Corporate Venture Capital
Innovation Funding

Innovation Lab 2014
Table of contents

- Definition & Mission
- Global Market Analysis
- Seeding a future growth: Investment Goal
- Structure & Governance
- Portfolio Strategy: Investment Management
- CVC Models in a Snapshot & Case Analysis
- Italian Scenario
- Our proposal: Vertical Corporate Venture Capital
- Survey’s Process Results
- Back up
“CVC is defined as **equity investments** in small, young and privately held entrepreneurial companies by **established** corporations, usually motivated not only by financial goals, but mainly by **strategic** interests”.

*(our elaboration from Chesbrough and Tucci, 2002)*

**Open Innovation** is the use of purposive inflows and outflows of knowledge to accelerate internal innovation, and expand the markets for **external use of innovation**.

*(Chesbrough 2003)*

Corporate Venture Capital is part of the wider Open Innovation model, it speeds up corporate innovation processes through external innovation keeping control of its financial aspects.
USA is the main corporate venture capital market. Despite its numbers the European market is growing and present great investment opportunities.
Corporate Investment Goals: Strategic vs Financial

**Corporate Venture Capital, Seeking Innovation and Strategic Growth- NIST, 2008**

**Strategic objective**

**EMERGENT**
- Focus on **exit value** of ventures strictly related to Corporate core business
- **Long term goal**, possibility to: 
  - explore white-spaces
  - leverage underutilized technology
  - experiment new capabilities
  - develop back up technology

**DRIVING**
- Focus on achieving **impact strategy** through integration of ventures with the core business
- **Exploitation** innovation strategy, unable to produce disruptive innovation
- **Common benefits**: promoting standard, improve market share and technology efficiency

**CVC preferred objective**

- **EMERGENT**: 15% strategic, 15% more strategic than financial, 20% financial, 50% more financial than strategic

**Operational link**

**PASSIVE**
- Focus on **exit value** of ventures
- **Pro-cyclic** investments: “opportunistic” to positive economic cycle (Bull market)
- No immediately clear benefit for corporate BU Stakeholders

**ENABLING**
- Focus on core business market **proximity**
- **Exploration-exploitation** innovation strategy
- Develop **ecosystem network**
- Stimulate corporate demand by offering complementary products/services

"CVC Investments strictly depend on investor’s goal. The strategic focus is predominant in CVC investment. CVC literature evidences investments not only strictly linked with core business but also in cross sectors."
Corporate Venture Capital Models

CVC Model | Key Dimensions | Structure | Observations
---|---|---|---
Corporate/direct investments | Objective: **Strategic**  
Level of Innovation: **Exploitation**  
Risk of investment: **Low Risk** | Maintains control of all investment decisions. Receive all strategic returns. Risk of inefficiency due to the absence of professional VCs. | 
External Subsidiary Fund | Objective: **Primarily Strategic**  
Level of Innovation: **Exploitation & Exploration**  
Risk of investment: **High Risk** | Greater opportunity to discover new emerging businesses and technologies. Requires greater resources and commitment. | 
External independent Fund | Objective: **Primarily Financial**  
Level of Innovation: **Exploration**  
Risk of investment: **High Risk** | Greater opportunity for disruptive innovation. No investment decision-making power | 

The key is selecting the right model for the intended CVC goals. Three Key Dimensions should be considered: **Objective**, **Innovation** and **Risk** of Investment.
For the success of a CVC fund, a key aspect is to align the CVC goals with the reporting and the compensation’s system of the CVC Team.
CVC represents a link between investors in financial Markets and Investors in seed stage.

The CVC investment focus is expanding. Companies explore market adjacencies going beyond their core competencies.
CVC Supporting Services: Business Development Opportunity

There are many advantages to working with CVCs. They can offer funding as well as access to new customers, more advantageous supply chain relationships and skilled expertise in business areas required.

Compared to other forms of financing, CVC can help Start-ups to fill the strategic and operative gap.

