Venturing to succeed

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Corporate venturing reached a peak of popularity at the height of the dot-com boom. But that was only the latest in a series of popularity peaks for an idea that has been around for 40 years. In spite of slipping out of corporate fashion, corporate venturing will return once again. The question is whether organisations will have learned the lessons in making the idea work.

Corporate venturing is the process of actively investing in small start-up businesses by large firms. Typically, corporate venturing is managed through a separate entity – a venture unit – which is given the responsibility of identifying suitable start-ups to invest in, adding value to those businesses, and deciding whether and when to exit them. There are many different types of venture units and often they end up performing several different functions. The common element, however, is that they all make active investments in start-up businesses.

Over the last two years we have spoken to executives in 50 venture units in eight different countries and gathered questionnaire data from a further 50. While many companies got out of corporate venturing altogether in the last couple of years, many others have persevered and a few have thrived. This article highlights the key factors that appear to separate the winners from the losers.

Before describing the results of our research, it is useful to provide some context on the phenomenon of corporate venturing.

Since the 1960s, corporate venturing has gone through three cycles. The first ended in 1973 with the oil price shock and the ensuing recession. The second began in the early 1980s and was fuelled by the growth of the computer and electronics sectors. It came to an end in the late 1980s (again because of recession). The third wave began during the great 1990s technology boom, and it peaked in 2000 before falling steeply. This latest wave was driven by a combination of new technologies (the Internet, microprocessors, telecommunications, biotechnology and so on) and also a bubble economy that made it seemingly possible to make very quick returns by investing in exciting new technologies.

In 2001 the total number of firms investing in corporate venture capital fell by about a quarter (with a further fall in 2002) but even during this downturn a number of new investing firms have also emerged. The total invested amounts have been estimated to be $7.6bn, based on 2001 investment figures gathered by Venture One. (See Figure 1)

The current slowdown has been due to a number of well-known factors – the collapse of high-technology stocks, a loss of faith in most Internet-based business plans and a number of high-profile corporate failures. Companies that have got out of corporate venturing over the last three years include British Airways, Reuters, Vodafone, British Gas, Marks and Spencer...
and Compaq. Corporate venture capital investments in the US fell by two thirds in 2001, though by comparison Europe has remained at a relatively higher level of investment (approximately €544m, which is 46 per cent down) according to *Real Deals* magazine. Corporate venturing in the US, in other words, seems to have suffered more than in Europe, in large part because the business environment in Europe had some catching up to do.

**Increasing research and understanding**

Academic thinking on corporate venturing provides some perspectives on how these cycles emerged as they did. The first academic studies looked at the various different structural forms of corporate venture units. They also documented many of the internal tensions that make corporate venturing difficult and showed that in most cases venture units failed to deliver value to their parent companies. While the oil price shock of 1973 killed off the first wave, the lack of success that most corporations experienced meant that corporate venturing did not return into vogue for another 10 years.

The second wave suffered from many of the same affictions as the first, perhaps in part because it was focused in the computer and electronics industries, which had no prior experience with venturing. Again, problems emerged and most corporations struggled to gain a return on their investment. In his book *Venture Capital and Private Equity*, Joshua Lerner describes three structural failures that can be identified in the approach to corporate venturing adopted during this period: most venture units had multiple goals rather than one clear mission; there was not sufficient management commitment to venturing, with the result that the necessary skills were not developed; and compensation schemes were not aligned to the growth of the ventures, with most venture managers paid on salary rather than in accordance with the new wealth created by the businesses in their portfolio.

During the 1990s considerable progress was made in understanding these problems through the enormous growth of the venture capital (VC) industry. VCs were true specialists in creating new businesses and they achieved their success through very disciplined investing, developing highly specialised skills, aligning incentives and creating strong external business networks. As corporate venturing took off again during the 1990s many venture units drew explicitly from the VC model. Well-known venture units including Intel Capital, Xerox Technology Ventures and Lucent’s New Venture Group all adopted the VC model in an overt way and with considerable success.

However, the current proliferation of literature on corporate venturing offers mixed views on whether the VC model is entirely appropriate. Most studies acknowledge the wide variety of different forms of
corporate venturing that have emerged and suggest that the appropriate model is highly contingent on the strategy adopted by the parent firm. There is also a sense that while the VC model has been effective at delivering financial gains, it has not delivered the strategic benefits that corporations typically seek.

Our sense is that the learning from the VC industry has been extremely valuable and it still has some way to go before it permeates the entire corporate venturing industry. However, there is a danger in adopting the VC model wholesale because ultimately most corporate venturing units are attempting to deliver strategic value back to their parent companies and this cannot be done with complete independence.

