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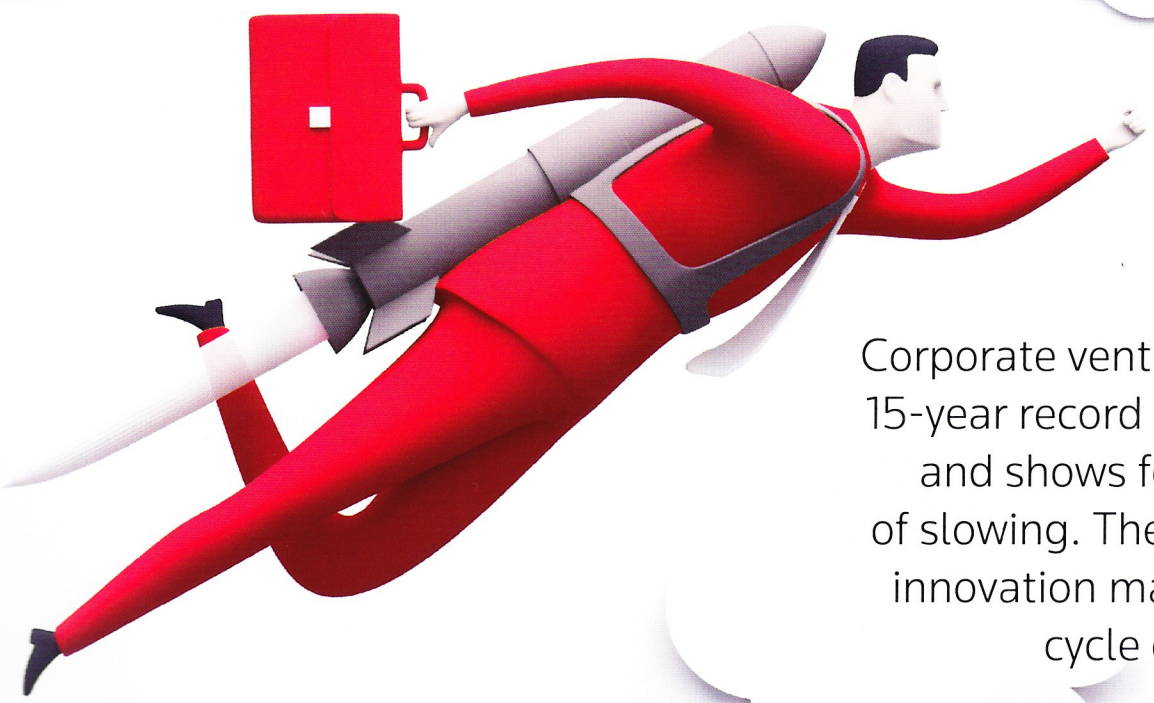

