Global Corporate Venturing

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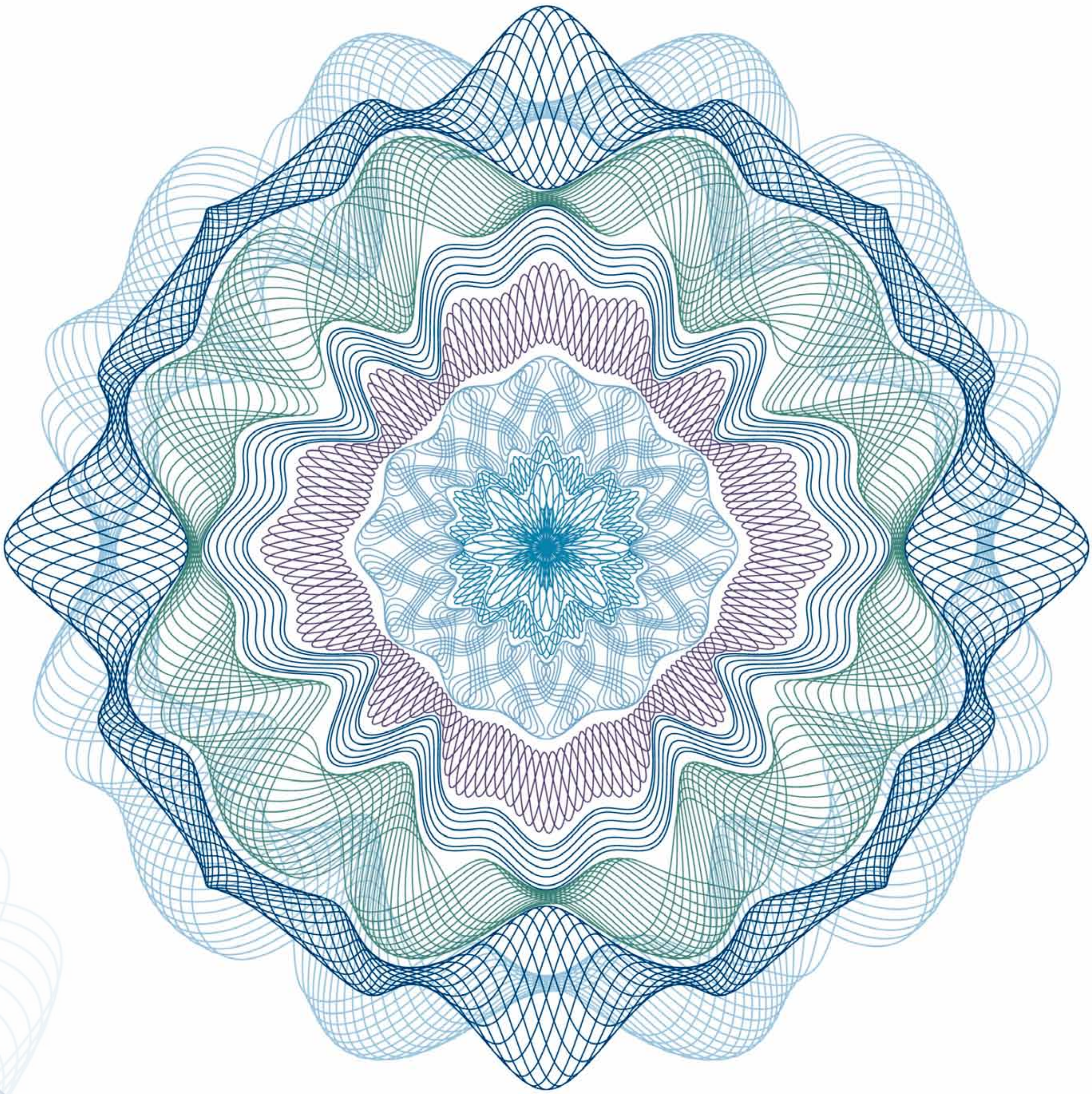

CORPORATE VENTURING **301**

BUILDING ON **SUCCESS**

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Contents

Global Corporate Venturing

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Welcome to this third supplement in a series by Global Corporate Venturing looking at how the industry tackles the challenges of managing units over time.

Passing the DECADE'S THRESHOLD

The first supplement, Corporate Venturing 101, published in 2012, looked at how companies thinking of setting up a unit or having just done so answered the questions of why do so, how it can be organised and managed and, finally, how to invest.

The second supplement, Corporate Venturing 201, last year looked at the groups that have survived and thrived through the first few years and are then grappling with the next set of challenges as they mature between four and nine years in age.

This, the third supplement, takes the series further by looking at which units have passed the 10-year milestone, and asks the corporate venturers, now with at least a decade managing a unit, what lessons they learned and how they have evolved over the years.

Research by Global Corporate Venturing has, for the first time, identified how many units there are in this group.

In some circles, corporate venturing has been regarded as being historically procyclical – more groups are set up and deals done at the end of the economic cycle just before a bubble pops. But this popular history ignores the corporations that around the world have kept the faith that venturing is an important innovation strategy that, when done well, can provide significant relative outperformance for investors.

The 181 corporate venturing programmes with identified start dates, therefore, form an important pool of expertise in an industry where experience is regarded as important and there is persistence in returns.

It is a more significant number than many realised. US-based trade body the National Venture Capital Association said ahead of its webinar – Spanning the valley of death: lessons on longevity from corporate VCs – there were more than 20 groups within its membership that had been in existence for more than 10 years, and more than five that had been in existence for more than 15 years.

The tips provided by these groups are likely to be the estimated third of the industry created during the Golden Age between 2010 and 2013 – notable for being the first time a significant number of groups were founded as the global economy emerged from a downturn.

As ever, this supplement will hopefully be only the start of the conversation and discussion on this topic.

And, also as ever, our thanks to the sponsors, SVB Financial Group and DLA Piper, and the industry figures who made this supplement possible. They have opened the next door to a successful corporate venturing programme.

Turning the cycles to an ADVANTAGE

James Mawson

Global Corporate Venturing's third supplement in its series on how corporate venturing units evolve over time looks at those with a decade of investing behind them.

Timing when to start investing, therefore, can be crucial to the prices paid on deals and how long investing groups have until an economic downturn puts pressure on them to show financial results as chief financial officers scour all assets for potential cash.

The history of corporate venturing since the 1960s has fallen into this generalisation, but hopes for a more sustainable future are higher this time. Indeed, management consultancy Boston Consulting Group (BCG) after reviewing Global Corporate Venturing's data in 2012, said: "We strongly believe that this time is different."

Part of its, and others', conclusion stemmed from the countercyclical nature of the current corporate venturing units – more than a third set up in the Golden Age between 2010 and 2013 as the global economy emerged from its latest downturn, as well as new insights into the experienced cadre of venturers that have been through more than a decade of investing activity – the focus of this report, the third in our series.

Out of more than 1,000 corporate venturing units now tracked by Global Corporate Venturing, 850 are credited with a specific year of formation. Of these, 181 were launched before 2004 *(see graph p.9)* – these are the ones with at least a decade's experience, although the nature of some balance-sheet investors is that some may have non-continuous track records by failing to conduct deals in every year.

Venture investing is a procyclical activity. More money is raised and invested as economies heat up, only to fall as the cycle turns down towards or into recession

As a result, while it is easier to track new units as they emerge on deals, it is harder to track groups that have, or are effectively, discontinued, beyond generalised criteria concerning whether they have done a deal publicly in the past five years.

Global Corporate Venturing counts as one unit any minority equity investment activity in entrepreneurial third parties by a corporation, even if done by different subsidiaries or funds. For example, of the 19 new units and funds tracked in the first three months of the year, 13 were from established groups, such as IDG, Siemens, IBM and Cisco, that had a focus on a specific region or geography.

By this measurement, the peak year in the current wave was 2012, when at least 154 units were formed.

BCG, in its October 2012 report, *Corporate Venture Capital: Avoid the Risk, Miss the Rewards,* said: "Corporate venturing, once an experiment, has entered a new, more mature phase. Companies across the business landscape have embraced venturing. They are reallocating resources from internal research and development toward external innovation and committing those resources for the long term."

Global Corporate Venturing counts as one unit any minority equity investment activity in entrepreneurial third parties by a corporation, even if done by different subsidiaries or funds

By contrast, BCG said the first wave of corporate venturing in the mid-1960s was a period when companies looked for above-average financial returns. Corporations, however, "lost their taste for the game" in 1973 when the market for initial public offerings collapsed, BCG added. Similar patterns occurred in the mid-1980s and 1990s, when more than 400 units were launched, until stock market crashes put paid to many of them.

But not all. By 2007, half the 30 largest companies by market capitalisation in both the technology and pharmaceutical sectors retained corporate venturing units, joined by another third in the Golden Age, according to BCG. In part, this was a shift to other sectors, such as media, energy, consumer, medical technology and construction, which boasted a lower percentage of active units in 2007 and had seen more dramatic increases by 2012, BCG added.

At least half the 30 largest companies in the IT, pharma, telecoms and media industries had corporate venturing units by 2012, which BCG said was "a sign of the growing recognition of corporate venturing's value as a tool for innovation, corporate development and competitive advantage".