Global corporate venture capital survey 2008-2009 - E&Y
### CVC Models in a Snapshot

#### CVC Strategic Model

<table>
<thead>
<tr>
<th>Structure</th>
<th>Internal dedicated fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Governance</td>
<td>Internal corporate resources</td>
</tr>
<tr>
<td>Compensation</td>
<td>Fixed + Bonus on Strategic KPI</td>
</tr>
<tr>
<td>Portfolio</td>
<td>Enabling/Driving investment&lt;br&gt;Focus on Expansion and Later Start-ups</td>
</tr>
<tr>
<td>Start-ups Support services</td>
<td>Based on Corporate Start-ups synergy</td>
</tr>
<tr>
<td>Success Measures</td>
<td>Measurements of direct strategic inputs</td>
</tr>
</tbody>
</table>

#### CVC Financial Model

<table>
<thead>
<tr>
<th>External Independent fund</th>
</tr>
</thead>
<tbody>
<tr>
<td>Experienced VCs and potential secondees from corporate</td>
</tr>
<tr>
<td>Fixed + Bonus on Financial KPI</td>
</tr>
<tr>
<td>Passive investments&lt;br&gt;Focus on Seed and Early Start-ups</td>
</tr>
<tr>
<td>Based on CVC fund competences</td>
</tr>
<tr>
<td>IRR, ROI</td>
</tr>
</tbody>
</table>
**Case Analysis 1**

**Corporate:** Johnson & Johnson  
*Year of foundation:* 1973

**Mission**  
"JJDC determines the success of an investment’s performance not only in financial returns, but also in the viability of providing strategic growth options for Johnson & Johnson."  
*Source:* Corporate Venture Capital Fund Profiles

**Structure and Investment models**

**Maximum Investment (MM):** € 4.16  
**N° of Companies currently in Portfolio:** 224

**Portfolio Strategy**  
With a specific focus on **Healthcare**

In particular  
**Medical Devices & Diagnostics**  
**Pharmaceuticals & Biotechnology**  
**Consumer Products**

*Source:* Corporate Venture Capital Fund Profiles

**Geographical Distribution**  
JJDC invests primarily in North America and Europe.

**Investment Stage**  
JJDC considers all the investment stages.

<table>
<thead>
<tr>
<th>Stage</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seed</td>
<td>4%</td>
</tr>
<tr>
<td>Early</td>
<td>17%</td>
</tr>
<tr>
<td>Expansion</td>
<td>20%</td>
</tr>
<tr>
<td>Later</td>
<td>37%</td>
</tr>
</tbody>
</table>

*Source:* Dow Jones
Case Analysis 2

**Corporate:** Google  
**Year of foundation:** 2009

**Mission**
«We look for entrepreneurs with a healthy disregard for the impossible. Our team is so diverse and so is our appetite for investing – we work with companies in virtually any sector and at any stage of the journey. We invest for financial return».

Source Corporate Venture Capital Fund Profiles

**Structure and Investment models**

**Total Assets Under Management:** $1.5 billion  
**N° of Companies currently in Portfolio:** 209

**Portfolio Strategy**
With a specific focus on IT, Mobile, Energy and Healthcare

In particular
**Medical Devices & Diagnostics**  
**Biopharmaceuticals & Biotechnology,**  
**Energy,**  
**Consumer Products, Media**

Source Corporate Venture Capital Fund Profiles

**Geographical Distribution**
Google invests primarily in North America, with particular focus in California.

Source Dow Jones

**Investment Stage**
Google considers all the investment stages.

<table>
<thead>
<tr>
<th>Stage</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seed</td>
<td>17%</td>
</tr>
<tr>
<td>Early</td>
<td>43%</td>
</tr>
<tr>
<td>Expansion</td>
<td>16%</td>
</tr>
<tr>
<td>Later</td>
<td>19%</td>
</tr>
</tbody>
</table>

Source Dow Jones
Our Proposal

Vertical Corporate Venture Capital
Italian Key Elements for CVC prospects

Few but important CVC players

Italian structural aspects

Media for Equity

Italian competitive market

VC & PE Attractiveness Index (OECD - 2014)
- 34th place

Corporate Investor: 20% of the investment (27% for social and green start-up) investment upper limit €1,800,000.

