Corporate Venturing Units: Vehicles for Strategic Success in the New Europe

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INTRODUCTION

The reality facing multinational corporations (MNCs) is that traditional models of innovation are fast becoming obsolete. Multinationals used to manage innovation either through their centrally located research and development (R&D) activities (on a “center-for-global” basis) or through the development activities of their individual subsidiaries (on a “local-for-local” basis). Economic changes confronting MNCs, however, bring these approaches into question. Increasingly, these traditional approaches are too slow to provide the necessary rates of innovation. They also fail to adequately recognize the interconnectedness of the corporation’s multiple geographic entities. In Europe, in particular, the reality facing MNCs has been – and continues to be – subject to fundamental political and economic shifts, which mean that the local-for-local model is no longer feasible or appropriate, and the center-for-global model only works for a small subset of cases.

New models of MNC innovation are emerging that recognize a new set of “rules.” Under these new rules ideas, skills and initiative can come from anywhere – anywhere inside the company, and outside it as well. While multinationals may still steer innovation from the center, it is increasingly recognized that individuals and units anywhere in the world may be involved, and that the knowledge and insights needed for innovation are as likely to crop up in Stockholm or Madrid as in Silicon Valley. Many corporations, including Procter & Gamble Co., Cisco Systems, Inc., GlaxoSmithKline PLC and Unilever PLC have actively embraced this new “open” model of innovation.

These new rules necessitate new vehicles for MNCs to navigate global economic landscapes. The new vehicles for tapping into ideas and capabilities that emerge around the world include scanning units, active acquisition searches, and university cooperation schemes, as well as corporate venturing activities. The focus of this paper is on the latter – the role of corporate venturing units as vehicles for helping European MNCs to successfully navigate their new environments.

Essentially, corporate venturing involves the creation by a parent company of an organizational unit charged with investing in and developing new businesses. Multiple forms of corporate venturing units exist, but, across all types, a frequent commonality is a global dimension.

Intel Capital, one of the best-known corporate venturing units, is a case in point. Started officially in the early 1990s, Intel Capital’s portfolio included investments in over 1000 companies by the start of 2004, with approximately 40% of these outside its North American base. The regions in which it has active investments include Latin America, Asia and Europe.

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America, Southeast Asia, Western Europe, Central and Eastern Europe, Israel and Japan. Its investments play four critical roles in maintaining its leading global position. Demand for the microprocessor is buoyed through its “ecosystem” investments. Technology adoption in foreign countries is speeded through “market development” investments. Open positions in growing markets are closed by “gap filler” investments. Aptly named “eyes and ears” investments allow Intel to spot disruptive technologies it may otherwise miss. In all, Intel Capital’s venture units have amassed an impressive array of mechanisms for keeping ahead in the changing game of global innovation.

In this paper we describe the findings of our recent research into 95 corporate venture units across Europe and North America. We cover two areas that have received little research attention but which have important implications for managing corporate venture units. These are: an analysis of key factors influencing the success of corporate venture units, and observations on the evolution of corporate venture units during the three-year period of our study.

CORPORATE VENTURING ORIGINS AND FORMS

Corporate venturing is a highly focused approach to innovation. It involves a parent company establishing a specially designated entity – a corporate venture unit – to invest in new business opportunities. Venture units take many forms and pursue a wide range of objectives, but their critical common element is their mandate to identify and develop new businesses for their parent firms. Two sub-types of venture units are typically distinguished: “internal corporate venture” units, which focus on opportunities identified within the company; and “corporate venture capital” units which focus on opportunities external to the company, in the form of independent start-ups. Frequently, however, venture units pursue some combination of internal and external opportunities.

Venture units are by no means new features on the organizational landscape. The first major wave of corporate venturing activity occurred in the mid 1960s, with 25% of Fortune 500 companies boasting a corporate venturing program by 1970. However, the inherent tensions involved in running a venture unit alongside existing business units became too high when the global economy plunged into recession in 1973, and most of these activities were closed down. A second wave of activity began in the early 1980s, fuelled by substantial growth in the computer and electronics sectors. When recession hit in the late 1980s, once again, corporate venturing efforts sputtered and halted. Commentators on this period documented a host of internal problems confronting corporate venturing efforts. For example, Joshua Lerner in his book, Venture Capital and Private Equity, described three structural failures of venture units: multiple goals rather than one clear mission; insufficient management commitment to venturing; and the absence of high-powered (financial) incentive schemes for venture unit managers.