BCG said corporate venturing provided information about technology disruptions, checked new markets in adjacent industries and spotted trends in more distant ones, as well as affording the opportunity to move into them.

And companies with corporate venturing units outperform peers with no minority investment strategy.

Research by Gary Dushnitsky, an associate professor at London Business School, revealed at the Global Corporate Venturing Symposium in 2011, found the outperformance covered both a company's market-value-to-book-value ratio and its innovation capacity, as judged by patents.

Dushnitsky said between 1987 and 2009, 602 corporations had engaged in venturing activity out of 5,313 firms in a sample.

He said: "Companies with corporate venturing units outperform peers in similar fields judged by patenting output and using a market-to-book-value ratio." *(see here for presentation)*

As a result, Dushnitsky said: "Corporate venturing is one of the fastest-growing innovation strategies."

This means that as corporate venturing's importance grows, resources are being redirected towards it. BCG noted that in IT and pharma, average research and development (R&D) spending as a percentage of sales for the top 30 companies in each sector fell between 2007 and the end of 2011. In technology, R&D spending dropped from about 11.5% of sales to about 11%, while pharma R&D spending fell from about 16.5% to about 15% in this period, BCG said.

Claudia Fan Munce, managing director of IBM Venture Capital Group, said: "Driven by the fast-moving confluence of big data, cloud and mobile, many of the best-run organisations now view their corporate investing arms as an essential partner in accelerating innovation, charged with engaging the best and brightest entrepreneurs and startups though incubators, accelerators, and in-market labs."

Graeme Martin, president and CEO of Takeda Ventures (TVI), added: "TVI is part of a seamless external innovations triumvirate, sandwiched between a super-early scouting and funding team, New Frontier Science, and our business development colleagues looking for licensing and M&A [mergers and acquisitions] opportunities."

However, for both TVI and IBM, as well as almost all successful, long-term corporate venturing units, there has been an evolution in their organisations.

IBM moved from direct investment through funds of funds committing to external ventre capital firms (VCs) and then into ecosystem formation, while TVI changed its reporting function from R&D to business development. Others, such as Swisscom, have moved to an evergreen model in which the proceeds of earlier deals are reinvested in newer ones, while others, such as Disney's Steamboat Ventures, have become fully independent with external limited partners (investors) and the former parent is a minority or no longer a limited partner in funds raised.

Mary Kay James, partner at DuPont Ventures and this year's chairman of the NVCA's corporate venturing group, put the evolution in organisation structures and importance succinctly. "Early on, our group was happy just to have found a startup with a technology that was interesting enough to have others in the company wanting to have a look. As we got more experience we were able to put together a saleable investment or strategic concept for some startups. Now we have become a force that brings deep insights from very early-stage technologies that can influence the direction of BU [business unit] strategy as well as jump-start the BU's effort by engaging and investing in these early-stage startups."

For many *(see box for a selection)* of these 181 groups with more than a decade's track record, retaining or developing experienced managers has been important to their longevity, while others have rotated staff back into the parent's main businesses or senior echelons as a way of aiding communication and bringing an innovation mindset into core business units.

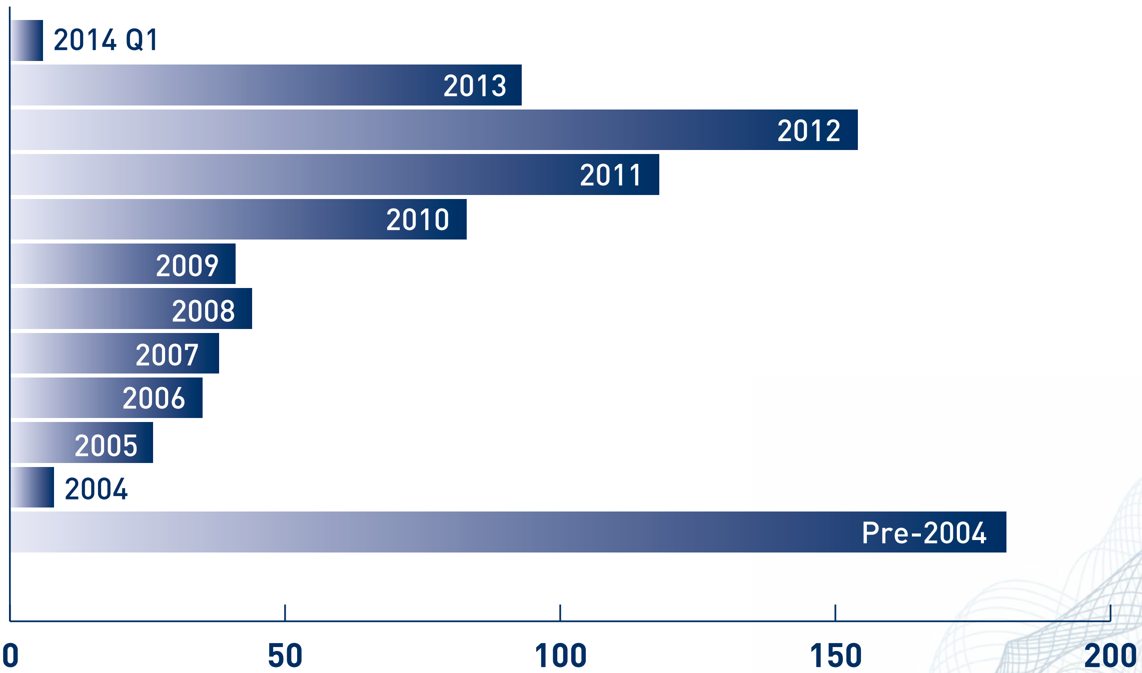
Some have nearly, or more than, 20 years in corporate venturing, including Barbara Dalton and Elaine Jones, both at Pfizer having previously worked together at GlaxoSmithKline's SR One, Brad Vale, head of Johnson & Johnson Development Corporation, and Ken Bronfin, who has spent 18 years at Hearst Ventures and was one of the earliest limited partners in China's oldest unit, IDG, run by Hugo Shong since 1993.

While many of these experts are based in North America – where the vast majority of corporate venturing units are domiciled and operated by US-based parents – the mix is suitably global in range.

As the Golden Age corporate venturing units mature, it is likely this list will continue to grow, both the units themselves and their managers. The fraction of corporations that engage in equity investment as a one-off activity – that is, invest only for a single year – was cut in half, while the proportion of those that invest for four years or longer has doubled for corporate venturing units active between 2000 and 2009, according to further research by Dushnitsky for *The Oxford Handbook of Entrepreneurship*.

About a third of the near-700 people working as corporate venturers in the US over the past decade have changed their

Number of corporate venturing unit launches by vintage



Source: Global Corporate Venturing

jobs, according to research at the end of 2011 by Global Corporate Venturing and the NVCA. The list is by no means complete, but gives some insights into career development prospects in the sector. It also shows the cadre of experienced corporate venturers continues to grow in number, which could prove invaluable if or when the next global downturn hits. BCG noted that the "most successful" units had the backing of corporate leadership prepared to invest for the long-term and prepared for the consequences of occasional failure, setting clear investment parameters aligned with overall corporate objectives.

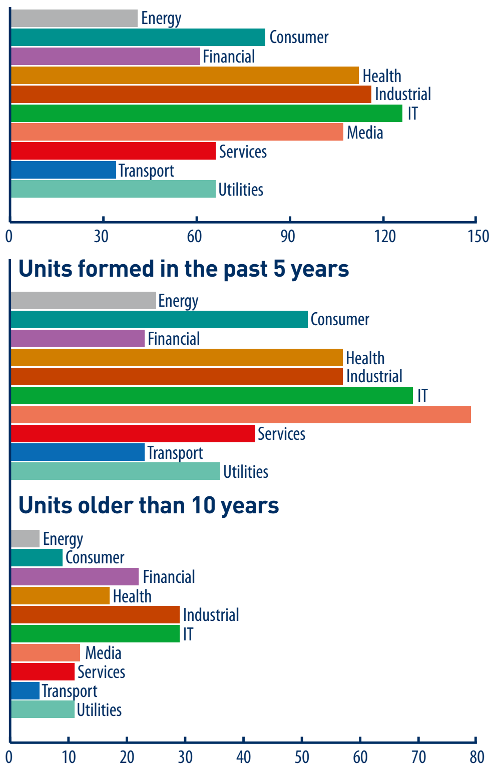
Its report concluded: "Considering the benefits that venture investing offers when best practices are employed, the real question is whether corporations can afford *not* [BCG's italics] to join the game."

But as more have done so through the Golden Age so, increasingly, it will be likely that relative outperformance for corporations will come from building groups and teams that can grow and develop over the decade.

Fred Wilson, a venture capitalist at Union Square Ventures, said it took him 10 years to become "halfway decent" as he was a long time learning the business.

It is a learning curve some are going through, but now with plenty of examples from corporate venturers who have passed a similar milestone.