Individual Investor: 19% of the investment (25% for social and green start-up) investment upper limit €500,000.

Industrial overview
- 100 industrial districts
- SME's = 99,9%
- Large companies = 0,1%

Italian districts
- Fashion
- Automation
- Furniture
- Agroindustrial
- Other

Following the introduction of a Tax deduction on investments and due to its industrial structure, Italy would need a CVC model appropriate to its characteristics.
Our Proposal: Vertical Corporate Venture Capital

We propose to apply the **Vertical Corporate Venture Capital** as the best way to introduce this financial instrument and exploit the potentiality of the Italian production system that is based on industrial districts and many SME’s.

**Mission:** Develop a cross national and cross industry innovation network to speed up investor innovation process.

**Key aspects:**
- External Subsidiary fund
- Cross industry investments to exploit complementarities and synergy for the all the investors.
- Strong investors commitment for start-up Business Development.
- Corporate resources to fill start-up competence gap.
Investment Board and Strategic Committee are designed to balance investors' financial commitment and minor investor boardroom presence.

**AD Selection and Investment Approval.** Composed by CEO and CFO of fund partner companies.

**Strategical Valuation.** Composed by CTO, CIO and Business Developer of fund partner companies.

**Start-up Investment Selection and Negotiation.** Composed by External Professionals.

Flexible teams established *ad hoc* in order to help start-ups growing up according to their organizational and business needs. Composed by Partner Firms' competencies.

Our proposal: Vertical Corporate Venture Capital
Vertical CVC: Investment Decision Process

Scouting Team

Scouting

Screening
Evaluation of technology, business model, market and financials.

Due Diligence
Checklist to identify concrete business opportunity.

Negotiation of investment contract

Final Deal Evaluation
Strategic and technology evaluation of each deal.

Funding Approval
Investment board reviews each investment proposal and approves funding.

Start up’s Supporting Process
According to their organizational and business needs.

Final Exit

Our proposal: Vertical Corporate Venture Capital
Our proposal: Vertical Corporate Venture Capital
Vertical CVC: Investment Dimensions

Three relevant dimension to evaluate the investment portfolio:
- Target industries
- Investment Stage
- Investment Areas

<table>
<thead>
<tr>
<th>Investors in Automotive ecosystem</th>
<th>Example of adjacencies Interest sector</th>
<th>Innovation Area</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIAT</td>
<td>HealthCare</td>
<td>User comfort</td>
</tr>
<tr>
<td>SONY</td>
<td>TLC</td>
<td>Infotainment System</td>
</tr>
<tr>
<td>BOSCH</td>
<td>NanoTech</td>
<td>Automotive Network</td>
</tr>
<tr>
<td>VALEO</td>
<td>Material Science</td>
<td>Control Units</td>
</tr>
<tr>
<td>BREMBO</td>
<td></td>
<td>Contactless Locks</td>
</tr>
</tbody>
</table>

Investors in Vertical CVC will take advantage of technology developed in adjacency sectors.

Investment target industries

Investment stage
- Start-up technology/strategic value prevails over development stage in the investment decisions.

Investment areas
- Vertical CVC aims to develop a cross national industrial district.

Our proposal: Vertical Corporate Venture Capital
Vertical CVC: Compensation

Manager MBO is strictly aligned to fund main objectives by the right mix of performance indicators.

Our proposal: Vertical Corporate Venture Capital
Surveys’ Process Results

- Literature analysis.
- Preparation and dispatch of **2 surveys** for CVC and NO CVC companies in such sectors as **Utilities, Energy, Healthcare, Consumer, Financial, Industry, IT, Media, Service** and **Telco**.

