seen as valuation enhancer for portfolio companies
- Measuring strategic impact as related to revenue growth and shareholder value remains ongoing challenge, especially given rapid changes
  - Try to keep it simple: cash on cash return; number of 'landings', etc. Cases speak for themselves
  - Quantitative metrics for transitions to 'landing spots' e.g., how many accepted for inclusion in Sales Handbook/Price lists (along with Sales team evangelism and incentives; measure number of successful pilots with innovation centers and strategic licensing opportunities, potential for downstream M&A.)
  - With refinement of front end investment process and early planning for landing spots, measuring reduction in investment mortality rate
  - Pilots best linchpins to scale; steady state focus on transitions from pilots to adoption (again, very quantitative). Predefined key people and transition templates necessary to insure/speed each landing. Goal: increase in adoptions as indicator of CVC performance and business value contribution

- CVC Portfolio reporting on quarterly basis: standard, efficient process, data driven with well-defined financial tracking and key strategic performance metrics/value capture plans for investments & portfolio as a whole. Other ad hoc reporting as needed
- Increased sophistication in tracking and analyzing investment, portfolio and partner performance data. Rigor in data collection and performance formulas

Top Friction Points/Corporate Antibodies:

- Management rotations and changes in parent/BU strategic priorities affecting charter, performance goals and funding for established, large scale CVC program
  - Potential for increasing friction with competing agendas, diverging priorities and progressive inhibitors for growth between CVC team and parent company – maintain strategic relevance to parent, make mark in new areas
  - Challenges and tension for CVC team in maintaining external positioning and trusted network while managing around/insulating external network and portfolio cos. against internal slow-downs, new reporting structures, etc.
- Team retention: Experienced, senior CVC people from established, 'brand' programs are attractive candidates for both CVCs and VCs…serious flight risks if parent corp. can't match comp (e.g., through upside bonus pools, career paths, etc.)
- CVC/Parent HR structure discontinuities present ongoing challenges to competitive comp design
  - CVC vs business leaders comp (i.e., CVC MD in same band as business leader; business leader manages huge organizations and large P&L)
  - CVC blurring of lines with M&A operations (need new guidelines?) and compensation bands (M&A team may be paid less, for specialized transaction expertise in doing historically larger company M&A with sizable dollar values)

Rising Interest in CVC Program Spin-Outs

The reality is that most corporates who have had corporate venturing initiatives over numbers of years have started and stopped them multiple times, with CVC programs falling victim to loss of champions and funding during management turn-overs and reorganizations. With each cycle comes scattering of specialized teams, legacies of orphaned and strategically irrelevant corporate investments; and institutional 'amnesia' regarding knowledge and experience in developing specialized CVC processes, practices, professional talent. Each cycle is a restart.

For CVC teams in the 3-5 year group (but also in the early part of the 6-9+ group) who have been at the mercy of many of these typical but highly disruptive corporate management changes and strategy shifts, the idea of existing in an operating environment tuned to venture investing and free of corporate HR misalignments/ongoing friction seems very appealing -- especially as it relates to creation of the market-competitive CVC compensation packages which are so necessary to recruit and retain experienced teams. Hence the interest in re-examining and potentially innovating on models for CVC spin-out.

Key drivers behind interest in spin-outs

- CVC Team/Parent company organizational and cultural impedance mismatch, particularly at scale:
    - CVC team investing in transformational or adjacent areas that require highly specialized investment team; and move faster and/or operate very differently than parent core business (e.g. software/digital)
    - CVC team set up for program expansion and increased momentum (cuts execution time in half/delivers on CVC end-to-end investing principles), just as cyclical management rotations and strategy shifts slow it down, threatening to undermine strategic alignment with CVC team, portfolio companies, partners
    - Strategic alignment and internal network are vital for delivery of end to end investing. Shifting parent organizational and strategic landscapes <u>test CVC team/program agility</u>: ability to adjust and maintain close alignment with parent, without sacrificing accelerated pace/quality of portfolio and partner development & performance
- High performance professional investing team retention --- team being recruited
    - Growing compensation misalignment between established business HR structures/banding and market-competitive CVC salary increases/bonus structures and career path planning
    - Market-competitive base, bonus, 'staying in place' career path requires parity increases with CVC team job promotions and individual, team and portfolio performance. <u>Tests corporate parent commitment to 'make it work'</u> – promise & deliver -- and CVC team's willingness to compromise
- Parent regulatory constraints (E.g. Financial Services and Healthcare) seen to limit both investment process efficiency and potential strategic value to be derived CVC program
    - Regulatory limits on investing models and conduct of commercial trials
    - Unwieldy house decision-making and investment management processes with heavy risk management overlay

Lack of successful resolution /continuing friction on these points can lead to wearing, unproductive, impediments to growth and sustainability of CVC programs/team. Spin-out option perceived to provide potential relief from these friction points as alternative solution for program growth and sustainability.

What's potentially attractive to CVC teams and corporate parents about spin options?

For CVC team: More freedom to operate and optimize fund/portfolio performance when out from under inhibitors in corporate environment. Also, CVC teams get market-competitive compensation packages including carried interest (direct alignment of reward with fund performance).

For corporate parent: reduction of operating, organizational, cultural discontinuities and 'system friction.' With operating insulation, also comes attendant reduction of regulatory challenges, brand and shareholder exposure.

NOTE: While current interests in Spin-Outs is increasing, there are few CVC teams who have successfully executed on this option. Many factors and dependencies. Harder than it looks – myths vs. realities. With innovative, new variations on CVC spin models also come significant strategic and operational complexities and new types of friction/conflicts to be managed. Bottom line: some shouldn't try; aren't good candidates from the outset. For those that do, one size doesn't fit all.