The third major wave of corporate venturing activity began in the mid-1990s as large MNCs belatedly jumped on the dot.com bandwagon, and sought to emulate the successes of venture capital (VC) firms by investing in Internet-based start-ups. Predictably, this enthusiasm for corporate venturing peaked in 2000 and declined rapidly thereafter. However, in absolute terms, the current levels of corporate venturing activity are still fairly high, with more than one hundred large MNCs still active in corporate venturing.

One difference between this third wave and the previous two was that many corporations adopted the operating model of independent VC firms as a template for their venture units. Attracted by the spectacular returns achieved by VCs during the 1990s, many corporations hoped that the VC operating model would resolve the earlier difficulties encountered in corporate venturing. Imitating VC practices – particularly embarking on corporate venture capital activities – provided, as well, an attractive “new economy”
means for large corporations to try to spark up their share prices. Venture capital practices – such as staged approaches to investments, syndication of investment deals, general partner equity stakes in investments, and a highly disciplined approach to managing exits from ventures – were emulated in the venture units of prominent companies, including Intel, Lucent Technologies, Inc., Nokia Ab oyj, Roche, Unilever Plc, and Xerox Corp. For example, Unilever’s Nick Allen stated that a key goal in designing Unilever’s Group Corporate Ventures was to “build a corporate venturing model that is as close as possible to a real venture capital model.”

A brief look at four prominent venture units illustrates the diversity of purpose amongst contemporary corporate venture units. Lucent New Ventures Group, for example, was set up to generate value from underutilized company assets by commercializing intellectual property and technology from its R&D unit. GE Private Equity utilizes its privileged access to a stream of investment opportunities to invest directly in the private equity market, with the overriding goal of superior financial return. Siemens AG’s Mustang Ventures invests in other businesses (such as suppliers and customers) that may help it chart a sustainable role for the firm’s existing business activities in the future. And Shell Oil Co.’s GameChanger unit functions primarily to increase innovation within the corporation’s exploration business, by providing a process that channels promising employee ideas into funded projects.

SURVEY OF NEW GENERATION VENTURE UNITS

We set out to research this most recent generation of venture units, those operating in the early 2000s. Most had been founded during the late 1990s technology boom, but a few, including Innovacom (owned by France Telecom) and Johnson & Johnson Development Corporation, were more than ten years old. We deliberately included both internally and externally focused venture units to gain exposure to the full scope of corporate venturing models.

In 2001–2002, we conducted in-depth interviews with executives in 50 venture units in eight countries, and surveyed 95 venture units across Europe and North America. Two years later, we conducted another round of interviews and surveys to establish how this sample of venture units had evolved. As far as we know, this is the most comprehensive body of primary data on multiple types of corporate venture units, which are notoriously difficult to obtain public information on.

Of the 95 venture units, 48 were headquartered in Europe, and 44 in North America (there were a further three based in Asia). Most were very young, with almost half established in 1998 or 1999. On average, the units had 17 full-time members and had made 42 investments. Each venture unit received (on average, and comparable with VC practice) a hefty 631 investment proposals per year, evaluating fewer than 10% of these, and ultimately investing in just 1% of proposals. Table 1 provides more data on the characteristics of the sample.

Intriguingly, more European parent companies saw their venture units as global vehicles in the search for investment oppor-

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<th>TABLE 1</th>
<th>CHARACTERISTICS OF SURVEYED VENTURE UNITS</th>
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<tr>
<td>MEAN VALUE</td>
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<tr>
<td>Age of venture unit (in years)</td>
<td>4.5</td>
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<tr>
<td>Number of full-time employees</td>
<td>16.7</td>
</tr>
<tr>
<td>Total number of investments made</td>
<td>42.1</td>
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<tr>
<td>Proposal data</td>
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<tr>
<td>Incoming proposals per annum</td>
<td>631</td>
</tr>
<tr>
<td>Number evaluated in detail per annum</td>
<td>69.2</td>
</tr>
<tr>
<td>Number invested in per annum</td>
<td>6.8</td>
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<tr>
<td>Investment data</td>
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<tr>
<td>Investments still in portfolio</td>
<td>25.5</td>
</tr>
<tr>
<td>Investments having experienced a trade sale/IPO</td>
<td>12.3</td>
</tr>
<tr>
<td>Investments closed down</td>
<td>4.4</td>
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<tr>
<td>Investments integrated into parent company</td>
<td>0.5</td>
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n = 95.
tunities than did their North American counterparts, which seemed to take a more U.S.-centric approach to investment opportunities. Of the 48 European units, 19 searched only for opportunities within Europe, another 19 extended their reach to North America as well as Europe, and 10 engaged in global investment. (See Fig. 1). In contrast, 34 of the North American units focused exclusively on investment in their home continent, 5 units extended their reach into Europe, and another 5 units considered their reach to be global in nature.