Survey

- **The main 600 companies** performing CVC activity and the **100 Corporate venturing Executives** taken from the ‘Global CVC Powerlist 100’.
- **2500 European companies NOT** performing CVC activity taken from the ‘Amadeus’ database (Top 250 per sector for revenue).

Report

- Elaboration of results.
- Dispatch of a **CVC report** showing the relative positioning of the respondents compared to the average sample results.

Example of some respondents:
Thanks for your attention!
Appendix

Further deepening:

- Corporate Venture Capital Main Trends
- Main Reasons to do Corporate Venture Capital
- CVC Terms and Conditions
- CVC Final Acts
- Comparison of measures for investors and start-ups
- Italian laws and fiscal aspects
- Vertical CVC Terms & Conditions
Global CVC Investments Trend

- After the dot-com bubble in 2000, total investments stabilize over **25 billions $** a year.
- CVC investment represents about **8% of total investments** in Venture Capital.

- The average number of CVC deals is about 15% of VC ones.
Global CVC Investments: Sector & Geographic Region

- Biotech and software industry account for more than 50% of total CVC deals.

- Retailing/Distribution presents the **higher average investment** per deal.

- USA account for more than 65% of global CVC deals distribution.
Main reasons to do Corporate Venture Capital

### Strategic impact factors

<table>
<thead>
<tr>
<th>Factor</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Map emerging innovations and technical development</td>
<td>4.7</td>
</tr>
<tr>
<td>Window on new market opportunities</td>
<td>4.6</td>
</tr>
<tr>
<td>Import or enhance innovation within existing business units</td>
<td>4.2</td>
</tr>
<tr>
<td>Develop new products</td>
<td>3.9</td>
</tr>
<tr>
<td>Provide additional revenue growth opportunities for parent companies</td>
<td>3.8</td>
</tr>
<tr>
<td>Develop relationships with IVCs</td>
<td>3.7</td>
</tr>
<tr>
<td>Identify and establish partnership and joint ventures</td>
<td>3.7</td>
</tr>
<tr>
<td>Identify acquisition candidates</td>
<td>3.4</td>
</tr>
<tr>
<td>Leverage internal technological developments</td>
<td>3.2</td>
</tr>
</tbody>
</table>

Global Corporate Venture Capital survey 2008-09, E&Y

### Financial Goals

- **CVC activity**: 18%
- **CVC output**: 15%
- **Value-added contribution to business units**: 17%
- **Performance of individual investments**: 19%
- **Overall financial results**: 31%

Global Corporate Venture Capital survey 2008-09, E&Y

- The main CVC **strategic** aims deal with the increasing of company innovation level and discovering new market opportunities.
- The most agreed **financial** objective focuses on achieving overall financial results.
Benefits for Corporate investors

**Regular voting board seat**: 6%
- It allows the investor to influence Start-ups activity taking a full voting member seat on the board.

**Veto rights**: 9%
- It gives investor a lot of power because it has veto right over Start-ups initiatives.

**Direct co-investment options**: 9%
- Investor gets the option to invest directly in a start-up with a partner reducing his financial effort.

**Convertible preferred stock**: 39%
- It postpones the value of the investor’s equity simplifying the negotiation with Start-ups.

**Dilution protection**: 42%
- Investor gets the chance to be paid first in case of such events as liquidation or company sale.

**Liquidation preference**: 56%
- It allows investor to defend his share when other investors decide to finance the start-ups.

**Non-voting observer board seat**: 58%
- It’s a balance between the control of the Corporates and the start-ups’ freedom.

Global corporate venture capital survey 2008-2009- E&Y
CVC Final Acts

- **Trade sale** is the most common exit strategy in CVC.

- CVC average holding period is **significantly lower** than VC due to support provided with several services and extensive network.

