Corporate Venturing and Innovation:
Driving Growth and New Business Development

01/2021-6651-U

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Introduction

This class note introduces Corporate Venturing Activities (CVA), a range of activities that established firms pursue in order to drive innovation and new business development within their organizations. The rationale for engaging in CVA includes a mix of strategic and financial metrics, and involves participating in entrepreneurial ecosystems, developing closer relationships with start-ups, and developing insights into emerging technological innovations. To engage in CVA, corporations take on a range of actions, including sourcing suitable start-ups, investing in early-stage companies, and nurturing and scaling nascent business ideas. The ultimate goal is generally to capture value for the parent company by leveraging innovative solutions for the parent’s core business, acquiring the new company, or selling the acquired equity stake.

Proponents claim that corporate venturing activities operate as vehicles for strategic renewal, and can import “disruptive technologies” and new business models into established corporations. These activities increase innovation rates by providing “windows” into new emerging technologies, allowing firms to tap into innovative ideas internally and externally. Some characterize corporate venture capital activities as complements to corporate research and development (“R&D”), while others suggest that CVA can even replace in-house R&D—in effect, outsourcing it to start-ups.¹

Corporates have become a prominent fixture in the early-stage investment landscape. An example of CVA is the Corporate Venture Capital vehicles (CVCs) of established corporations, which often play a vital role in funding and enabling start-ups and scale-ups. SoftBank Group Corp, Intel Capital, Mubadala Investment Company, Google Ventures, and Naspers Ltd top the list of the most prolific corporate players over the last 30 years. While high-tech corporations are some of the most active investors, Corporate Venturing Activities are undertaken by corporations across all industries, regardless of whether their core focus is high-tech or not.

Corporate Venturing Activities

From the parent company’s point of view, all Corporate Venturing Activities (CVA) are undertaken to augment in-house R&D, expand the parent company’s awareness of innovations and industry trends, gain insights that reduce potential threats to its core business, and build new businesses.

Corporate venturing is typically conducted through a distinct organizational entity to capture ideas generated either internally or externally, and to subsequently turn these into commercial entities that are useful for the parent company through acquisitions, spinoffs or IPOs.

We explore several distinct types of Corporate Venturing Activities (CVA):

1. **Corporate Venture Capital Unit (CVC):** Corporate Venture Capital Units are distinct organizational entities designed to make external equity investments in a portfolio of high-potential start-ups.

2. **Corporate Venture Builder (CVB):** Corporate venture builders are organizations that create new companies by combining their in-house opportunity identification and development methodologies with externally sourced entrepreneurial talent to leverage corporate assets and resources. They are holding companies that own all of the equity in the various corporate entities they create.

3. **Venture Client Model:** A venture client model is a specific type of strategic partnership and a highly integrated tool that corporations can use to purchase the first unit of a start-up’s product, service or technology when the start-up is not yet mature enough to become a client.

4. **Corporate Incubator / Accelerator:** Corporate Incubators are specialized units that hatch new businesses by providing resources and support. Such units can source ideas from the firm’s existing employees who might be interested in creating start-ups to solve specific problems faced by the company's business units, and as such provide a single contact point to guide the interactions of co-innovating start-ups with the other divisions of the corporation. Related to this are Corporate Accelerators, which offer highly structured, fixed-term, cohort-based programs that typically last no more than three months. These programs are usually run by large enterprises and provide start-ups with the facilities, resources, and expertise needed to speed their product development and time to market.

**Corporate Venture Capital Unit**

Corporate Venture Capital Units are distinct organizational entities designed to invest capital from the corporate parent into external start-up companies in return for a minority equity stake. The size of the ownership stake varies widely and may depend on the investment amount, the stage of the start-up, the likelihood of follow-on investments, and other market conditions. CVCs are becoming a larger part of the venture capital landscape, with 1 in 4 VC deals including a corporate investor as of Q3 2020.²

CVCs generally co-invest with independent venture capitalists (IVCs), may not be the lead investor in many cases, and generally invest during later funding rounds once the start-up is more established. Unlike IVCs, CVCs often do not take on a board seat, instead retaining board observer rights. At the same time, CVCs engage in many of the same activities as IVCs, including deal sourcing, due diligence, adding value to the investment through ongoing working relationships with the entrepreneur, and exiting their investment stake.³ As a

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minority investor, corporations have limited control over the start-up’s operations, product development, and decision making.

