Like problem children, if they’re not handled well corporate ventures can cause their parents financial heartache and make them wish they’d never been born. But they can bring rich rewards if gently nurtured to their best ability. Julian Birkinshaw offers advice on practical corporate parenting.
Corporate venture units exist to nurture and develop start-up businesses for their parent company. But the irony is that most corporate venture units are themselves start-ups. With a few exceptions, like Intel Capital and Johnson and Johnson Development Corporation, the vast majority were established in the late 1990s, during the boom years of the technology bubble. Not only did these operations face all the classic challenges that start-ups are familiar with – inexperienced management, securing access to funding, attracting customers – they also had to weather a meltdown in the technology sector that left most corporate parents wondering why they had got involved in corporate venturing in the first place.

So how has corporate venturing fared in the post-dot-com world? Is it still a viable and exciting approach to new business development in large corporations? Or has it fallen out of favour, a wasteful indulgence suited only to more munificent times?

Intel has invested in hundreds of start-ups over the years for two symbiotic reasons – as a means of supporting the growth of its core microprocessor business, and to provide it with access to the latest emerging technologies.

A close look at the evolution of corporate venture units shows that the story is more complex. Some venture units have indeed been shut down, but most have survived the downturn and a few new ones have been started up. And significantly, the survivors have adapted their strategies and organisation models to cope with the more risk-averse business environment we are now living in.

The CV for CVs
Many large firms use corporate venturing. It is an approach to new business development in which they establish a separate organisational unit (a corporate venture unit) that invests in and nurtures start-up business ventures. There are many different reasons why a large firm might want to create a corporate venturing unit, but four common approaches can be identified – ecosystem venturing, innovation venturing, harvest venturing and private equity venturing.

Ecosystem venturing is a way for certain types of firm (particularly in the high-tech sector) to support the development of their community of suppliers, customers, and makers of complementary products by providing venture capital support for their activities. A well-known example of this approach is corporate venturing is Intel Capital. Intel has invested in hundreds of start-ups over the years for two symbiotic reasons – as a means of supporting the growth of its core microprocessor business, and to provide it with access to the latest emerging technologies in its sector. In addition, it has made good financial returns on its investments over the years.

Innovation venturing employs the methods of the venture capital industry to undertake traditional functional activities such as research and development. Typically, managers set up a separate unit alongside the existing function. The unit rewards people for value created, invests in many projects to spread risk, uses joint ventures and links with the venture capital industry and sets stage gate targets to help assess progress. Royal Dutch/Shell Group’s GameChanger is a good example of this model in action. It provided seed funding to new ideas in the exploration division swiftly, without going through the traditional layers of hierarchy.

Harvest venturing is a process of converting existing corporate resources into commercial ventures and then into cash. It is part of a broader function within large companies whose objective is to generate cash from selling or licensing corporate resources. In some cases the resources in question can simply be sold. In other cases the resources have no immediate commercial value, so the company puts in place a harvest venturing process for evaluating, investing in and developing these resources to the point where they attract interest from outside buyers. Examples of this model include Lucent's New Ventures Group and BT’s Brightstar, both of which were ultimately sold to a private equity firm.

The fourth approach is private equity venturing. Here, a corporate private equity unit invests in start-up businesses as if it were an independent venture capitalist. The goal is financial: there is no requirement that the unit will assist existing businesses or find a new growth platform to add to the portfolio. In effect, the company is doing little more than diversifying into private equity. Examples of this are GE Equity and Nokia Venture Partners.

All four of these approaches to corporate venturing can be successful, but there are problems associated with each one. Common mistakes include not giving the venture unit enough independence in choosing which ventures to invest in and sell; not providing sufficiently clear objectives; and not giving the venture unit enough time or money to deliver on its objectives. Indeed, the problems encountered by the current stock of
corporate venture units are classic examples of history repeating itself. Much the same mistakes were made in the previous waves of corporate venturing in the early 1970s and mid-1980s.