VENTURE UNIT SUCCESS FACTORS

The first major objective of the research was to establish the factors that caused some venture units to deliver on their objectives while others failed. While each different type of venture unit clearly has its own specific objectives and its own preferred way of working, we were nonetheless able to identify a number of practices that were important to venture unit success across the board, irrespective of the particular model followed by a unit. And, interestingly, VC firms do appear to hold some valuable lessons for corporate venture units. Most instances in which VC practices were adopted resulted in superior performance, although certain VC practices did not appear suited to corporate contexts.

Three key lessons (shown graphically in Fig. 2) emerged from our analyses: (1) provide clear separation from the parent company in decision-making and funding; (2) encourage close linkages with the VC community; and
(3) don’t rely on financial incentives if you actually want strategic returns.

**Separation from Parent Company**

It has long been established that venture units and their parent companies are strange bedfellows. Typically, venture investments require long-term support, while parent companies want to report short-term results; venturing involves comfort with uncertainty and ambiguity while parent companies may frequently be risk-averse; and venturing requires speedy decisions and actions while parent companies frequently follow slow, consensual decision-making processes.

Despite these differences, many companies try to “force fit” aspects of their venturing activities into the established organizational routines of the core business, for example by using standard investment criteria for venture projects, or by requiring existing business units to sign-off on new ventures before they can proceed. In such cases, venture units end up spending much of their time in paper-generating exercises and political processes, rather than actually investing in ventures that may ultimately be in the firm’s best interests. Too often the inimical cultures and processes of the core and venturing businesses seem only to be recognized once corporate venturing starts to “go wrong.”

Our research suggested simply that those venture units with substantial levels of autonomy performed significantly better. Autonomy in this context implies two things: a separate pot of money allocated to the unit for investments, and venture unit decision rights over both relevant investment and management matters. Only with these in place is a venture unit able to customize and adapt its operations to meet the needs of its chosen investment domain.

VC firms embody these principles too. To preserve their tax privileges, the limited partners who invest in a VC fund are not allowed to be involved in managing the fund, thereby giving the general partners the autonomy to make all ongoing decisions concerning the investment capital under their control, as well as the fund operations.

The separation dictum does not imply, however, that a venture unit should have no accountability to senior levels in the parent company, nor should it avoid any engagement with its fellow business units. Actually, quite the reverse: venture units should be fully accountable for achieving the business creation mandates assigned by executives in their parent companies; they also need to ensure sufficiently cooperative relationships with the core business units such that, where required, ventures can be effectively integrated into the core. Shell, for example, discovered through its GameChanger venture program that the critical phase in the life of a new venture was the process of integration into an existing business unit, colloquially known as “entering the valley of death.” By building relationships between the venture team and executives in the business unit, the hazards involved in this integration process could often be overcome.

What needs to be avoided, however, is the interference of senior levels or horizontal line management counterparts in the day-to-day operations and management of the venture unit. This is especially so in its early years, given the typical lack of familiarity with the requirements for successful venturing, as well as the high potential for conflict between venturing and core business logics, including objectives.

**Engagement with VC Community**

Many of the companies in our sample maintained close contact with the VC community: 45% said their venture unit communicated with partner VC companies on a daily or weekly basis; 48% had daily or weekly contact with other companies or individuals in the VC community.

Venture units and VC firms have developed a variety of inventive ways of working together. Unilever, for example, sought advice from VC firms in establishing its first venturing program, including establishing
its venture selection processes and criteria. It continues to co-invest with VC firms in many ventures, and it sees the co-investment by VCs in its internally funded organic corporate ventures and spin-outs as an "acid test" of the ventures’ potential. Other venture units may involve VCs in conducting due diligence on investment opportunities, in discussing industry trends and opportunities, or in sharing information on investment "deal flow" (i.e., the stream of investment opportunities to which parties are exposed).

Such contact appears to pay dividends for venture units in achieving both their strategic and financial goals. Various explanations help to account for these positive effects. VC contact, especially with prestigious VC firms who occupy central positions in their social networks, may expose venture units to higher quality deal flow. It may, by allowing venture units to tap multiple sources of expertise, aid better investment decision-making by venture units. It may facilitate greater venture unit familiarity with the capabilities required to be an effective venture capitalist. It may also provide opportunities for venture units to build relationships with other companies in which they may wish to invest. Last but not least, it may enable venture units to develop investment portfolios that better diversify risk.