Corporate venturing units by sector



Source: Global Corporate Venturing

20 PEOPLE WITH MORE THAN A DECADE AT A FIRM

- **Toshihisa Adachi** (Itochu)
- **Tony Askew** (Reed Elsevier Ventures)
- **John Ball** (Disney's Steamboat Ventures)
- **Ken Bronfin** (Hearst Ventures)
- **Chris Coburn** (spent 13 years at Cleveland Clinic Innovations, now at Partners Healthcare)
- **Claudia Fan Munce** (IBM Venture Capital)
- **Mary Kay James** (DuPont Ventures)
- **Nagraj Kashyap** (Qualcomm Ventures)
- **Graeme Martin** (Takeda Ventures)
- **Dirk Nachtigal** (BASF Venture Capital)
- **Carole Nuechterlein** (Roche Venture Capital)
- **Daniel Piette** (LVMH's L Capital)
- **Ralf Schnell*** (Siemens Venture Capital)
- **Reese Schroeder** (Motorola Solutions Venture Capital)
- **Charles Searle** (Naspers' MIH)
- **Hugo Shong** (IDG Capital in China)
- **Arvind Sodhani** (Intel Capital**)
- **Brad Vale** (JJDC)
- **Gunnar Weikert** (Inventages)
- **Zhu Linan** (Legend Capital)

* Schnell has spent nine years at Siemens but four at Infineon, so was included at the editor's discretion

** Sodhani was part of Intel's treasury since the 1980s

Source: Global Corporate Venturing

Insights from
VENTURING EXPERTS

Claudia Fan Munce,
managing director of
IBM Venture Capital

In the early days, we invested considerable time in building credibility and relationships with the institutional venture capital (VC) community, mainly in the US

How has corporate venturing industry changed?

A decade ago many of us were viewed as "dumb money", with little to offer a startup beyond a cheque. Now, strategic investors are highly valued in many verticals, such as clean-tech/energy, financial services and healthcare, where deep expertise, broad ecosystem and scalable go-to-market are essential to success. IT [information technology] giants' ability to partner, acquire and mentor young startups has become well understood by all venture investors, which is fostering a much closer collaboration among financial venture firms and corporate venturing entities.

Many corporate venturing arms have moved away from direct investment to more of an ecosystem partnership model, where plugging into a proven and scalable ecosystem is worth more to both than equity investment.

Driven by the fast-moving confluence of big data, cloud and mobile, many of the best-run organisations now view their corporate investing arms as an essential partner in accelerating innovation, charged with engaging the best and brightest entrepreneurs and startups through incubators, accelerators and in-market labs.

What changes has your group undergone from launch, through early years (1-5) to more mature (5-10) and now experienced (10+)?

1-5 In the early days, we invested considerable time in building credibility and relationships with the institutional venture capital (VC) community, mainly in the US. We invested directly in startups, then moved into LP [limited partner – investor] investment as a fund of funds to foster these key relationships.

5-10 In the middle years, we focused on delivering value to our VC partners beyond just participating in their funds, on building out our reach internally across the corporation, and on expanding our global capabilities in places like China, India, Brazil and elsewhere where we had a unique position to help nurture startups in those regions or startups aiming at those markets.

10+ As we have gained experience and wisdom, we are much more selective regarding which internal projects we take on, and the venture firms we choose to partner. We are also more focused on a global set of VC partners that are strategically well aligned and understand our business models. We also became much more involved with helping our clients with their innovation strategies, from insights to pilot startup engagement to execution of go-to-market partnership.

What lessons would you pass on to others?

Rather than just tee up interesting startups, become a valued partner with your business units. Become an essential extension of their strategy team, working closely with the business unit leaders to identify gaps best filled by partners or acquisition.

Be patient. Wheels tend to turn slowly in larger organisations, so plan ccordingly, set expectations wisely and focus on quality. To sustain your value inside the corporation, make sure you create references of success stories that impact the business from your work with venture and startups.

How do you keep the group and personnel invigorated?

Consider the group as truly a team and not merely individuals focused on separate missions. This drives better performance and greater esprit de corps.

Stay engaged with the business beyond an introduction and initial engagement. Become an integral and essential part of the business unit.

Leverage the opportunity to become thought leaders, to stay well-connected and a valued member of the VC community and ecosystem.

Make sure you hire high-performance individuals and lay down a growth career path for them inside your corporation.

What challenges do you foresee over the next decade?

As the cost of starting a technology-related company continues to drop, and the market will continue to be flooded with attractive technologies and business models, corporates will need to stay focused on what is truly strategic for them, and not merely interesting. Again, impact-to-business is what will drive the sustainability of corporate ventures, not IRR [internal rate of return].

The need for technology investment will continue to come from an ever-wider set of units from across the corporation. It will be challenging for the typically small corporate venturing arm to scale to meet this demand.

As the lines between enterprise and consumer continue to blur, it will be essential for a corporate venturer to develop and maintain a competency around technology and business models that engage end users and provide line of sight to how their customer's customer will leverage these solutions.

Speed, speed, speed. Things move much faster than the speed at which corporations are comfortable to execute. Helping to drive the speed of execution that can capture opportunities will continue to be a key challenge.

Graeme Martin,
president and CEO of
Takeda Ventures

This has been a long, slow learning curve – as it would be with any rapidly globalising, culture-diversifying, multinational corporation

How has corporate venturing industry changed?

Within the pharmaceutical/biotech industry, venturing has become a common-place component in the corporate toolbox, not simply to serve as a window on external innovation as in the past, but to embrace it more completely. The change reflects a desire of both industry and early-stage innovators to foster more of an open R&D culture, encouraging genuine two-way dialog with the goal of achieving a mutual symbiosis. The startup entrepreneurial culture dances well with the Occam's razor of real innovation, something pharma has never really been able to do – and certainly not since the bean-counters took over the helm of the major corporations. Pharma, on the other hand, has infrastructure, know-how and some proprietary R&D offerings that are essential in guiding a novel concept into commercial reality. In short, both the industry and the outside world of academia and entrepreneurialism have recognised that neither can afford to be wallflowers at the dance. Proximity – with the unwritten rights that come with proximity – is the only way to secure genuinely mutual benefit.

What changes has your group undergone from launch, through early years (1-5) to more mature (5-10) and now experienced (10+)?

In our case, the major change has been to separate ourselves operationally from R&D, and hence escape the circularity of internal competition for innovation dollars. We now report up through global business development, which, for a purely strategic venture unit, seems to me to be an ideal fit. Takeda Ventures is part of a seamless external innovations triumvirate, sandwiched between a super-early scouting and funding team, Takeda New Frontier Science, and our business development colleagues looking for licensing and M&A opportunities. This has been a long, slow learning curve – as it would be with any rapidly globalising, culture-diversifying, multinational corporation – but we are now close to optimal in mission and operations. Ask me this question again in another five years.

What lessons would you pass on to others?

1. Senior managers must have patience. Takeda Ventures has operated in purely strategic mode for 10 years now – just long enough for the strategic value of investments we have made to start to be realised and widely appreciated internally. It has also been long enough, having had to walk through a prolonged shadow of the financial crisis of 2008, to demonstrate that even our early-stage focus has delivered capital returns to Takeda marginally above one-times to date. In other words, we run the venture unit at operating cost only, with investment returns covering investment outlay. This is almost competitive with similar vintage life sciences venture capital funds.

2. Define clearly what you are. A critical distinction among venture units is the extent to which their performance is assessed by financial returns. In our mind, the tension between financially and strategically motivated investment is way too great to allow any hybridisation of these aims. It has to be one or the other. Both are good for the ecosystem, but decide what the real purpose of the venture unit is to be, and build the model to suit.

How do you keep the group and personnel invigorated?

Science, science, science. The thrill, as in many things, is in the chase. However, even more thrilling is finding out about something that had not yet encroached on our imagination. Our investment in 2009 in Envoy Therapeutics qualifies as an example of such groundbreaking science. Encouraging our colleagues in Takeda subsequently to explore the technology and work with the founders resulted in Takeda acquiring the company in 2012 – a good example of how our inward-facing efforts are just as important as our outward-facing efforts to support therapeutic innovation.

What challenges do you foresee over the next decade?

Keeping pace with change and opportunity. Convincing the organisation to recognise the need to adopt new practices ahead of the curve. Growing and maintaining an internal awareness of how valuable the venture lever can be as a key tool for any R&D organisation.

Mary Kay James,

partner at DuPont Ventures and this year's chairman of the NVCA's corporate venture group

How has the corporate venturing industry changed?

Over the past 11 years that I have been working in DuPont Ventures there have been big changes. We managed to move from hardly noticeable to the VC industry to increasing dramatically in numbers and relevance. Corporate investors are more experienced now and understand how the industry works. We are leading rounds, capitalising companies and helping them grow.

Corporate investors are more experienced now and understand how the industry works. We are leading rounds, capitalising companies and helping them grow

What changes has your group undergone from launch, through early years (1-5) to more mature (5-10) and now experienced (10+)?

Early on, our group was happy just to have found a startup with a technology that was interesting enough to have others in the company wanting to have a look. As we got more experience, we were able to put together a saleable investment and strategic concept for some startups. Now we have become a force that brings deep insights from very early-stage technologies that can influence the direction of BU [business unit] strategy as well as jump-start the BU's effort by engaging and investing in these early-stage startups.

What lessons would you pass on to others?