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Buyouts Insider

COVER STORY

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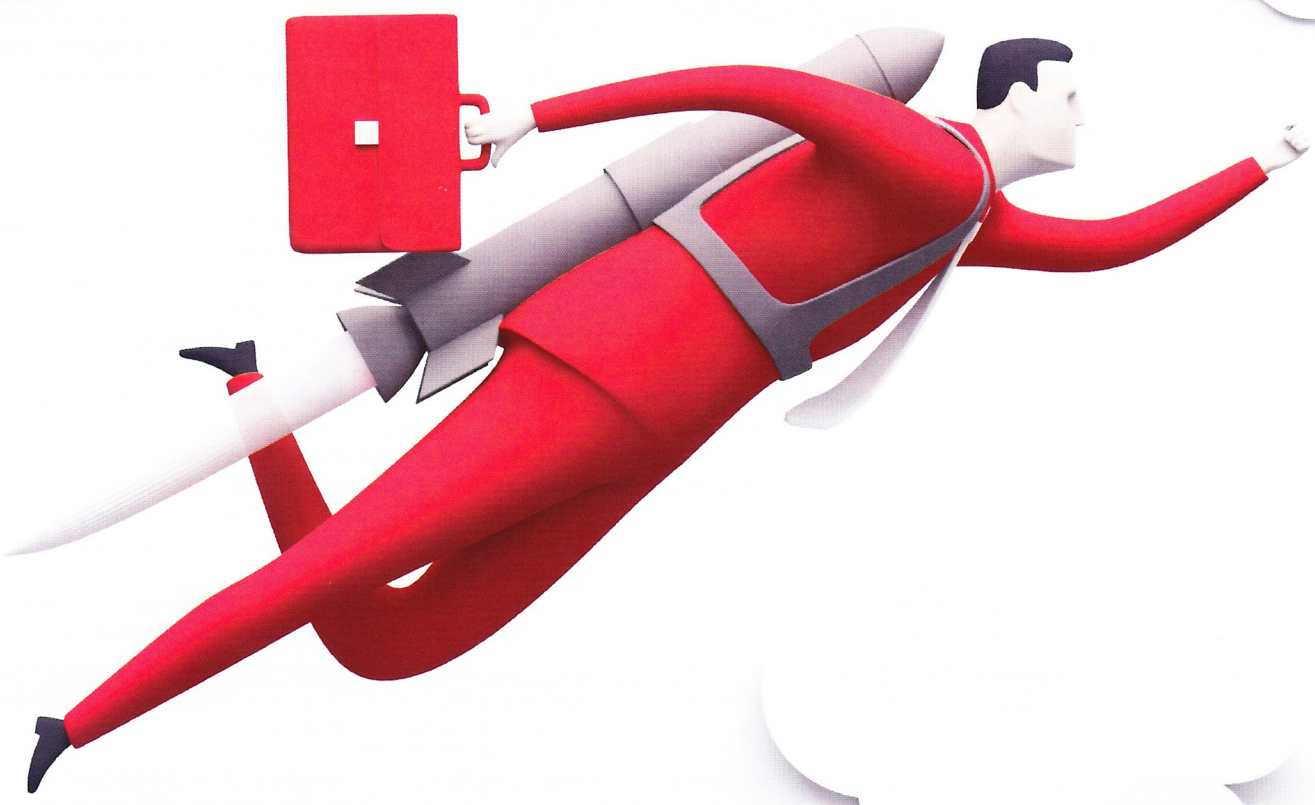

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Corporate venture set a 15-year record last year and shows few signs of slowing. The pace of innovation makes this cycle different

MARK BOSLET
SENIOR EDITOR

Fifteen years ago when **Webvan** and the **Pets.com** sock puppet were the talk of the venture business, corporate investors were at the height of their game.

In 2000 alone, they plowed a record $14.9 billion into U.S.-based startups, piling cash into an unequalled 24.2 percent of venture deals. We all know how that ended.

The good times are back. Last year, corporate investments rose to $7.6 billion, as investors put cash in 20.7 percent of deals, producing the strongest year since the dot-com bubble. This is up 37 percent from an already lofty 2014, according to the MoneyTree Report from the NVCA and PricewaterhouseCoopers, based on data from Thomson Reuters.

The big question is whether the enthusiasm will outlast the up cycle this time. Interviews with more than 15 VCs, corporate investors and market experts suggest there are strong reasons to believe it will. Investing may ebb and flow with the economic turmoil. But an awakening appears to have taken hold in the way corporations view startup innovation.

"Corporate venture is going to be too important a tool for it to go away," said **Mark Radcliffe**, a partner at the law firm **DLA Piper**. "It is here to stay."

Robert Ackerman

Opinions vary as to how strong the commitment will remain if the global economy stumbles badly in the next year or so. A deep downturn could, of course, bring a broad exodus. But few expect such a whole-scale retreat, especially if more benign conditions persist. A temporary plateauing is more likely, with the possibility of another record to follow as more programs come online.

The explanation is that startup innovation has become too threatening for corporations to ignore. With young companies transforming industries once thought immune from startup disruption—transportation and hospitality are two examples—corporate venture is drawing the attention of top execs.

Last year, 801 corporate venture units were active investors, an increase of almost a quarter from 2014, according to **Global Corporate Venturing**. New programs were born more than one a week.

In February, for instance, **JetBlue** launched **JetBlue Technology Ventures** to invest in, incubate and partner with startups at the intersection of technology and travel. And **Campbell Soup** announced the launch of **Acre Venture Partners**, a $125 million venture fund to back food tech startups.