One important aspect of working with VCs that we studied is the practice of participating in syndicated investments. This occurs where a lead VC investor invites other VCs and professional investors to co-invest in a portfolio company. It has obvious attractions to the corporate venture unit, both in the potential returns on investment and in the opportunity to work more closely with the VC. However, there are also costs, including a loss of flexibility and control over ventures, and the potential conflict of interests between the venture unit and other partners. Taken together then, these costs and benefits balanced each other out, and we found no direct correlation between the venture unit’s use of syndication and its performance. So, while the message from the research study is to encourage engagement between venture units and the VC community, syndication with VCs should be treated with some circumspection for most types of venture unit.

**Rewarding Desired Venture Unit Outcomes**

How to reward venture unit managers and staff is a question that has received repeated attention over the years. Most companies continue to compensate venture units with more-or-less standard corporate packages, such as a flat base-rate salary (used by 61% of our sample), possibly with some add-ons like variable bonuses. However, an argument is commonly made for greater use of high-powered financial incentives.

The practice of VCs has been instrumental in encouraging this new viewpoint. Their objectives are entirely profit-oriented, and general partners in VC funds are rewarded primarily through a "carried interest" in the equity of the fund’s portfolio firms. This practice is credited with aligning the interests of the general partners and limited partners, with providing clarity of focus to VC activities, and with attracting highly skilled investment professionals to work for VC funds.

But do these arguments really carry weight in the corporate venturing context? The evidence from our research suggests not. We found no link between the substantial use of equity-linked or highly leveraged financial incentives and venture unit performance. The explanation for this finding is probably rather straightforward: most venture units do not concentrate exclusively on financial returns, but on achieving some mix of financial and strategic goals for their parent company. In these instances, one does not want members of the venture unit trading typically longer-term strategic goals for short- to medium-term financial gains where these goals conflict. Heavily leveraged incentives provide a distraction, not an advantage, in all but the very most financially-oriented venture units. Indeed, in one case we are familiar with, the venture unit executive was forbidden by the corporate board from selling...
down his stake in a successful venture, for fear that it would compromise the venture’s long-term credibility in the market. Even though this executive was being evaluated on the venture unit’s internal rate of return, he was powerless to act because of the corporation’s strategic priorities.

One can also ask whether it is appropriate to apply the same incentive systems and principles for corporate venturers as for VCs. Opinions differ widely on this issue. At one end of the spectrum, some units (such as Lloyds TSB Strategic Ventures and Shell GameChanger) regard the intrinsic satisfaction (sometimes supplemented by a small financial bonus) of working on new ventures as sufficiently motivating to employees. In most cases, these employees are not, and may never wish to be, independent entrepreneurs. At the other end of the spectrum, other companies, such as Unilever Corporate Ventures, believe that employees involved in ventures should bear similar risk-reward terms as they would in the independent start-up market. Their reasoning is that other practices serve merely to distort the efficiency of market investment processes. Looking from the perspective of enhancing corporate venture unit performance, our research would tend to provide more, albeit tangential, support for the former view than for the latter.

**Other Success Factors**

A number of other practices were also found to have some link to corporate venture performance, though the relationships were not as strong as for venture unit autonomy or relationships with VCs. Very briefly, these included: (1) high-level support for corporate venturing, reflected in the venture unit reporting directly to the executive committee level within the parent company; (2) employing a mix of both VC and corporate trained people in the venture unit such that the logics of both types of firms are understood, and the staff thus possesses a balance of skills; and (3) devoting time and effort to nurturing and developing the businesses within the venture unit’s portfolio, not only to selecting and exiting investments.

**EVOLUTION OF VENTURE UNITS**

The longitudinal nature of the study allowed us to gain some insight into the little-researched topic of how corporate venture units change over time, and what types of venture units survive. We followed up on all the 95 venture units we originally surveyed to establish how many were still active two years later. We also got detailed questionnaire responses from 21 of these units to look more closely at how their practices had evolved over the two-year period. Although further research is needed to test whether our findings would hold over different time periods, we discuss four interesting themes that emerged below.

**Differences in Survival Rates**

Survival over the two years between our first and second survey depended to a large degree on the goals of the venture unit. Our earlier research identified 26 units with primarily financially-focused goals, and 44 that were more focused on strategic goals such as developing new businesses for the corporation. By the time of our second round of research in 2003, 23 out of 26 financially oriented venture units had survived. They had done so primarily by generating early results from their investments.