As we know, the industry is cyclical and it can be tough to maintain corporate venture investment groups in place over the long haul. An important element is to be proactively flexible, guiding the corporate investment group to make sure it is always relevant to the corporation, while at the same time continuing to find the areas of overlapping interest within the VC industry.

How do you keep the group and personnel invigorated?

Finding the right candidates to work in DuPont Ventures is important. We generally look for self-motivated, seasoned business development type individuals with credibility and a wide network within the corporation along with plenty of patience. You either like this type of work or you don't.

What challenges do you foresee over the next decade?

Maintaining innovation leadership in the US is something that is very important to our country and has influenced the world. Today, I see many governments passing new laws that encourage VC industry growth and I am hopeful our government will continue to do the same. Our world will get even smaller over the next decade, and understanding investing and accounting practices in countries outside our own will become more important than ever.

From the archives

Global Corporate Venturing editorial May 2011, by James Mawson

Corporate venturing begins its golden age

Welcome to the 12th issue of Global Corporate Venturing, and 12 months of covering the industry.

Having handed in my notice and given up the safe, well-paid job as an editor at Dow Jones in May last year in order to set up my publishing company, it seemed a good opportunity to use this issue to take stock. There has certainly been plenty to write about – contrary to the fears of some people before Global Corporate Venturing launched.

The industry has entered its golden age – having money at a time of rising demand from entrepreneurs and as rival sources of capital are more constrained due to liquidity issues and poor returns on average.

Rival sources of long-term capital are becoming increasingly constrained, as identified by Switzerland-based non-profit organisation World Economic Forum in last month's issue – and in a keynote speech at the Global Corporate Venturing Symposium in London – just at a time when the supply of entrepreneurs is at unprecedented levels. Business start-ups usually peak at the end of an economic recession but the credit crunch has coincided with a unique period of globalisation and economic liberalism where the opportunities and potential to set up a business have never been greater.

Given capital is fungible and the ultimate commodity, having money is not enough to warrant a golden age for the industry. The second, crucial requirement is the added value corporate venturing can bring to its portfolio companies and the innovation ecosystem.

Here, the lessons have been learned from previous eras of rising interest in corporate venturing from the 1960s onward. Those previous times, notably around the millennium, were characterised by programmes being set up at the end of the economic cycle and invested at a period of highest prices with little regard as to what the impact on the parent's business would be or how to deliver added value to the portfolio company.

Now, corporate venturing's position in a company's business development and innovation toolkit can be more clearly defined. That a company such as telecoms equipment maker Motorola can split rather than close its highly-regarded corporate venturing unit when the parent separates into two businesses is testament to the strategic importance of understanding what entrepreneurs are doing.

Corporate venturing as an investment concept is flexible enough to be used to help incubate internal ideas, commit to the best third-party venture fund managers and invest directly in business tangential or relatively close to existing core operations. Investing well and finding the strategic links is still difficult to do and takes time to show in results. One of the greatest challenges the industry still faces, therefore, is maintaining support from executives in the parent business, who often change roles more frequently than a portfolio company is held and strategy is set.

This challenge could also become harder. Just as the World Economic Forum identified an expected fall in traditional sources of long-term capital over the next few decades, the implication is that listed businesses will come under increasing pressure from short-term shareholders to cut expensive investment programmes in favour of greater distributions now.

The combination of hedge funds and activist shareholders, encouraged by management consultants and investment banks paid to encourage transactions and change and with the ear of senior managers, with willing buyers of assets in leveraged buyout firms supplied by debt given unfair tax breaks when compared with equity means longer-term decision-making could end up in shorter supply in the future.

If the industry is to capitalise on this golden age, corporate venturing units will be required to spend increasing amounts of time and effort showing their achievements and their potential – both in creating opportunities for the parent and as a risk management tool delivering

Pushing the BOUNDARIES

Heidi Mason, co-founder and managing partner of consultancy Bell Mason, talks to **Deborah Hopkins**, Citi's chief innovation officer (CIO), about approaches to corporate venturing in its maturity.

Mason: What does success look like five years from now for Citi Ventures, and how will you, as Citi's chief innovation officer (CIO), lead to execute on that?

Hopkins: Success five years from now will mean several things. First, I hope that Citi Ventures will have been a key catalyst in completely redesigning Citi's end-to-end customer experience and that Citi will be recognised as the industry leader in that realm.

We also want to be recognised as the best-in-class corporate venturing team. This is important because venture investing is how we bring the outside in and accelerate time to market for our businesses. We must also continue to inspire and energise the organisation by creating the systems, capabilities and processes that support innovation and sustainable growth.

We might not know exactly what the future looks like, but having a system for seeing and channelling innovation into the corporation is critical.

Mason: And in a way that innovation can be understood, absorbed and put to work by the corporation – no small issue with the natural antibodies it calls up within the established organisation, operation and culture, which has spent years tuning and streamlining its culture and operation to the present day's businesses and size.

But it has long been said that maintaining the status quo is not enough to win, or ensure position for the long term. Without an integrated approach to corporate venturing and innovation (CV&I) – and in a dedicated business unit that focuses on developing the commercial impact of innovation in ways that score for the corporation and contribute to its strategies for growth – staying power is questionable.

Heidi Mason
managing partner of consultancy Bell Mason

Deborah Hopkins
Citi's chief innovation officer

> **We might not know exactly what the future looks like, but having a system for seeing and channelling innovation into the corporation is critical**

The ability to expand, reinvent, hold industry leadership positions in this dynamically changing world ... well, you really have no prayer of getting to the next stage without this.

Hopkins: I completely agree, and I often say that one of the most critical success factors in our journey has been building and headquartering the team out of Palo Alto, Califomita. As a dedicated team, Citi Ventures is able to sit in the heart of where disruptive forces are born and, among other things, place smart bets on entrepreneurs – trailblazers who are pushing out the borders of banking.

This year we will look at over 1,000 entrepreneurial companies as part of these efforts. As a result, we help our businesses capitalise on outside forces in a way that is targeted and actionable through the deep domain knowledge that we gain by locating here.

Mason: Though the CIO is still a new role within executive management structures, over the past five years we have seen this role appear across industry sectors as a much more mainstream and a vital means of making innovation a practice with output, beyond a concept. In fact, I see the CIO emerging as the "chief executive of the business of innovation" and one of the prime architects of the corporation's continual renewal and staying power.

How have you shaped this vital role as Citi's first CIO for the past five years? What attributes and background do you think are essential in a CIO for making this role work at an executive management level?

Hopkins: I think of my role as being a catalyst and sometimes a provocateur. We have to be engaged with and relevant to Citi's businesses and help them find ways to step into disruption. I regularly draw on my experiences across multiple industries – automotive, aerospace, computing, telecommunications – and my former roles as chief financial officer of Boeing, and of Lucent Tech, and chief operations and technology officer at Citi. These experiences contribute insights ranging from systems thinking to product development expertise.

Ultimately, a CIO needs to have the ability to build the adequate support for his or her ideas, the perseverance to knock on doors multiple times when need be, a healthy sixth sense to take into account timing and organisational considerations, and the natural instinct to recognise patterns in order to unearth opportunities.

Mason: How have you organised your unit to fit your vision and achieve its goals within Citi?

Hopkins: Our work is structured around three areas. Venture Investing, led by Vanessa Colella, creates value for our businesses through strategic investing by actively scouting the most promising technologies and accelerating adoption within Citi through our commercialisation efforts.

Second, DesignWorks, run by Busy Burr, hastens our competitive advantage by designing new businesses and new capabilities including our end-to-end customer experience.

Third is the Citi Innovation Network led by Debbie Brackeen. It partners Citi's Global Innovation Council, which is a senior forum we founded to sponsor high-priority projects, capabilities and culture initiatives. Brackeen's team is also connecting all labs in Citi to identify opportunities to scale smart experiments from one business across the organisation. It is important to remember there is no single trail map for this, and so much of the work building a system for a lasting innovation business is tailoring the model to the culture of the organisation.

Mason: What about your core team and operations? How is it structured for its own growth in the innovation business on Citi's behalf? How important is formal business process and risk management to your success?

Hopkins: The former CFO in me determined early on that we needed to establish a best-in-class governance system that would make senior management comfortable that we are strong stewards of the firm's reputation and capital.

I am very pleased with what we have built here – for example, our investments are vetted and monitored by a risk review committee which meets on a weekly basis and is represented by nine functions ranging from finance to compliance to bank regulations. We also conduct quarterly portfolio reviews for all Citi Ventures projects and portfolio companies. Through these types of processes, we have created a strong partner-peer culture that ensures robust transparency and accountability.

Mason: So while personal executive champions are always important to your business, you are now institutionalising Citi Ventures' processes, mechanisms and core DNA, as part of the Citi organisation and operation, to bring long-term replicability and sustainability to the practice.

We believe that if you are building a professional organisation to last, rather than just being a hobby wholly owned and protected by an angel executive champion, the innovation business organisation design and transparent process is the enabler. This is fundamental to getting your department through the painful but natural cycles of the parent corporation's management turns and reorganisations, and escaping the typical start-stop-start-over syndrome it imposes on the innovation business – that, and a lot of consistent internal and external outreach and leadership by the CIO.