Changes in corporate venturing activity

The examples above were studied in 2001, when enthusiasm for corporate venturing was still high. In 2003 we went back to the same group of companies to see how their corporate venturing schemes had worked out. First we looked at which units were still in operation, and then considered 21 of the surviving units. We wanted to know what changes they had made to their activities, their investment portfolios, and their management systems.

Five broad themes emerged from the evidence. Usefully, the employee answering the questions was the same in each case–so the differences are truly representative of a change in the venture unit’s activities, not a difference of opinion.

First, survival rates varied dramatically across the four different types of venture unit, with the financially-focused units achieving a higher survival rate than the strategically-focused ones.

Our 2001 findings suggested that of the 95 units, 18 were harvest venturing units, eight were innovation venturing units, 36 were ecosystem venturing units and eight were private equity venturing units (Table 1). But by 2003 the survival rates across the four types were very different.

Sixteen of the 18 harvest venturing units survived, a fact that can be attributed primarily to their focus on creating fairly immediate financial returns. Seven of the eight private equity venturing units survived as well, which is a function of both their financial focus and the existence of outside investors (who often invest in the venture fund for a fixed period of around eight years).

By contrast, the survival rates for ecosystem venturing and innovation venturing units were much lower – 29 out of 36 and three out of eight respectively. This is essentially because these units were charged with developing and growing genuinely new businesses, and with long-term strategic objectives. The fact that many were closed down during 2001-3 is not necessarily due to their performance. Instead, it is indicative of the short-term thinking that is often seen in corporate headquarters, especially when the economy is on a downward slide. It is also a reminder that the cycle time for the development of a new business is usually longer than that of a corporate strategy – or the average tenure of a CEO.

Consider BT Brightstar, a venture unit that was created in 1999 to “unlock the hidden value” in British Telecom’s R&D operations. Although successful on many levels, BT Brightstar was unable to find viable exit options for its ventures while the market was in the doldrums. In 2002 the entire operation was sold off to Coller Capital, a private equity firm.

Our second finding was that venture unit executives were more careful and more selective in 2003 than they had been in 2001. Their operations had typically become smaller, with fewer investments. This is hardly surprising considering the period of consolidation that all venture units went through in the intervening years. The average size of the venture units dropped from 10.4 employees to 7.7 employees over the two-year period. And the average number of investments made by a single venture unit in 2001 was seven, whereas in 2003 it was just three.

We asked the respondents to tell us how many proposals they received, how many they evaluated in detail, and how many they invested in. In 2001, there were 656 proposals, 101 evaluations and eight investments. 2003 saw 626 proposals, of which 57 were evaluated and just four received investment. While the number of proposals stayed roughly constant, venture executives had become much more discerning about which ones they evaluated and which ones they invested in.

What explains the shift? Our research suggests a combination of greater experience on the part of the executives in question (many had only a year or
two's experience in 2001) and greater risk-aversion because of the change in attitude towards venturing in this period.

Growing up fast

We also found that there was less focus on internal venturing activities in 2003 compared to 2001, and much less emphasis on spinouts. Having said that, externally-focused venturing activities continued to attract the same level of attention.

We asked the venture unit managers to indicate the type of investments they focused on, choosing from one (never) to five (almost always). The results in Table 2 show that the externally-focused activities (the first two) had similar levels of attention, but the internally-focused activities (the third and fourth) gained less focus in 2003 than they did two years earlier.

The main reason for the change seems to be that the internal venturing process is simply more difficult – existing business units with claims on the intellectual property and the people working for the venture created complications. Additionally, there were several venture units whose mandate (defined by the parent company) shifted towards a greater emphasis on external investments.

Our fourth finding was that the activities of venture units matured from 2001 to 2003, with a greater focus on developing the ventures in the portfolio and an increased emphasis on delivering value to the corporate parent.