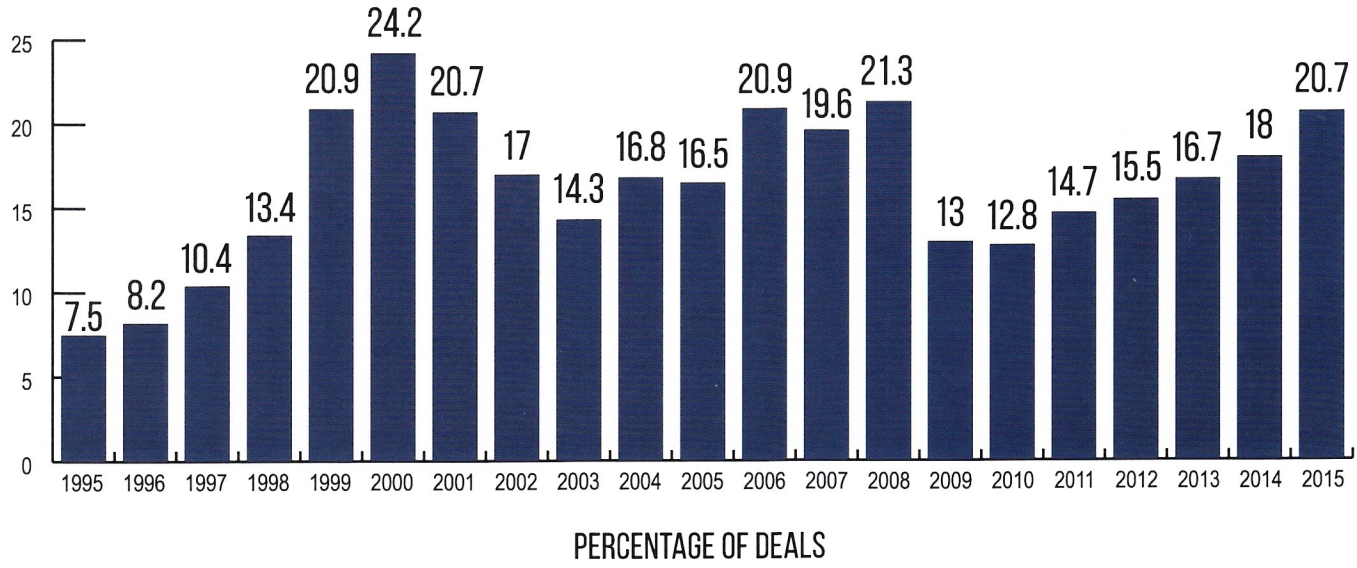
Twitter and **Workday** also opened the doors of their venture units in 2015.

Long-time investors aren't sitting back either. **Intel Capital** put $514 million to work last year, ahead of its $300 million to $500 million annual target. **Qualcomm** deployed about $200 million as it expanded efforts around the world in recent years.

"I think there's a higher general awareness," said **Jeff Grabow**, west venture capital leader at **Ernst & Young**. "I'm getting a lot of inbound requests to meet with corporate VCs and do portfolio evaluations."

Many corporates feel they can't afford to be blindsided, but their motivation is

Percentage of U.S. deals with corporate participation



Source: MoneyTree Report from National Venture Capital Association and PricewaterhouseCoopers, based on Thomson Reuters data.

COVER STORY

A new approach to innovation

In February, Spanish bank **BBVA** took a step that says a lot about the current up swing in corporate venture investing.

The bank spun out its internal investment unit into an independent firm called **Propel Venture Partners**, with a $250 million fund to enhance its long-term viability and BBVA's nearly 5-year-old portfolio.

With the assets came a broadened mandate to back fintech companies in the United States and Europe not just with later and expansion-stage rounds, but earlier ones now that the bank freed itself from regulatory 5 percent ownership restrictions.

So what does this say about the maturity of corporate venture programs? A great deal, actually. Maturity varies from program to program, but overall the trend is clear. Corporations are rethinking their strategies for the startup ecosystem with new determination and know how. This includes giving units more independence, hiring seasoned veterans from the ranks of financial venture capitalists, more readily joining follow-on rounds and employing new tools, such as incubators.

Sustainability won't be tested until the next downturn, but so far this cycle looks different.

"Now corporations are doing venture for the right reasons, most of the time," said Propel Partner **Thomas Whiteaker**. "They have woken up to the fact that they can't stop innovating and they can't keep up with the pace of external innovation."