Key success factors
Our research revealed a number of different corporate venturing models from the pure “portfolio” investments made by some corporate venture capital firms through to internally focused “incubators”. While there are obviously some important differences between these different models, in terms of such things as their objectives and the types of start-up operations they invest in, there are some broad key success factors that apply to all cases. None of these success factors will come as a great surprise. What is surprising is the number of venture units that have failed to follow them.

Develop clear goals – and a structure to deliver on them
Corporate venture units are established for a wide variety of reasons – making a company more entrepreneurial, providing a window on new technologies, making a strong financial return. But the more objectives venture unit managers have to balance, the more difficult it is to make smart investment decisions. Those units with single-minded objectives can build a focused organisation with the specific skills they need. Those units with multiple and conflicting objectives end up being stuck in the middle – they cater for many different types of investment opportunity, their skill sets become diluted and they are rarely the partner of choice for an external VC.

Clear goals can take many forms. The most common model, as exemplified by Innovacom and Lucent Venture Partners, is to focus on financial returns within a particular technology space. Ericsson Business Innovation focuses on creating the next core business for Ericsson. BT Brightstar is concerned fundamentally with spinning out under-utilised technology in BT’s labs. The most interesting model is the Nokia Venture Organisation, which has three dedicated venture units as well as a number of related activities. While on the face of it these venture units have the potential to get in each other’s way, each one was formed for a particular purpose. The result is a set of highly focused and clearly defined units.

Many other venture units have struggled to define clear goals. One London-based unit that was created at the height of the dot-com boom was given a broad mandate to pursue both internally focused and externally focused opportunities with the intention of providing both a strong financial return and delivering on a number of strategic goals. The result of this lack of focus was a stuck-in-the-middle venture unit that opportunistically followed whatever business opportunities came its way without a clear position on such things as the use of VC partners, investment levels or linkages to the parent company. After two years the unit was folded back into the parent company.

Build specialised capabilities
Venture capitalists often view corporate venture units as poor relations – they see them as short-term funds with blurred objectives typically managed by corporate executives who do not have the networks, experience

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**Nokia Ventures Organisation**

In the late 1990s Nokia realised that it needed a more structured ventures organisation as a way to create and develop new businesses outside the natural development path or current focus of core businesses. It was realised that different corporate venturing situations required different solutions.

As explained by Johan Schmidt, who leads one of the venture groups, “it enables us to look at opportunities outside the current business and on a longer time horizon”. Ultimately Nokia’s model developed into one New Ventures Organisation (NVO), responsible for co-ordinating the different venturing activities and reporting directly to the president of the company. It thus ensures close alignment with the corporate strategy.

Nokia separated its venture activities according to two main criteria: the primary business driver and the future link with Nokia’s core business. In fact, as layers of an onion, it has built several corporate venture groups around Nokia Mobile Phones and the Nokia Networks, the existing core of the company, in order to deal with new venture opportunities.

The first layer is a strategic planning group called Insight and Foresight, an organic business function within the Nokia Ventures Organization, identifying new opportunities based on market and technology disruptions and contributing to the advanced business development of the existing core. Business ideas from this process may grow into the next layer as concrete business plans.

The second layer, New Growth Business, looks at internal business opportunities that have a high likelihood of a future link with the core business, and the main driver is to create strategic new businesses. The structure is a small team, within NVO, and organically a part of the Nokia organisation.

The third layer is the Nokia Early Stage Technology Fund. It is a closed Fund, with all money coming from Nokia, investing in ideas with high growth potential. Its focus is on ideas coming from inside the company that have a possible future link with Nokia’s core business. The driver for this fund is creating strategic options as well as a return.

The final layer is a very outward-looking closed fund, Nokia Venture Partners. It operates at arms length to the parent organisation and is structured as a venture capital fund, with Nokia as the largest general partner. The driver is therefore return on investment, and it invests in new ventures that are non-core to Nokia. However, it has a very clear investment focus on new ventures that operate in the telecommunications and networking business. Here, Nokia can add value through technical expertise in the due diligence phase and gets an insight into new technologies, markets and business models being developed in the outside world.

In summary, the different structures of Nokia Ventures Organization overlap somewhat, but they reflect very well the distinction in different roles that a ventures organisation can play for a corporation. The success is due in some part to the direct support from the top-management, through which it gets high visibility and support throughout the organisation. The high level of support also seems to have a direct and positive effect on the entrepreneurial culture within the corporation.

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While this is an obvious point, it is surprising how many corporate venture units have been established without any attempt to buy in these capabilities or develop them in a systematic fashion. At the height of the dot-com boom, for example, many large corporations sank tens of millions into venture funds with complete disregard for the capabilities and discipline needed to realise a return on those funds. Today, venture units are far more savvy though many still work on the incorrect assumption that they can get up to speed on the finer points of
venture investing in a few months flat. They cannot – it takes years.