The respondents told us how involved they got in various activities, such as identifying new business ideas, developing existing businesses and networking with VCs. Back in 2001, the emphasis was on the deal making side of the business – making investments, networking and negotiating exits. By 2003 these activities had declined in importance. Instead, the development of existing business opportunities had become more significant, as shown in Table 3.

Back in 2001, the emphasis was on the deal making side of the business – making investments, networking and negotiating exits. By 2003 these activities had declined in importance.

We invest in independent start-ups /external business ideas purely as financial investments

We invest in independent start-ups with a view to learning from them and developing strategic relationships

We invest in internally-generated business ideas with a view to spinning them out as separate businesses

We invest in internally-generated business ideas to promote organic growth

1= never  2 = only in exceptional cases  3 = occasionally  4 = frequently  5 = almost always.

Table 2. Venture unit investments

We also looked at patterns of communication inside and outside the company. Over 2001-3, the frequency of contact with corporate executives decreased, but the frequency of contact with front-line managers, real customers and suppliers in the portfolio companies increased (Table 4). This suggests a shift of emphasis from establishing the venture unit as a going concern towards the active development of the businesses in the portfolio – a very healthy shift, all things considered.

A relevant point is the level of decision-making autonomy that the venture units received from their corporate parents. In 2001, most venture units had to gain ratification from their parent company on most decisions. By 2003 the average
level of autonomy had increased significantly, especially with regard to exiting from existing investments. This suggests an increasing level of confidence in the capabilities of the venture unit’s executives.

Could do better

Our last finding was that most venture units are still not performing to expectations. The average ratings in 2003 were lower in every case than in 2001, albeit not by a significant figure. The biggest drops were in financial performance, recognition from the rest of the company and developing strategic relationships with external partners (see Table 5).

Another indicator of performance is what happened to the businesses in the venture units’ portfolios. In 2001, each venture unit invested in an average of 25 businesses. Five were exited at a profit, 2.4 were closed and the rest were still in the portfolio or existed as businesses in the parent company. In 2003, the average portfolio size was 27, of which five were exited at a profit and 4.5 were closed. In other words, there were hardly any exits in the group of venture units but the number of closures doubled.

This result is scarcely surprising to anyone working in the industry, because it is widely known that following the dot-com bust, the market for new ventures dried up. It serves to emphasise just

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Table 3. Activities of venture units

<table>
<thead>
<tr>
<th>Activity</th>
<th>2001</th>
<th>2003</th>
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<tbody>
<tr>
<td>Networking with other parts of the company to develop support for our ventures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working with individuals to develop and commercialise their plans, and turn them into viable businesses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working with individuals to develop their ideas into business plans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identifying / seeking out business ideas in which to invest</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1 = never 2 = only in exceptional cases 3 = occasionally 4 = frequently 5 = almost always.

Table 4. Communication with various groups

<table>
<thead>
<tr>
<th>Communication</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communication with executives in corporate business units</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Communication with front-line managers in business units</td>
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<tr>
<td>Communication with suppliers</td>
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<tr>
<td>Communication with customers</td>
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</tbody>
</table>

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how difficult the venture unit executive’s job has become.

A streamlined future

There have been important shifts in the strategic focus and internal management of venture units. Most of these shifts can be attributed to an increased level of sophistication on the part of venturing executives, as their venture units begin to grow up. Today, venture units are more focused, more selective and more streamlined than they were in the late 1990s. And their executives now have the self-assurance to know when to resist the inevitable meddling of parent company executives.

This increased maturity does not guarantee survival, but it certainly helps. After all, many venture units just need time: time to figure out what they are really doing and where their priorities lie, and time to grow their ventures through their most fragile years and into viable businesses. Problem children can become high-earning adults, if their parents know how to handle them.

Resources


Table 5. Performance of venture units


Financial returns to corporation (IRR)
Contribution to top-line growth
Development of strategic relationship with external parties
Increased recognition in rest of corporation

1 = below expectations  3 = equal to expectations  5 = above expectations

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