BBVA's new interest and prowess for venture is not an isolated case. **Citigroup**'s venture unit not just survived a change in the bank's leadership, a positive sign of longevity, but stopped talking a couple years ago about innovation and started talking about growth, said **Citi Ventures** CEO **Deborah Hopkins** recently at the GCVI Summit.

"Innovation not at scale is nothing but a hobby," she said. "The interest and demand for what we do has gone up so much."

In February, **Lewis & Clark Ventures** welcomed a corporate backer for the first time into its new $104 million fund, offering **Express Scripts** a window into its early-stage investing. And when **Index Ventures** split off its healthcare operations into **Medicxi Ventures**, the new firm held onto **Johnson & Johnson** and **GlaxoSmithKline** as LPs.

At **Intel Capital**, one of the longest running corporate programs, new President **Wendell Brooks** identified tuning his operations as one of his first tasks. He vowed to speed decision-making, lead more deals and increase the focus on bringing added value to portfolio companies. The new goal is to lead between 50 percent and 60 percent of deals, compared with about 40 percent in the past, and to take more board seats.

"I think we can learn more when we do that," Brooks said recently.

At nearly the same time, the organization took a step back in a different area, showing that maturity is not always a straight line forward. Intel Capital eliminated shortly before Brooks arrived a carry-like compensation scheme that rewarded partners for the profitability of their deals. The scheme attempted to help close the pay gap with financial VCs and provide an extra incentive for investors to shepherd their deals. Its elimination helped push several partners to depart.

In interviews with more than 15 corporate and financial VCs and market experts, the raft of new corporate priorities toward venture seems real and significant this time. And it has already begun to impact the structure of corporate venture, as a recent study from **J. Thelander Consulting** points out. The work found a steady uptick in organizations operating as separate, independent entities and a small corresponding reduction in those obtaining funds on a deal-by-deal basis. Now 16 percent of units are separate entities.

Today "corporate venture is a very highly regarded professional skill inside corporations," said **Claudia Fan Munce**, now a venture advisor at **New Enterprise Associates** and a former managing director at **IBM**'s venture capital group. "There is a career path" that wasn't there that many years ago.

This has brought more seasoned staff into programs. Two key examples are the additions of **Sue Siegel** at **GE Ventures** and **Jim Lussier** at **Dell Ventures**.

The picture also looks brighter on syndicate participation. Corporates seem more willing to back follow-on rounds.

They can't just turn off their participation the way they did in 2001, said **Paul Straub**, a director at **Claremont Creek Ventures**. They need the innovation.

"Frequently we're seeing groups that understand how venture capital works and, if things go as you hope, probably will be in future rounds," Straub said. "You just have to have the conversation upfront."

This is not to say every hurdle has been cleared. Over the years, the rap against corporate VC programs has been that they are slow, as many programs still can't decide quickly enough to make a deal's first close, and that their money has two masters: the good of the portfolio company and the goals of the corporation.

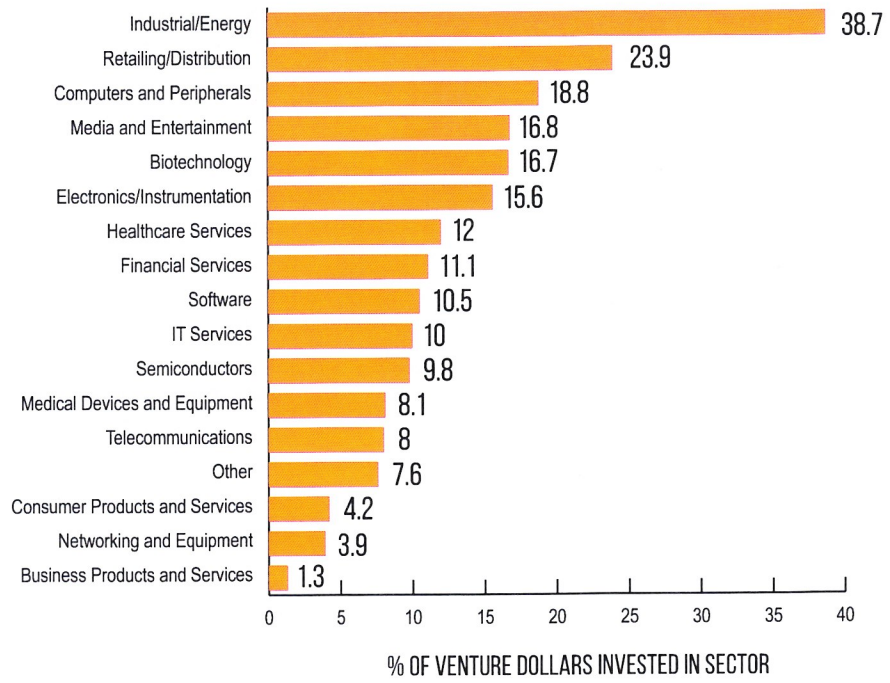
The perception is reinforced in many instances when corporates take cash off the balance sheet to fund deals and fail to link it to an individual investor's bonus, or benchmark it with IRR-like returns. This creates the concern that corporate motives aren't entirely aligned with the rest of the syndicate.