We also bring in select external individuals who bring unique innovation skills to the table. It is a highly diverse team bounded by a common mission

Hopkins: Definitely. We benefit from having a venture board made up of senior leaders across the company with whom we have an ongoing dialogue about trends and critical priorities. In addition, we employ a regular cadence of engagement with the businesses to truly understand their priorities so we can match the right opportunities to their needs.

Mason: And your current Citi Ventures programme leaders – how did you get Citi to support you in building your team? How did you find who you needed?

Hopkins: We were incredibly fortunate to have a thoughtful human resources partner from the start. She understood the big picture and how Citi Ventures was different in size and talent-mix requirements. She understood that these were new roles that required people with certain specialised skill-sets and traits – such as design-thinking expertise and the ability to thrive in an atmosphere of ambiguity.

Mason: One who can see a new kind of order – dots and how they connect – out of complexity.

Hopkins: Exactly.

Mason: How do you think of a career planning for those and others in these different but complementary CV&I programmes – venture capital-style longevity of partners, or rotation of talent?

Hopkins: You want the right mix of people who are passionate about their area of expertise, such as venture investing, complemented by business unit transfers who are eager to grow professionally in Citi Ventures and eventually want to assume business leadership roles in other groups in Citi. We also bring in select external individuals who bring unique innovation skills to the table. It is a highly diverse team bounded by a common mission.

Are we riding a wave or FLOATING IN A BUBBLE?

Mark Muth, formerly of Unilever Ventures

The proliferation of corporate venturing businesses in the past five years has reached unprecedented proportions. Can the industry continue to grow or has a bubble been created that will inevitably burst?

Comparing the current state of corporate venturing with previous phases is a useful starting point in answering this question.

There have been three generations of corporate venturing during the past two decades – the dot.com-driven phase of the 1990s, the post-dot.com or open innovation period from 2001 to 2008, and the current post-credit-crunch generation. While the expansion and contraction of corporate venturing has generally followed economic cycles, the current phase is distinct – the industry has grown rapidly while the economy has been in recession or has stagnated.

The impetus behind the dot.com era was the advent of the internet. Corporate venturing was about investing in the technologies that would determine the nature of the internet.

Fortunes were made by investing in the big-name successes – Yahoo and AOL, to mention just two. By the late 1990s, the pace of investment was frenzied and the volume of rhetoric deafening. Everyone was on the bandwagon. General Electric (GE) dubbed 2000 the year of digitisation. At a beginning-of-the-year rally, a senior GE Capital executive walked on stage holding a printer, which he lifted high above his head and then flung to the floor, shattering it into pieces. "This is the end of paper," he asserted.

The past few years, companies have sought new products, technologies and business models to enhance their competitive position

GE's corporate venturing unit reported a $1bn profit that year, harvesting the gains from investing significant sums of money in dotcom businesses. The profit represented about a tenth of GE's total in 2000, not bad for a group of 125 professionals in a global enterprise that employed several hundred thousand.

By the end of the 1990s, the success of corporate venturing was largely due to timing. Those who were able to convert their investments into cash became heroes. But much of the recorded profits were revaluations based on marking to market the share prices of the slew of companies investors had managed to float in a rising market. The stockmarket crash in 2001 wiped out the previous gains. The GE executive's declaration was prescient – it was the end of paper profits.

At the turn of the millennium, the number of corporate venturing units had peaked at about 400. In the following two years, the number had halved, the fall-out from the dot.com and stockmarket implosion.

The post-dot.com phase of corporate venturing began more soberly. Lessons had been learnt. Don't leave your corporate venturing unit on the balance sheet of the parent if it gets too big, or keep it small, consider carefully the objectives and strategy of the corporate venturing business and create the appropriate structure, embrace realistic goals. The quick profits achieved by a select few in the dot.com generation proved to be ephemeral.

Post-dot.com corporate venturing, from 2001 to 2008, had its impetus in open innovation. Companies had woken up to the fact that their research and development and marketing departments were not the exclusive source of new products and revenue models. Start-ups had also produced a few good ideas. By investing in early-stage businesses, corporate venturers could tap into this stream of innovation. By taking minority stakes rather than making outright acquisitions, the corporate venturer could foster ingenuity and avoid the risk of suffocating the start-up by integrating it into the corporate infrastructure.

The open innovation phase of corporate venturing had a brief hiccup during the credit crunch of 2008. Withdrawal of credit decimated the leveraged buyout and recapitalisation markets. Similarly the overall private equity market declined. According to trade body the European Private Equity and Venture Capital Association, total venture and growth capital investment in European companies peaked in 2008 at €14.6bn ($19.8bn) before falling to €10.9bn in 2009 and to €8.1bn by 2012.

In contrast, an analysis of statistics compiled by Global Corporate Venturing indicates that investment by corporate venturers grew steadily from €730m in 2008 to €1.22bn in 2012, representing 16% of total European venture and growth capital investment, over three times the percentage it represented in 2008. Likewise the number of corporate venturing units has burgeoned, having now reached nearly 1,000 globally, up by a third in just the past four years.

The number of corporate venturing units has burgeoned, having now reached nearly 1,000 globally, up by a third in just the past four years

While the current post-credit-crunch wave of corporate venturing is also driven by open innovation, there are other reasons for the proliferation of corporate venturing. In the stagnant western economies of the past few years, companies have sought new products, technologies and business models to enhance their competitive position, and corporate venturing has become a standard tool in the quest to innovate. The fact that so many companies have created corporate venturing units has meant the range of industries targeted for investment has broadened. While the next generation of internet technologies features in the investment scope of many corporate venturers, there is not the overconcentration in internet start-ups characteristic of the digitisation phase.

New investment trends include sustainability – renewables, waste-to-energy, distributed power, recycling and efficiency technologies, low-impact consumer products – healthy living, such as functional foods, natural or organic products, lifestyle products and services, and social impact venturing. It is unlikely there is an industry sector that has not been touched by corporate venturing.

Viewed in its entirety as a portfolio of investments, corporate venturing is surely better positioned to withstand the next recession and market decline simply because of this diversification. There does not appear to be any systemic bubbles in the economy that would lead to an overall market crash.

The question is whether the corporate venturing industry has created its own bubble because of the sheer weight of numbers – not everyone can be successful. It is also possible that much of corporate venturing represents a strategic fad, similar to the cycles of diversification and consolidation that drive merger and acquisition activity.

Even without external causes, corporate venturing could self-destruct as quickly as it has grown. There are early signs that not all is well – some of the new entrants were set up hastily in order not to miss the innovation bandwagon; some units have conflicting objectives, are inappropriately staffed and poorly structured.

Venture investing, by corporates or independents, is an inherently risky business. Those firms without the right structure, personnel and mindset, are likely to become the casualties in the next downturn.

While there are no simple formulae for success, or any single way to carry out corporate venturing, paying -attention to the fundamentals is the only way to survive or thrive.

That means careful consideration of how to match structure to strategy, hiring the right people and, above all, being persistent.

Independents can embrace the **CORPORATE IMPERATIVE**

The challenge is meshing apparently nonaligned strategies



Reed Elsevier Ventures is one of the few corporate funds set up in 2000 – the heady days of the dot.com bubble – to be celebrating its 10th anniversary this year. **Diana Noble**, above left, former partner at Schroder Ventures (now Permira), was persuaded to lead it, and first to join her was **Tony Askew**, centre. **Kevin Brown**, right, followed Askew across as a principal and was promoted to partner the next year. Noble stepped down as managing partner at the end of 2004 to join the William J Clinton Foundation and Askew took the reins. Here the three of them talk to editor James Mawson about how the ventures team was originally structured and its approach to investing.

SNAPSHOT OF A DECADE

Reed Elsevier is one of the world's largest media companies, publishing content and information solutions for professional markets worldwide.

Year 2000

Chief executive: Sir Crispin Davis
Revenue: £3.75bn
Profit: £800m
Operating businesses: LexisNexis, Elsevier Science, Reed Business Publishing, Reed Exhibitions, Reed Education (UK)

Year 2010

Chief executive: Erik Engstrom
Revenue: £6bn
Operating profit: £1.5bn
Operating businesses: LexisNexis, LexisNexis Risk Information & Analytics (inc Choicepoint), Elsevier Science, Elsevier Health, Reed Business Publishing, Reed Exhibitions

Reed Elsevier Ventures invests in high-growth media, information and technology businesses in the US, Europe and Israel.