Building specialised capabilities can be done in a variety of ways. One obvious approach is through partnership. Unilever, for example, partnered with a London-based VC when it established its Unispark venture unit in 1998. Lucent, Intel and Nokia all worked with VCs in their early days and still have external partners in some of their funds. Roche has an internally focused venture unit but an integral part of its venture programme is commercial skills training for the hundreds of people every year who come forward with promising ideas.

Separate, separate, separate
It’s the oldest story of them all. Venture units work on new ideas that do not fit with the mainstream business so they need to be separated otherwise the ideas will be killed. At the same time, however, it is also recognised that too much separation is bad because the potential strategic benefits from venturing will never be realised.

Our initial bias in this study was towards greater integration with the parent company but the evidence pushed us the other way. Our analysis reveals a strong correlation between separation and venture unit performance. At least in the early stages, it is imperative that venture units create distance between themselves and their parent companies. This distance can include such things as having a separate fund (rather than corporate funds subject to internal review), a high level of decision-making autonomy, strong links to the VC community, and incentives based on carried interest and bonuses. These are all ways of preventing the venture unit managers from being second-guessed by their corporate parents.

One particular issue is worth highlighting here. If the venture unit is investing in potentially disruptive technology, should they seek approval or sign-off from the relevant business unit? Some people we spoke to felt business unit sign-off was essential – to ensure their support in developing the idea and to facilitate their eventual adoption of that technology. Others disagreed and argued that business unit sign off would kill any potentially disruptive technology. Our research finds some evidence for the latter point of view. In other words, the more successful units typically were the ones that did not require business unit sign off on new ideas.

Build links back to parent when you are established
It is rarely enough for the venture unit to be successful purely as a stand-alone entity. Even financially driven venture units are looking to make investments in companies that will offer some strategic benefits to their parent companies. And for such benefits to occur there have to be operational linkages back from the venture unit to the corporation. These linkages can take many forms – business unit employees helping with due diligence, business unit executives taking board seats on portfolio companies, explicit partner agreements between portfolio companies and the parent company and so on.

Johnson & Johnson Development Corporation, one of the most successful venture organisations, actively cultivates linkages between its portfolio companies and the relevant business units. Intel Capital will often work with Intel Architecture Labs on due diligence studies.

The challenge here is to reconcile the need for linkages with the need for separation. Our belief is that complete separation is necessary in the early stages of development. But once the venture unit has established itself – with some proven winners and a positive return on investment – it can begin to cultivate links back to the parent company.

High-level sponsorship and critical mass
Venture units are by definition misfits. And misfits are always the first things to be killed off whenever high-level strategic changes are made or whenever problems arise. To survive these periodic culls, the venture unit needs committed sponsorship from the highest level, preferably the CEO or president of the company. All of the real success stories in corporate venturing – including Nokia, Intel, J&J and Lucent – have CEO-level support. Many of the others have much more mixed levels of sponsorship.

High-level sponsorship does not equate to the line of reporting or to the presence of senior executives on the board of advisors. Rather it means there is a senior executive prepared to stick his/her neck out for the venture unit when it loses money for its first five years of operation. The term “air cover” is often used to describe this phenomenon – someone in a senior position who pushes back all criticism of the venturing activities while the venture managers get on with doing their job.
Related to high-level sponsorship is the issue of critical mass. Corporate venturing is all about managing a portfolio – on the basis that the few big winners will make up for the many under performers and outright losers. Research from the financial markets tells us that you need a portfolio of 30 or so companies to balance out the risks from individual companies and to a large extent the same logic applies to corporate venture units. So if a venture unit only makes 10 investments in the first three years, it is almost certainly below critical mass.

Evidence from our research suggests that most internally focused venture units are below critical mass. And indeed, in some cases we are seeing consolidation underway. Siemens, for example, has now pulled together its various venturing funds under a single management structure.

**Linking corporate venturing to the broader corporate strategy agenda**

The second set of insights from our study is concerned with the link between corporate venturing and the broader strategic agenda of the parent company. It is self-evident that such linkages should exist. However, there are many different models in terms of how the relationship between the venture unit and the parent company is structured and there are significant variations in terms of how the venture unit evolves over time. A number of specific points can be made.

First, corporate venturing should be viewed as one approach to corporate development alongside others such as acquisition, strategic investment and alliance rather than as a stand-alone activity.

Many companies, including Philips, Sun and Alcatel, are very clear on this logic. For example, if a potentially interesting start-up company is identified they will examine its prospects, capabilities and strategic fit and only then will they decide whether to build a relationship with it through the venture unit or through an alliance or acquisition. The aim is to match the investment or development “vehicle” with the opportunity in such a way that the long-term value creation potential is optimised. This is easily said but it requires a high level of co-ordination to work – which is hard to deliver on while also giving autonomy to the venture unit.