Longevity is another issue. Financial VCs still have a bad taste in their mouths from the dotcom collapse, when numerous corporate programs closed up and startups were left without backers and board meetings went unattended.

The reality is that maturity and sustainability go hand in hand, said **Robert Ackerman**, a managing director at **Allegis Capital**. Venture is a relationship business and corporate programs have learned they can't swap out staff every couple years and expect the relationships to continue.

"Corporations are getting better at understanding they can't be just point investors," writing one check and then backing away, Ackerman said. "I view all that as a sign of maturity." *–Mark Boslet*

Percentage of corporate involvement in U.S. deals by sector (2015)



Source: MoneyTree Report from National Venture Capital Association and PricewaterhouseCoopers, based on Thomson Reuters data.

Corporate dollars in U.S. venture deals

Year	CVC investments ($M)	% of dollars in deals from CVCs
1995	$433.2	5.4
1996	$672.4	6
1997	$942.6	6.3
1998	$1,742.7	8.1
1999	$7,418.5	13.5
2000	$14,873.2	14.2
2001	$4,525.3	11.1
2002	$1,941.3	8.7
2003	$1,290.7	6.6
2004	$1,524.8	6.7
2005	$1,430.6	6.2
2006	$2,675.1	9.6
2007	$2,662.0	8.3
2008	$2,729.4	9
2009	$1,374.9	6.8
2010	$1,849.1	7.9
2011	$2,367.1	7.9
2012	$2,297.5	8.3
2013	$3,162.0	10.4
2014	$5,523.2	10.9
2015	$7,580.7	12.9

Source: MoneyTree Report from National Venture Capital Association and PricewaterhouseCoopers, based on Thomson Reuters data.

offensive, as well. Executives see an opportunity to mine the ecosystem in Silicon Valley and elsewhere for products and services that could change their businesses. Many feel at a disadvantage. While the costs of starting young companies have fallen, costs of innovation at large companies have not.

"There is genuinely a lot more concern about innovation in the C suite than ever before," said **Gerald Brady**, a managing director at **Silicon Valley Bank**'s venture capital group. "I genuinely don't believe the corporates are going away."

Last year's corporate participation rate seems to bolster this claim.

In 2015, corporates supplied venture with 12.9 percent of dollars invested in the United States, the highest percentage since 2000 and the fourth consecutive year of an increase, according to the MoneyTree Report. In retailing, the percentage was 23.9 percent; in biotechnology, 16.7 percent; in computers, 18.8 percent; and in energy, a gargantuan 38.7 percent.

In recent years that participation rate has shown greater stable than in the past. After the 2000 peak, corporate cash as a percentage of venture investing fell 56 percent before bottoming out in 2005. The fall from peak to trough after the 2008 recession was a more modest 24 percent, and it rebounded after one year. A change appears to have taken place in the corporate mindset.

That's not to say there won't be periods of correction, said **Robert Ackerman**, a managing director at **Allegis Capital**. If a downturn gets deep and protracted, big cuts will likely come.

But when they ask themselves during darker times why they are involved, "there will be much better answers to the question," Ackerman said. "I think that will help some of them stay the course. They are not going to pull back whole-scale, like in the past."

Part of this can be explained by improving financial discipline. In the past, programs were driven by strategic more than financial returns. A more equal balance appears in place now.

"There is a lot more savvy about how to achieve financial return," said **John Riggs**, a senior managing director at PricewaterhouseCoopers. "I find clients who are absolutely eager to learn. We hold the potential for breaking the cycle."