Racing to Innovate, Corporations Embrace Venture Capital

An inside look from VentureWire at high tech start-ups and their investors

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With Traditional R&D Yielding Diminishing Returns, a Growing Number of Companies Are Turning to Venturing for Game-Changing Ideas As Well As Financial Gains, According to a New Report by The Boston Consulting Group

BOSTON, October 31, 2012—Corporate venture capital (CVC) investing is back in style, and this time it's here to stay. A host of new industries are rushing to join the game, and CVC veterans and newcomers alike are forming cross-industry networks to fund promising start-ups, according to a new report by The Boston Consulting Group (BCG). The report, Corporate Venture Capital: Avoid the Risk, Miss the Rewards, is being released today.

Corporate venture activity has accelerated in recent years, the report says. Once almost exclusively the stronghold of innovation-intensive industries such as technology, pharmaceutical, telecommunications, and media and publishing, CVC is being embraced by industries that once shunned the activity. Senior executives in several industries have told BCG that they regard venturing as an indispensable tool for innovation and development—an assertion borne out by comparing their internal R&D spending with their venture investing. Across the board, corporate R&D spending as a percentage of sales is declining even as companies intensify their venture activities.

"Venture investing is, of course, an inherently risky activity," said Alexander Roos, a BCG partner and coauthor of the report. "But considering the disruptive potential of the innovations emerging from start-ups, the greater risk is not to invest at all."

Since the 1960s, CVC has cycled through three distinct boom-and-bust periods, with the bust coming each time as a result of financial-market or macroeconomic downturns. Now a fourth growth phase is under way, leading some observers to suggest that history is repeating itself. BCG argues otherwise, citing compelling evidence that CVC, once an experiment, has entered a new, more mature phase. Not only are new industries entering the arena, but the life spans of corporate venture units have increased steadily in the past ten years. For example, the length of time that CVC units in the pharmaceutical industry have been in continuous existence increased by 50 percent from 2002 to 2012, while the average lifetime of consumer industry CVC units has lengthened to 4.9 years in 2012 from 1.5 in 2002.

What's more, corporate venture investing has spread geographically beyond the U.S. and Europe to vibrant, fast-growing emerging markets. In the first half of 2012, for example, the dollar value of consumer industry venture investments in China rose 18 percentage points, to 63 percent, from the second half of 2010, while U.S.-focused investments shrank by 14 percentage points, to 20 percent.

The report takes a comprehensive view of the CVC landscape, analyzing the industries and companies engaging in venture investing as well as the industries and regions where they are focusing their capital.

New Players Are Joining the Game

Today, more than 750 corporations around the world have CVC units in operation, according to the report, citing the definitive database of Global Corporate Venturing, a leading industry publication. Between July 2010 and June 2012, these corporations engaged in more than 1,300 transactions. Analysis of the data reveals that corporations and industries with a long history of venturing are stepping up their presence in the field, while sectors that went largely unrepresented in earlier decades are also entering the arena. To gain a sense of the evolution of corporate venturing, BCG compared the venturing activities of four of the traditional industries (technology, pharmaceutical, telecommunications, and media and publishing) with those of four relative newcomers (machinery, power and gas production, consumer, and construction).

The Pressure to Innovate Is Fueling the Surge

The comparison shows that venture investing is taking root across a broad range of industries. Within the traditional sectors, the percentage of the 30 largest companies with dedicated CVC units has been climbing steadily since at least 2007. In three of four sectors (pharmaceutical, telecommunications, and technology) more than half of the 30 largest companies have such units in place—a sign of the growing recognition of CVC's value as a tool for innovation, corporate development, and competitive advantage.

The same pattern holds, on a smaller scale, in those industries that have traditionally been less reliant on pure innovation to drive growth. "In recent years, these industries have come under growing pressure to innovate in response to demands for cleaner technology, more sustainable operations, and an improved user experience," said Dinesh Khanna, a BCG partner and coauthor of the report. "As a result, they are looking past internal R&D toward other innovation channels." Starting from a very low level, CVC concentration in all four newcomer industries in the comparison increased markedly from 2007 to 2012.

The Search for Disruptive Technologies Is On

As CVC expands beyond its traditional strongholds, the investment focus is widening as well. Corporate investors are looking beyond their core businesses toward sectors such as clean technology, which has the potential to disrupt industries ranging from power generation to building materials to transportation. Industrial companies, for example, are spreading their investments widely but maintaining a focus on related sectors; they invested in clean technology (the target of more than half of industrial CVC investment), information technology, health care, and transportation. CVC units in the chemical sector, meanwhile, diversified away from the core toward targets in the clean technology, health care, and industrial sectors, where they are seeking, for example, to exploit the potential for biochemical processes to supplant petrochemical ones. Overall, the most popular investment targets, measured by total number of transactions, were in IT, health care, media and publishing, and clean technology.

In addition to seeking opportunities outside their industry, corporate investors are deploying their capital outside the U.S. The data reveal that while the geographical investment focus varies widely by industry, corporate investors in most sectors are, in one fashion or another, directing much of their capital toward emerging markets. CVC investors are also increasingly willing to co-invest with other companies.

One of the most active networkers is General Electric. In clean technology, for example, GE is partnering with 14 different corporate investors, 8 of them representing five other industries. It is connected with Google through the two companies' investments in CoolPlanetBioFuels, for instance.

The Old Rules Still Apply

The most successful CVC units are guided by distinct ground rules that dictate how those units define both their operating principles and their strategy, how knowledge is captured and transferred, how corporate assets are leveraged, and how venturing teams are staffed:

Operating Principles. Leading CVC units have clearly defined investing parameters. Corporate leadership has committed to venturing for the long term, with the understanding that venture investors, by definition, take risks and that the occasional failure is the cost of doing business.

Strategy. Befitting their key role in the innovation management effort, successful CVC units are tightly aligned with their corporate parents' overall business and innovation strategies.

Knowledge Transfer. Companies with high-performing venture units often designate specific business units to serve as "guardians" of individual investment targets. "The guardians are responsible for ensuring that the knowledge gathered from target investments feeds directly and reliably into the larger corporation-wide innovation pipeline," said Michael Brigl, a BCG principal and coauthor of the report.

Leverage of Existing Assets. Successful CVC units also make the most of their corporate resources. Some corporations, for example, give researchers from target companies access to their laboratories, while others contribute manufacturing expertise, offer broader distribution of the target company's products, or provide administrative support for patent applications.

Staffing. Finally, proven venturing performers pay close attention to staffing issues, choosing team leaders who combine broad familiarity with the VC landscape with deep understanding of the corporation's strategy and processes. hanged. BCG