Second, corporate venturing should never be viewed as a permanent solution.

Our opinion is that “business creation” should be viewed as a corporate capability that ideally exists throughout the organisation. The venture unit can therefore be seen either as a “second-best” solution in corporations that feel they will never be able to win over the mainstream business units or as an “agent of change” whose role is to build specialised capabilities in venturing.

Indeed, our research suggests that one way of looking at corporate venturing is through a life-cycle model (see Figure 2). Most companies sit at stage 1 of the model – new business development is suppressed and the few entrepreneurs that the company has are dispersed throughout the organisation. Companies like this occasionally see new businesses emerge but only through the dedicated effort of the lone entrepreneur who succeeds despite the system.
The creation of a venture unit takes the company into stage 2 of the model. While the organisation as a whole does not support entrepreneurship, the creation of a focused and dedicated unit provides it with a “centre of excellence” in which the necessary skills and capabilities around new venture development can be built. Assuming the venture unit has critical mass and high-level support it can begin to generate support for the concept of new venture development, and it can act as a catalyst for change.

In the next stage (stage 3), the venture unit managers start providing their services to other parts of the organisation, helping new business ideas to get established without the protection afforded by a distinct venture unit. And in the final stage (stage 4), the venture unit managers essentially work themselves out of a job. They push the process out into the mainstream business units, giving individuals in those units responsibility to make their own investment and development decisions and closing down the central unit.

This model has support among companies that we have studied. Hewlett Packard, for example, argues that it has no corporate venturing activity but it frequently makes strategic investments as an integral part of its ongoing business development process. Royal Sun Alliance had a separate venture unit for several years but folded it back into its corporate strategy activity when it became apparent that closer integration with the mainstream business units was necessary. Marks and Spencer essentially did the same and ensured that all the individuals from its venture unit were given senior jobs back in the mainstream business to ensure that their learning was not lost.

Third, there are a number of corporate-level capabilities that venturing can help to develop.

Many companies are trying to develop a broad capability in business creation. But underneath that are a number of very specific capabilities important to a company’s long-term success that corporate venture units are well positioned to help develop. These include:

- **An entrepreneurial mindset among employees.** For example, BT’s Brightstar venture unit was created to uncover the “hidden value” in BT’s R&D laboratories but a secondary – and no less important – goal was to change the culture in the organisation to make individuals more commercially minded and entrepreneurial.
- **Commercial capabilities throughout the company.** For example, Roche’s venturing process has involved training large numbers of people in business plan development so that they can effectively pursue their new ideas. Lonie Shoff, who runs the unit, observed that in his view the single biggest change they have brought about is a broader understanding of business concepts and models.
- **Networking inside and outside the company.** Venture units are perfectly positioned to create linkages between their parent company and the VC community and such links are an invaluable source of new business ideas and fresh thinking. Venturing also demands high levels of networking by managers across the various different parts of the corporation.
- **Market sensing.** In a rapidly changing world, companies need to be very responsive to new opportunities as they arise. And again corporate venturing units potentially offer a strong market-sensing capability that can benefit the entire corporation. For example, when Unilever created Unispark its intention was primarily to grow and amplify the set of new ideas that were coming into the company. Likewise, Diageo’s venture unit invests a lot of time in brainstorming and new idea creation processes.
- **The discipline of funding and killing projects.** Large companies have traditionally been relatively bad at phasing the funding of new projects and even worse when it comes to killing off projects that have not met their objectives. Venture units have learnt from their VC cousins how to do this properly and again this is a capability that top management can and should infuse into the corporation as a whole.

**Prospects for venturing**

What are the prospects for corporate venturing in the coming years? There are several reasons to be pessimistic.

The economy in North America and Europe is struggling, new business scandals are seemingly emerging every week and there is still a backlash underway against anything associated with the excesses of the dot-com era (including corporate venturing). So most
companies do not want to use their diminishing capital available in seemingly risky ventures.

On the other hand, corporate venturing still has many supporters. One of the enduring lessons of the dot-com era is that companies need to take disruptive technological change seriously and have to invest in the development of new businesses to protect themselves from that threat.

Corporate venturing is never easy but it is beginning to be recognised as something that far-sighted companies cannot do without. Our prognosis is that there will be a gradual reduction in corporate venturing activity over the next couple of years but for many large corporations it will remain firmly on the agenda, as an engine of corporate innovation and growth.

The key findings from this research project are available in a report, Corporate Venturing – State of the Art and Prospects for the Future. The research involved interviews with executives in more than 40 companies in eight countries and the collection of systematic data on 95 corporate venture units worldwide.

**Resources**