- Average **CVC holding period is around 4 years.**
Comparison of best measures for investors and start-ups

Each country is characterized by a particular measure of success for investors and start-ups.

<table>
<thead>
<tr>
<th>Country</th>
<th>Public Funding</th>
<th>Co-funding in R&amp;D</th>
<th>Tax benefits</th>
<th>Exemptions from corporate legislation</th>
<th>Exemptions from labor law legislation</th>
<th>Territorial programs</th>
<th>Best practice</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>–</td>
<td>✓</td>
<td>Reduction of 50% of the cost for the patent application.</td>
</tr>
<tr>
<td>GERMANY</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>–</td>
<td>✓</td>
<td>High level of competitiveness of the taxation and particular benefits for companies.</td>
</tr>
<tr>
<td>ISRAEL</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>Governmental support of $300 million for hi-tech enterprises and R&amp;D.</td>
</tr>
<tr>
<td>CHINA</td>
<td>–</td>
<td>✓</td>
<td>–</td>
<td>✓</td>
<td>–</td>
<td>✓</td>
<td>Territorial program to attract investors in high-tech areas.</td>
</tr>
<tr>
<td>FRANCE</td>
<td>–</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>–</td>
<td>✓</td>
<td>Tax concession for start-ups covers up to 30% of all annual costs of R&amp;D.</td>
</tr>
<tr>
<td>ITALY</td>
<td>✓</td>
<td>–</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>–</td>
<td>Tax benefits in favor of investors and measures to encourage start-ups.</td>
</tr>
</tbody>
</table>

Innovative start-up requirements - Italy

The Decree Law, n. 179/2012 entitled "Further urgent measures for the growth of the Country", converted with amendments by Law n. 221/2012, introduced in the Italian legislative framework the definition and the specific requirements of innovative start-ups.

**List of requirements**

- Must not be listed and almost 51% controlled by individual shareholders.
- Must have been incorporated for no longer than 48 months.
- Must have reached total annual revenues of no more than €5 million;
- Must never have distributed dividends.
- Its statutory object primarily provides for the production and marketing of innovative products or services of high technological value.
- Must have not been formed by a merger, corporate split or as a result of the sale of the business or business unit.

**In addition, one of the following conditions must be met:**

- R&D must not be less than 20% of the higher value between cost and total revenues of the innovative start-up.
- No less than one third of the total labor force must be composed by employees or associates with a PhD or still attending a PhD course.
- The start-up must be the owner, the licensee or the user of an industrial patent.

Source: Art. 25 del D.L. n. 179/2012 converted in L. n. 221/2012.
Italian measures to encourage start-ups: Decreto Crescita 2.0

If the requirements are met, Innovative Start-Ups benefit the following measures:

- Low establishment costs and favoured system on losses.
- Regulations on fixed-term work more flexible than other firms.
- Management incentives: stock option and work for equity.
- Tax credit of 35% for permanent employment of highly qualified personnel.
- Free access to the ‘Fondo Centrale di Garanzia’ for the state guarantee (up to 80%) on bank lending without additional guarantees.
- Collection of risk capital through online portals (equity crowdfunding).
- Simplified procedures for liquidation and closure.

Source: Ministero dello Sviluppo economico (2013), “Per un’Italia sempre più a misura di startup: Stato di attuazione della policy a sostegno delle startup innovative a un anno del Decreto Crescita 2.0.”
Dilution Protection
It protects start-up’s owners avoiding equity reduction in case of external investor capital participation.

Direct co-investment option
It allows 2 or more industrial partners of the fund to invest together whether avoiding possible conflicts or giving more financial resources to the smallest partners.

Liquidation preference
It helps protect Corporates (even the Small and Medium ones) from losing money by making sure they get their initial investments back before other parties.

The 3 best terms and conditions to be applied to protect and benefit Corporate, especially the smaller ones, and Start-ups.

Our proposal: Vertical Corporate Venture Capital