In contrast, the survival rate for strategically focused units was much lower, with only 32 out of 44 still in existence, 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 2001–2003 is not directly a function of how they were performing. Rather, it is indicative of the short-term thinking that is often seen in corporate headquarters, especially when the economy is in bad shape. It is also a reminder that the cycle-time for the
development of a new business is typically longer than the cycle-time of a corporate strategy or the tenure of a chief executive officer (CEO). Take the case of BT Brightstar, a venture unit that was created in 1999 to “unlock the hidden value” in British Telecom’s R&D operations. While successful on many dimensions, BT Brightstar was unable to find viable exit options for its ventures while the market was in the doldrums, so in 2002, the entire operation was sold off to Coller Capital, a private equity firm.

Consolidation and Focus

Second, we found that venture unit executives were more careful and more selective in 2003 than they were in 2001. This is hardly surprising, given the period of consolidation that venture units went through during this period. 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 7, whereas in 2003 it was just 3.

We asked the respondents to indicate the typical numbers of proposals they received, how many they evaluated in detail, and how many they invested in. For 2001, the average numbers were 656 proposals, 101 of which were evaluated, with 8 investments made; for 2003 the corresponding numbers were 626, 57, and 4. (See Table 2.) So while the number of proposals stayed more-or-less constant, venture executives had become much more discerning about which proposals they evaluated, and which ones they invested in.

Why this shift? Our research suggests a combination of greater experience on the part of the executives in question, since many had only a year or two’s venturing experience in 2001, and greater risk aversion due to the change in attitude towards venturing over this period. As Michael Pearson of Lloyds TSB observed: “Venturing remains less fashionable than it once was and is therefore unlikely to take off explosively. But when sensibly pursued, with tight controls on investment, it can be an important way for firms to deliver innovation and top-line growth.” Similar learning curves have been observed in VC firms, too.

Decreased Emphasis on Internal Venturing

Third, we asked the venture unit managers to indicate the types of investments they were focused on. While the frequency of investment in external business opportunities was similar from 2001 to 2003 (3.2 vs. 3.4 on a 5-point scale), the frequency of investment in opportunities from inside the firm went down significantly (2.7 down to 1.8 on 5-point scale). Why the change? The primary reason appears to be that the internal

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<th>Table 2  CHARACTERISTICS OF VENTURE UNITS FOLLOWED OVER THE DURATION OF THE STUDY</th>
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\(n = 15\).
venturing process is simply more difficult: we noted earlier the frequent tensions between venture units and parent companies over operating time frames, risk propensity, and decision-making processes; the claims of existing business units on the intellectual property and the people working for the venture also create additional complications for venture units to manage.

**Increased Emphasis on Venture Development**

Fourth, we asked respondents to indicate 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, and the development and nurturing of existing business opportunities had become more important. We also looked at patterns of communication inside and outside the company. Over the two-year period of study, the frequency of contact with corporate executives decreased, whereas the frequency of contact with front-line managers, and with real customers and suppliers in the portfolio companies increased. This indicates a change in emphasis away from establishing the venture unit as a going concern, and towards the active development of the businesses in the portfolio. And in parallel with this shift, the level of venture unit autonomy increased significantly over the two years, suggesting an increasing level of corporate confidence in the capabilities of venture units’ executives.

Taken together, these pieces of evidence suggest an increased level of sophistication on the part of venturing executives, as their venture units began to “grow up” over the period of the study. Those venture units still in existence at this point are typically more focused, more selective, and more streamlined than they were in the late 1990s. And their executives have enough self-assurance to know when to resist the inevitable meddling of parent company executives.

**CONCLUSION**

While there is little doubt that corporate venturing is a challenging activity to get right, it has recently shown itself to have the potential to deliver valuable strategic benefits to large, established firms. In particular, it may provide a pragmatic, focused means of spotting and tapping into new business opportunities. This is especially the case under the new rules of the increasingly global game of innovation.

In order to deal with the changing political and economic landscapes created by European integration, as well as widespread pressures to take more seriously the potential for innovation to spring up from almost anywhere across the globe, we believe that European MNCs would do well to seriously consider corporate venturing as a vehicle for achieving strategic success.
A more detailed description of our research can be found in J. Birkinshaw, R. van Basten Batenburg, and G. Murray’s, Corporate Venturing: The State of the Art and the Prospects for the Future, (London Business School: Centre for the Network Economy, 2002).


For ongoing updates on corporate venturing, see GRIST’s Corporate Venturing and Credo’s Corporate Venturing Journal. The findings of another recent survey of corporate venture units are described in A. Gaule and M. Moore’s, Review of Leading Global Corporate Venturing Units (Henley-Incubator, 2004).

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