Year 2000

Investment team: Diana Noble, Tony Askew, Kevin Brown, Valerio Massimo, Tom Aley

Year 2010

Investment team: Tony Askew, Kevin Brown, Tom Drummond
Capital invested: $125m-plus
Number of investments: 21 (US: 18, Israel: 2, UK: 1)

Number of exits: 10 (returning more than all capital invested in portfolio)

Selected investments:
Healthline Networks (www.healthline.com), consumer health information services
Palantir (www.palantir.com), analytics platform
Martini Media (www.martinimedianetwork.com), ad network for the online affluent
Babylon (www.babylon.com), translation software/services, initial public offering TASE 2007)
Netli (www.netli.com), application delivery network, acquired by Akamai in 2007

Financial performance: Upper-quartile fund by net IRR against Cambridge Associates Benchmark of all US VCs

Investments 2010

Capital invested: $125m-plus

Current portfolio

Babylon, language translation, **www.babylon.com**

Healthline, health information, **www.healthline.com**

Palantir, investigative analytics platform, **www.palantir.com**

Recruiting.com, recruitment software **www.recruiting.com**

Fina Technologies, big data predictive analytics, **www.finatechnologies.com**

Partminer, electronics parts information database, **www.partminer.com**

First Life Research, crowdsources adverse events data, **www.firstliferesearch.com**

Intelligize, legal research software, **www.intelligize.com**

Logistics Health Corporation,healthcare delivery, **www.logisticshealth.com**

Martini Media, ad network targeting the online affluent, **www.martinimedianetwork.com**

Spacecurve, geospatial database technologies, **www.spacecurve.com**

Exited portfolio

Inxight, unstructured data management, acq: Business Objects

Business.com, business search engine, acq: RH Donnelly

SRD, large data entity management platform, acq: IBM

Inpharmatica, discovery informatics platform, acq: Galapagos

Netli, applications data networking, acq: Akamai

Siperian, master data management platform, acq: Informatica

AllBusiness.com, small & medium sized business media, acq: Dun and Bradstreet

iPhrase, natural language search engine, acq: IBM

Intraspect, collaboration platform, acq: Vignette

Nextpage, peer to peer content management, acq: Fast

Mawson: What persuaded you to establish a corporate venture team?

Noble: I had previously been a partner in an independent fund and was initially sceptical that investing could work within a corporate setting. And the dismal record of most corporate funds bore this out. So it is fair to say it was the challenge that attracted me. I wanted to see whether a well-architected structure and the right team could negate the different cultures and motivations that typically divides a venture team from its corporate host and instead harness the deep sector knowledge to provide genuinely differentiated capital and an approach that would be valued by the best early-stage entrepreneurs.

Askew: We developed the approach together. I have a technology, media and telecoms background with Random House, and Cellnet (now O2) building their new media and wireless internet businesses and later had turned down a partnership with Andersen to join Diana at her previous fund. Overall, I was intrigued by whether it was possible to build an attractive portfolio across a broad geography of US, Europe and Israel tapping into the enormous wave of telecoms, media and technology innovation.

Mawson: Knowing what you know now, would you recommend corporate venturing to any company?

Noble: It is a highly challenging model to deliver but, done well, it provides a deep insight into external innovation that is difficult to achieve any other way. Company culture, risk tolerance and time horizons conspire against innovation at large corporations. Internal innovation efforts generally lead to incremental add-ons, not orthodoxy-flipping, game-changers. If companies accept they will not monopolise the next generation in their industry, how do they at least build a bridge to the innovators? And a bridge that identifies them early, allows open learning about what they are doing and why, and enables a range of relationships, from knowledge sharing to commercial partnerships to acquisition, to evolve naturally over time. Corporate venturing is exactly that bridge.

The investment due-diligence process drives a far deeper understanding than pure business development conversations

Askew: The alternative approach is to hire a business development team but it can never bring the same depth of insight. In that sense it is a kind of a mirage. The dialogue will be much more closed and suspicious without the independence of a venture team and there is little incentive for an early-stage company to open its doors and reveal its strategies and vision to a behemoth in its industry without the lure of capital. The investment due-diligence process drives a far deeper understanding than pure business development conversations. And a board seat as an investor provides a ringside perspective into the strategy and evolution of the emerging company.

Mawson: Why do you think this works at Reed Elsevier?

Askew: Corporate venturing works best when innovation is significant enough in a company's industry to really engage and/or scare senior management. This is what typically provides the initial impetus and helps galvanise the activity. Reed Elsevier certainly sits in the midst of tectonic shifts in its industry – in business models, in technology and in customer expectations. On the other hand, compared with some other media groups, Reed did not really have the brand name that would attract dealflow by itself. But, on reflection, its lack of real brand recognition and drive to reinvent itself were both positives. The first left us a relatively free hand to build our own brand of venturing distinct from the host, and the second played well into our message concerning entrepreneurial insights and innovation.

But, on reflection, its lack of real brand recognition and drive to reinvent itself were both positives

Brown: The pace of innovation is what drives the scale and quality of dealflow. Back in 2000, Reed's management had only a partial view of the rapid and disruptive developments shaping its industry, particularly those driven by private companies. They had the typical, poor-quality, passive dealflow that most corporates had in 2000 and our first few months were mostly taken up with saying no nicely to all of this. Developing a strategy to identify the more interesting companies that were not naturally going to reach out to Reed took much longer. Another important consideration is that venture investing sits more comfortably within a business that is used to partnering. This was not always the case with Reed Elsevier, whose traditional model was predicated on full ownership and control. However, they did recognise that they did not find it easy to engage with small companies or understand the entrepreneurs' perspective, and that having a venture team gave them a mechanism for doing this.

Mawson: Let us talk about the objectives you set for the fund. How did you think about your financial and strategic approach?

Askew: The first point is we never counterbalanced the two. If a company was interesting financially then it had to have relevance in Reed's broader markets, otherwise we would lose all the benefits of staying focused on our sectors. And if it was strategically interesting, we would never water down our financial criteria, because ultimately we were motivated by generating carried interest.

Mawson: What were your financial criteria?

Askew: We set ourselves the same targets as if we had been an independent fund raising external capital. We aimed to be in the top quartile of all funds, whether independent or corporate, established in the same time period, based on the European Private Equity and Venture Capital Association's measure for net returns. We have achieved this and hopefully we will even do better. We have returned more than all the capital invested in 21 companies from 10 exits so far and the remaining portfolio of 11 is valuable, some already profitable and growing strongly.

Mawson: What about the much-discussed strategic criteria?

Brown: Although we agonised a lot over this in the early days while we were building internal credibility, today we are much more relaxed. Our philosophy is that most corporations, including Reed, make decisions heavily influenced by their current orthodoxies, whereas most venture capital firms, including us, make investment decisions based on market trends. Sometimes these views coincide, which is when corporations do well, but mostly it takes time for a company's orthodoxy to change and that is a big part of the value that we bring – an early view on the shifting direction of the market beyond the "here and now" that drives all big companies.

So much of what we learned and that Reed has taken from our activity has come from participating in the journey, as it can take years for strategic relevance to become apparent

Noble: When we started, we were quite structured in our thinking and divided potential investments into Horizon 1 (an existing or imminent commercial relationship), Horizon 2 (where a business unit clearly wanted a relationship in time) and Horizon 3, where no relationship was envisaged but where the venture team felt valuable learnings could be gained in both directions. At that time, we tried to concentrate on the first two, so that we could demonstrate strategic relevance internally and not promote too many investments that would result in head-scratching among our corporate colleagues.

Askew: Over time though, we have deliberately stretched this. Our value, strategically, comes from our activities across the board and not just from investments made. Because we have now engaged for over 10 years with entrepreneurial companies across Reed's sectors and close to them, we have developed a valuable perspective on the evolution of technology, customer needs, data consumption and other critical areas. We also track trends of where capital is flowing to fund innovation. In measuring strategic impact, as long as you are making good financial decisions by investing in companies that have a relevance in the host's market, then you are strategic. So much of what we learned and that Reed has taken from our activity has come from participating in the journey, as it can take years for strategic relevance to become apparent.

Mawson: How do you build internal links between the venture team and a widespread group like Reed Elsevier to ensure this knowledge genuinely flows between you?

Brown: This is something that evolved over time. In the early years we set up a formal structure to build these links. We asked each of the major business units to appoint a venture associate, typically the strategy or business development director. These would be our main interface with the unit and also act as a broad internal advocate for Ventures to allow us to concentrate on investments. We drew the associates into our world by involving them in deals, introducing them to interesting management teams and organising regular Venture Associate Days – opportunities to feed back market knowledge and share Ventures' skills and approach, for example workshopping private company valuation methodologies.

Askew: We ended up phasing out this role, as the strength of our relationship with the business unit chief executives developed and became more direct – for example, organising regular trips for senior executives to visit Silicon Valley to meet entrepreneurs, and participating in senior management offsites. One pitfall that had to be navigated was that once our reputation grew internally as a sensible team with reasonable judgement, we started to be viewed as a resource available to the corporate to be consulted for general strategy, mergers and acquisitions or internal innovation. We had to tread carefully in being helpful where we could be, which always had a benefit in building internal relationships further, but also managing our time so that we spent the time we needed externally to support our main objective – a financially successful portfolio.

Mawson: How did you build the right Ventures team to deliver the financial and strategic objectives?

Noble: For anyone questioning whether to favour VC or corporate backgrounds in the team, there is no doubt in my mind. Venture capital skills are paramount in corporate venturing. The judgement and mindset necessary to build a strong VC portfolio are just different from those developed in a corporate environment. Each investment professional has to be able to span a range of capabilities: to filter proposals quickly, identify the core issues and run a process able quickly to reach a conclusion; to understand a sector, often in huge flux, in depth and be able to identify the early-stage companies able to create value; to judge an entrepreneur and their team at the same time as building an open and candid relationship with them; to drive a hard financial bargain on valuation and rights of each class of shares; to understand that legal agreements can seriously affect the value each investor creates relative to each other and relative to the management team; to stay deeply involved through all the twists and turns of an early-stage company and to know the best way to support management, when to challenge and, in extreme cases, when to consider a change

Askew: Ultimately our brand is our behaviour. We deal with many stakeholders, including Reed, entrepreneurs and investors, and ensure our structure, ownership and investments are transparent to all. This requires individuals who are able to influence strategic thinking at the highest level, balance buying and selling, manage around turf wars, soothe egos, orchestrate and facilitate the meeting of minds and yet lead and drive a tough commercial negotiation and be assertive in managing portfolio decisions. These individuals are hard to find. Kevin and I have worked together for over a decade investing in more than 20 companies, and Tom Drummond, of our Silicon Valley office, has been with us since he left Cambridge six years ago.