CVC teams that spin out in search of compensation 'liberation' must also now adjust to a different operating 'pay to play' partner model with management fee for operating costs, inherently riskier basis for compensation, and unpredictable lead times and outcomes re: carried interest.

Regardless of model and among other issues: CVC Spin team **must** find way to maintain close strategic alignment/ongoing relevance with parent/LP, continue to be seen high yield vehicle for new corporate growth and rapidly developing market-maker positioning. This also demands that CVC team/senior BD professionals stay up to date (insider info) on management rotations and reorgs, and maintain ongoing quality of internal network of key corporate relationships. This is prime enabler of continued delivery on CVC promise of 'end to end investing' and accelerated commercial traction that multiplies value for all stakeholders. There are past precedents that suggest that 'priority relevance' is increasingly difficult to maintain with corporate parent over time, given 'departure from the nest' (physical, legal, operational, organizational, cultural separation and mutually shifting priorities and focus).

Current Examples:

Some recent examples of spin-outs – Sapphire (SAP), BMW iVentures, Propel (BBVA), Deutsche Telekom Capital Partners, Echo Health Ventures (Cambia + Mosaic), Gilde Healthcare to name a few – all from different sectors/types of parent companies (ops/cultures) with different regulatory and risk environments. This obviously affects strategic investment focus areas and priorities, although many share interest in horizontal areas that affect developments in their spaces (e.g. data management & analytics, cyber, AI/machine learning, AR/VR cloud, sensors, fintech, software platforms, mobility). The spins themselves all have variations in their in charters/goals, investing and operating models, fund sizes and focus (strategic focus areas, target ecosystems, partners), stage of investing, governance. Some have multiple corporate LPS; many have their previous corporate parents as sole LP; others have institutional syndicate/Fund involvement. All operate as VCs with financial performance goals and most with VC compensation structures (Management fee/carry/synthetic carry); some had to buy in, as typical VCs would; others did not.

'Stay close to LPs': At the same time, CVC spin-outs acknowledge importance of consistent delivery of additional strategic value and insight to LPs, communications outreach and events are central part of this. They see benefit from business support and assistance with 'landing spots'/commercial traction being sensitive to their priorities and interests, etc. – (in much the same way that captive CVC programs/teams are to their parent companies). But an easier, often more efficient path for spin-out is sometimes straight to parent's customers/users vs. getting re-embroiled in parent's internal business org/ops again. So, for spin-outs, while the operating model is VC; the central business model must ensure the all-important LP strategic value delivery via BD relationship management and strategic communications programs with LPs.

Tuning to get the right model, charter and operating agreements ahead of time is critical, as well as finalizing terms <u>before</u> the cord is cut. In the past, there have been more examples of failures than ongoing successes. Current CVC spin-outs are clearly pioneering next generation approaches, but don't yet have long histories, and are operating in new environments with different conditions than in the past.

Tools and Resources

Contributing CVCs mentioned a number of tools and resources relied on to accelerate the development of their CVC operations.

VC/CVC market intelligence/deal data - for sourcing and due diligence

Although curated word-of-mouth referrals from top syndicate partners are viewed as best source of quality deals; many also rely on 3rd party deal data providers for sourcing, ecosystem mapping, potential syndicate partner identification and due diligence. Sources listed by frequency of mention include:

- PitchBook – best deal and valuation data
- CB Insights – useful infographics, most user-friendly interface
- GCV – good global coverage, less mature data offering
- Other sources mentioned: CapIQ, Datafox, SVB Analytics

Networking

Given the unique position of CVCs within their parent corporations and the specialized nature of their work; CVC professionals typically participate in both CVC and investment domain-specific networking events. Many described emerging market focused and valuable competitor CVC relationships that would not be possible in other parts of their respective parent businesses.

Sources by frequency of mention include:

- CVC-specific:
  - GCV – Summit for North America, Symposium for Europe, Academy for training
  - NVCA – more VC/lobbying focus but has Corporate Venture Group
  - ICEX – small peer networking/problem-solving group (quarterly meeting)
  - CVC Summits & startup events – e.g. Intel, Qualcomm
- Domain-specific events: e.g. healthcare, tech, cleantech, consumer…
  - Conferences
  - Accelerator sponsorships (geo and sector-specific) – sometimes in JVs with other corporates (e.g. Israel, Brazil, Europe)

Automation SW:

There is no one size fits all off the shelf automation solution for CVC; although all share a common need for CRM/pipeline management capability (both within CVC team and across related innovation groups). Most units start by using excel as basis for modeling CVC processes and managing data/reporting; and then move to automate key pieces once process and requirements are established.

Beyond CRM, other requirements may include investment (portfolio) management and reporting, back office management (financial reporting, cap tables, etc.) and project management (e.g. startup engagement/commercial pilot PMO, project portfolio management). Hardest nuts to crack seemed to be

- Strategic portfolio management (investment performance, strategic value capture), which becomes increasingly unwieldy as number of investments expands beyond 10-15

- Situations that involve combination of investments/project management (CDA/pilots/incubations, etc.)

Sources by frequency of mention include:

- **CRM/Pipeline emphasis**
  - Salesforce used by > 50% of respondents (Large # of VC-savvy developers available to customize, often used in other parts of parent business)
  - ProSeeder (new entrant, 'perceived to be complex')
  - Wellspring (tech scout heritage)
  - Pipedrive (small team sales CRM)
  - Legacy M&A deal flow SW
- **Portfolio management emphasis**
  - Some very large programs or entities with strict security and reporting requirements have built and manage full custom CVC management platforms
- **Back Office emphasis**
  - Relevant Equity Works (back office heritage)
- **PMO**
  - Traction TeamPage

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