Mawson: Where do you stand on compensation?

Noble: Tony mentioned the stability of the team, which in my mind has been a major factor in our success. You will never attract or retain the right people without paying VC-equivalent compensation, including carried interest. The differential between a high and poorly-performing funds outweighs by many multiples the additional running costs and share of upside given to a strong team with the right skills. This is exactly the equation that investors make in the VC market between different funds – the best performers with higher fees and carry will always be more highly subscribed than the average performers with lower fees and carry.

The differential between a high and poorly-performing funds outweighs by many multiples the additional running costs and share of upside given to a strong team with the right skills

Askew: Although carry marks out the team as different from corporate colleagues, Reed Elsevier has always recognised it is an integral part of the model, so it has never become an issue.

Mawson: How big is the team?

Askew: The smaller the team the better, as this increases focus and personal responsibility and means that everybody has to be ruthless in setting priorities.

Noble: It is also relevant in the context of the group. We never had more than five professionals in the team to cover US and Europe. Venture capital is extremely cyclical and we never wanted to end up in a position where realisations, or the absence of them, or writedowns affected the group's results publicly.

Mawson: CEO support is often cited as critical to the longevity of any CV fund. How did this work at Reed Elsevier?

Noble: Chief executive support is completely fundamental to the success of a corpo rate venture team, particularly during the down years of the cycle when the portfolio looks less healthy. Crispin Davis, who had in 2000 joined as CEO of Reed, took the trouble to really understand how I wanted to do corporate venturing and convinced me he was in it for the long term. And this was a major factor in agreeing to join in the first place. Initially, we agreed Ventures should report to him, not because he wanted to be hands on, but because it would demonstrate his personal commitment internally and externally. He was unwavering in his support throughout and this set the tone for the rest of the board and the senior management team.

Brown: Also, the range of our strategic activities and our proven financial track record have enabled us to build a broad base of support across the business unit leadership teams, not just the corporate teams and group CEO. The primary focus for the fund has always been on delivering financial and strategic value as a standalone entity rather than looking over our shoulder at Reed Elsevier organisational changes.

Askew: There have been two subsequent changes of group CEO which we have had to navigate, but neither has been problematic. Reed Elsevier's current chief executive, Erik Engstrom, was until recently the CEO of our Elsevier business. He had therefore already worked with us for a number of years and is a believer in what we do. Since taking over, I have reported to the group chief financial officer Mark Armour, who has headed our investment committee from day one. This reflected our maturity as an investing entity. Mark is a supporter of our approach and this relationship has been fundamental to our longevity. He understands the dual challenge of running an investment business while delivering strategic value and has enabled us to build a platform from which to operate as a financially-focused VC in a corporate context.

How market maps showed way to generate dealflow

Mawson: Where did you get your dealflow?

Askew: Dealflow is one of the most critical areas; it is the lifeblood of any venture capital (VC) firm. We recognised really early that a passive approach, where we just announced our existence and opened our doors, might generate deals but would not get us into the rarified atmosphere where the best deals are seen and done. Instead we set out to reverse the typical deal generation activities of independent VCs, which rely on networks and relationships to bring deals to them, across a wide range of sectors and designed a largely proactive approach.

Brown: We initially concentrated only on the markets which matched Reed Elsevier's strategic focus or which we thought were interesting tangential areas. And we got to know them really well. We mapped them out and identified all start-up companies already funded by VCs in these areas and clustered them into sub-areas. Before we even started contacting the companies, these market maps were fascinating to Reed Elsevier management, who were able to see where capital was flowing to fund innovation. We were then able to do desk research on each of the companies to identify those we felt were most interesting. And we started cold-calling the chief executives (CEOs).

Mawson: How did those calls go?

Brown: Remarkably well. Most CEOs were intrigued to open exploratory discussions even if they were not raising capital.

Some had never heard of Reed Elsevier, although the sub-brands (such as LexisNexis, Elsevier and Variety) had high recognition. This was the genesis of our proactive approach of targeting exciting companies in a focused set of industry sub-sectors.

Mawson: Did this sector focus give you any advantage in selecting the right investments to build an attractive portfolio?

Noble: It did. One of the main benefits of a corporate venturing fund comes from its strategic focus, which drives discipline and the ability to get a deeper understanding of the narrower range of sectors the team is investing in. Some of the biggest due diligence questions any VC will ask of a promising potential investment will be contextual about the sector. Is this genuinely a growth sector? Can it generate attractive margins? What do customers really want? What are the drivers of success? These are all answers that are hard to get at within a rapid investment time horizon if your deals are dotted across a broad universe of sectors.

Askew: This approach has contributed significantly to our financial performance. Taking the benchmark of European and US VCs, we are an upper-decile fund over the 10-year period. Our deep and narrow sector knowledge has given us the insights and access that has over time become our differentiator – both in selecting high-quality new investment and in making informed portfolio decisions.

Mawson: I thought most corporate venturing teams were reliant on the pure financial VCs for their dealflow?

Noble: This was not a strategy that yielded much for us in the early years and we did not make it a priority initially for a couple of reasons. First, top-tier VCs in the US and Europe are a tight-knit bunch with an understandable preference for syndicating the best deals among themselves. Second, our relatively narrow sector bias meant that even large VCs had only a small number of relevant companies in their portfolio.

Mawson: How do you build the reputation you want with VCs then?

Brown: Fundamentally, reputation develops over time and it is entirely based on the individual partners and board to investment interactions. Many top-tier VCs have firm level relationships that stretch back over decades and many individual partners have invested with each other across several funds. Even five years is a very short time in venture capital – as we hit our 10th anniversary we are only now beginning to feel the benefits of building enduring relationships with specific partners and firms.

Askew: Also we recognised there were certain things we needed as a minimum. First was financial alignment with other investors and the management teams. This was an important factor in us establishing the fund as a separate entity with standard VC structure and economics – principally partners earning carried interest, or performance fees. In addition, we needed to be able to make own decisions and run a VC standard process. Reed Elsevier understood this requirement and worked with us to establish an investment approval and funding process that is at least as streamlined as that of a pure financial VC. Unlike some other corporate funds, our deals have neither a business unit champion nor blackball and we have a small and senior investment committee – Reed Elsevier's chief financial officer, chief strategy officer and us – that is able to convene at very short notice.

Mawson: And how do you develop the right relationships with entrepreneurs and CEOs?

Askew: This is something that we have always paid a lot of attention to. Given our approach of targeting new investments via the management, a close working relationship with the entrepreneur or CEO is crucial from day one. All VCs have different approaches to this. Our style is typically to focus on creating the conditions that will make them successful and not second-guess executive decisions on a day-to-day basis. We make an effort to understand the skills and experience of all those around the board table – founders, CEOs, other VCs, industry independents – and focus our interventions on the areas where we can have the most impact. This varies significantly from board to board.

Mawson: In particular, how does the venture team avoid being seen as an espionage team on behalf of the corporate?

Brown: Theoretically, that looks like a challenge, but it never materialised in practice. I think there were two reasons. First, we always made it clear that our primary motivation as a team was generating carried interest and therefore our incentives were aligned to all their other investors – to build value in our investee companies Second, we have always operated as venture capitalists rather than corporate development teams for Reed Elsevier. Corporations without a venture team tend to be hung up on control and this colours all discussions with entrepreneurs. We were very careful to be open and candid about how we worked at the beginning of any relationship with management, and once the initial questioning was over, it never really gave us a problem.

> **Corporations without a venture team tend to be hung up on control and this colours all discussions with entrepreneurs**

Mawson: What strategy did you take to investing? Were you early stage or later stage?

Noble: We were relatively cautious when we started. We wanted to be early enough to catch innovative companies before they became too obviously successful and expensive. But not so early that we would have too many failures, which I did not think a corporate would stomach even if the capital amount was small, or so early that they would be too raw to have any meaningful dialogue with Reed Elsevier. So we chose series B and later investment rounds as the right point to invest. This had the added benefit of giving visibility of all companies funded up to and including series A or later which drove our proactive dealflow strategy.

Brown: Although that was the right place to start, we have since stretched this as we have built a deep understanding of our markets and we now invest from seed through to late-stage. We do not have hard and fast rules about amounts and stages, rather we take the view that we back smart entrepreneurs with novel approaches and transformative technologies. For example, our most recent investment was in a west coast US entrepreneur with an entirely novel approach to database technology – we led a seed round that will enable him to hire a small team and create a -product. That is not something we would have contemplated 10 years ago. We have also done several deals where we are the only institutional investor and the other funding has come from founders and angels.

Mawson: Most corporations avoid leading investment rounds and take a passive view of post-investment portfolio management. What approach have you taken?

Askew: Initially we thought we would be most likely to follow the lead of a financial VC in investment rounds. However, competition for the better deals meant that we were immediately drawn into leading deals. It turned out to be a good approach for us and we are very comfortable setting the price and terms of new financings, in fact we have led more than half of our deals over the 10 years. As for post-investment management, our style is very hands-on and we would see no distinction between financial VCs and us. We are long-term investors and understand everything that this entails, good and bad – management changes, debt and equity financings, and aborted and successful exits.

Mawson: When you now look at the portfolio you built over the past 10 years, did most of the strategic value for Reed Elsevier derive from investments made?

Brown: Actually I think this is only part, and perhaps the minority of the strategic value Reed Elsevier has benefited from Ventures. The team has engaged every day for the past 10 years with venture-backed companies in Reed Elsevier's sectors and we have had the benefit of hearing numerous entrepreneur perspectives on the evolution of technology, customer needs, data consumption and other critical areas for Reed Elsevier. We also track trends of where capital is flowing to fund innovation. The market maps described above are incredibly valuable to management. Although the portfolio has performed financially, it is the broad knowledge the venture team is able to impart on innovation, only part of which has come from investments actually completed, that is valued most highly by the senior team at Reed Elsevier.

Mawson: So how does Ventures affect the Reed Elsevier strategic agenda?

Askew: At the highest level we are the bridge between Reed Elsevier and the private marketplace. Over time we have developed two main ways of affecting the strategic and innovation agendas – market access and thought leadership. Market access is what every corporately-backed venture fund aims to provide and we view this as a spectrum of activities. We are constantly surfacing companies that the business units find interesting, either simply as forewarning of their existence or as potential strategic partners or even acquisition targets. Only a few of these meet our financial criteria and an even smaller number become part of our portfolio. Where appropriate we spend considerable time connecting these companies to the right places in Reed Elsevier and fostering relationships. Over time, we have developed very good knowledge of each Reed Elsevier business unit and their strategies and have personal relationships across each of them. We have also developed a very wide network of entrepreneurs and investors, which we proactively share with the Reed Elsevier businesses. An example of this is the US west coast road trips where we spend a week exposing senior management teams to innovators, entrepreneurs, CEOs and investors. These have proven to be the best way to challenge and extend their thinking.

Brown: One of the things we have spent a lot of time on is developing our approach to sharing information with Reed Elsevier. There are a number of elements to this, from extending our own market maps to versions which are specific for our business units to more general market trend analysis and abstraction. Our brief is to help Reed Elsevier understand the rapidly changing nature of the media and technology landscape. This can take the form of ad-hoc input during strategy sessions or more formal distillations of our experience and knowledge into briefings that we give to various constituencies across the group – from a half-day workshop with a business unit leadership team offsite to a presentation at a group-wide conference. Most recent examples of these thought leadership pieces include "Transformational media themes" (five broad trends we identified in driving the changes in the media landscape) and "The digital competencies blueprint" (nine key competencies that are the source of strategic advantage for modern media companies).

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DLA PIPER

Mark Radcliffe, partner

Many corporate investors have begun to shift from using board observers to board members in their portfolio corporations. A board member, by the nature of his position, has access to more information about the portfolio corporation and has more influence in guiding it. However, the position of board member has different legal obligations from a board observer. Corporate investors should consider these differences in making the decision to request a board member rather than a board observer.

The legal obligations of a board observer to the portfolio corporation are entirely governed by contract and are much more controllable by the corporate investor *(see my article on board observer in CV 201)*. On the other hand, the duties of board members are controlled by the corporate law of the state of incorporation. Most technology corporations are incorporated in Delaware so we will focus on Delaware corporate law, but many other states use Delaware decisions as a reference in corporate law so this analysis has broad applicability.

A corporation's board of directors is responsible for managing and directing the business of the corporation. Each board member is bound by certain fiduciary duties under state law that obligate all board members to serve the best interests of the corporation and its stockholders. Courts have articulated these fiduciary duties (and legislatures have subsequently codified them into state corporate law) in order to regulate the extensive power of directors to influence corporate actions and to help ensure that the directors work to effectively serve the stockholders who own the corporation. Under Delaware corporate law, by serving on a board of directors, a director undertakes three broad fiduciary duties owed to the corporation's stockholders – (i) the duty of care, (ii) the duty of loyalty and (iii) the duty to act in good faith. The failure to meet these duties can result in personal liability for the director's actions as a board member, such as approving or failing to approve a transaction. However, under the "business judgment rule," a director's decisions, even if they prove unwise or unsuccessful, have strong protection from liability if the director acts in good faith, uses common sense and acts in a manner which the director reasonably believes is in the best interest of the stockholders.

Duty of care: The duty of care requires that a director use reasonable care in making decisions. To meet this duty, the board must focus on procedural as well as substantive issues. Procedural issues focus on (i) the completeness of the information provided, (ii) the time taken in reviewing such information and (iii) the opportunity to engage and question experts. Substantive issues focus on the actual decisions by the board and whether such decisions are (i) consistent with the advice received from its experts, (ii) within the normal range of such transaction within its industry and (iii) reasonable given the alternatives.

Duty of loyalty: The duty of loyalty requires that a director make decisions based on the best interests of the corporation, and not any personal interest. The duty of loyalty prohibits "self-dealing" by directors. Directors are required to have an absence of personal financial interest in the matters before them. A more common issue for directors employed by corporate investors is the requirement under the duty of loyalty that a director make a business opportunity related to the business of the corporation available to the portfolio corporation before the director may pursue the opportunity for the director's own account or for the account of another entity, including the corporate investor and that the director not use information provided at the board meeting to compete with the portfolio corporation.

Duty of good faith: The duty of good faith is the duty to act in a reasonable and deliberate manner and in the best interest of the corporation. The Delaware Supreme Court has stated that, "[t]he good faith required of a corporate fiduciary includes not simply the duties of care and loyalty, … but all actions required by a true faithfulness and devotion to the interests of the corporation and its stockholders."

BEST PRACTICES

The corporate investor who is considering requesting a board position rather than a board observer should take the following steps:

Conduct a due diligence review

The corporate investor should conduct a due diligence review of the portfolio corporation and its management to ensure that they have the procedures and advisors in place to manage corporate goverance effectively.

Ensure that the corporate investor designates an appropriate representative

The corporate investor should be careful to ensure that its prospective board member understands his duties and has the background and available time to discharge those duties.

Adopt sound practices to discharge duty of care

In order to comply with their duty of care to the portfolio corporation, employees of the corporate investor serving as directors of such corporation should take the following stesp: diligently review board materials; insist on careful and deliberate review and discussion of all important board actions; and avoid not only haste, but the appearance of haste, in making important decisions.

Adopt sound practices to discharge duty of loyalty

In order to comply with their duty of loyalty to the portfolio corporation, employees of the corporate investor serving as directors should ensure that proper procedures are in place within the corporate investor for the protection of the portfolio corporation's confidential information and communications and that these procedures are properly documented so as to be useful in the event of future litigation. And the corporate investors should have procedures in place to avoid the usurping "corporate opportunities" of the portfolio corporation.

The corporate investor can also take the additional measures in the advice box to protect its employee who serves as a director. Similar to board observers, the employee who is a Board members should be alert to potential conflict of interest situations involving the portfolio corporation and the corporate investor or other directors or their affiliates and should disclose such conflicts and recuse himself from the discussion and decision.

ADVICE BOX

Why choose to have a board member?

- Board member has a vote on all issues coming before the Board
- Board members generally have greater access to information from the portfolio corporation
- Board members generally have greater influence on the portfolio corporation

Tips for board members

- Ensure that the portfolio corporation has a broad indemnity provision in the certificate of incorporation
- Ensure that the portfolio corporation has waived damages and limited liability for breaches of fiduciary duties to the extent permitted by the relevant state law
- Ensure that the portfolio corporation has a waiver of the corporate opportunity doctrine in the certificate of incorporation if permitted by the relevant state law
- Have an individual indemnification contract with the portfolio company to supplement the indemnity in the certificate of incorporation and avoid termination of indemnity rights due to amendment of the certificate of incorporation
- Consider having the portfolio corporation obtain director and officers liability insurance (more appropriate for late stage corporation
- Consider having the corporate investor add the director to its liability policy as a "backup" to the portfolio corporation's indemnity (and have a clear agreement that the portfolio corporation's indemnity will be used prior to any use of this secondary insurance)

DLA Piper is a global law firm with offices across the Americas, Asia Pacific, Europe and the Middle East.

We have one of the largest corporate venture practices in the world which assist corporations in:

- investing in emerging growth companies (both directly and indirectly through venture funds);
- spinning out existing operations; and
- intellectual asset management.

From the quality of our legal advice and business insight to the efficiency of our legal teams, we believe that when it comes to the way we serve and interact with our clients, everything matters.

We have joined with Global Corporate Venturing, Silicon Valley Bank, Deloitte and Bell Mason Group to form the Corporate Venture and Innovation Initiative to assist global corporations in managing innovation, including designing and implementing corporate venture programs.

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