Although every CVC has a distinct mandate (i.e., investment objective and KPIs), they usually strive to balance both strategic and financial objectives. Strategic objectives include early exposure to disruptive technologies, access to new markets and business models, and the identification of prospective targets for acquisition. Strategic objectives aim to leverage synergies between the new venture and the corporate parent in order to benefit both. Financial objectives target returns, which may or may not be in line with those achieved by IVCs. Given their mix of strategic and financial objectives, CVCs may have different time horizons as compared to IVCs with respect to exit as well as different financial returns expectations.

**Corporate Venture Builder**

Corporate Venture Builders (CVB) — also called tech studios, start-up factories, or venture production studios — are organizations that build new companies by combining their in-house opportunity identification and development methodologies with externally sourced entrepreneurial talent to leverage corporate assets and resources. Corporate venture builders’ partnership with large corporations is essential for this model to work.

Corporate Venture Builders do not invest financial capital into external start-ups the way venture capitalists or corporate venture capitalists do. Rather, CVBs mandate is to build ventures with and for large corporations by managing the entire building process, from ideation, to designing a potential validated solution, to building a venture around the validated solution — that results in ventures that are ready for a Series A investment event. CVBs usually follow a stage-gated approach that involves (usually) smaller investments that are committed based on projects hitting milestones. In this model, ventures are built ground-up from ideas - in contrast with accelerators and incubators that bring in external early-stage businesses.

Because CVBs are a new form of organization that is still evolving, there are no exemplars of the “typical” CVB. Some CVBs focus more on the ideation aspect while others focus on the solution design / build aspect and so forth. Correspondingly, some CVBs do these activities on their balance sheet while others roll them up into the corporate partner’s balance sheet. Compared to corporate venture capital units, CVBs tend to be more operational and hands-on. They employ staff resources, host internal coding bootcamps, design business models, work with legal teams, build MVPs (minimum viable products) and so forth.  

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**Venture Client Model**

The venture client model is a specific type of strategic partnership, and a tool used by corporations to purchase the first unit of a start-up’s product, service or technology. The product may not yet be sufficiently mature to satisfy the requirements of the corporate parent for a traditional client relationship. In this way, corporations are able to build relationships with the entrepreneur, influence the product development, and “lock in” future collaborations at an early stage.

Corporations help start-ups grow by giving them their first backing and granting them supplier status, a purchase order and revenue. Start-ups invoice the host company for their technology, products and services, but the corporation does not invest in the start-ups and takes no portion of their equity.

Venture client teams are typically run by the corporation with the help of skilled specialists. In contrast with venture capital, venture client divisions purchase the first unit of a start-up’s product, service or technology, but not its equity. Unlike accelerators, there are no shared spaces for the relationship with entrepreneurs. Following a very lean start-up approach, start-ups develop their projects independently and visit the company only to carry out the order with engineers and innovation managers. Start-ups work directly with corporate’s engineers and managers on real innovation projects during a variable period of time of at least three months.

**Corporate Incubator / Accelerator**

Corporate incubators are specialized corporate units that hatch new businesses by providing physical resources and support. This includes mentoring and value-added services to support entrepreneurs building viable, market-ready ideas. The typical incubation period ranges from 18 to 24 months with an average investment of $500,000.

Internal innovation units are a form of an internal corporate incubator. Internal innovation units have a high strategic emphasis on sourcing appropriate ideas from the firm’s existing employees who might be interested in creating start-ups to solve specific problems faced by the company’s business units. There is less emphasis on financing start-ups in the traditional sense of taking minority equity stakes as the company is able to choose between many different ideas to see which ones are the most viable. There is, however, a strong emphasis on nurturing innovative ideas into commercial products as the company often directs considerable resources towards start-ups.

According to a paper by the World Economic Forum, internal innovation units may oversee a co-developed innovation prototype and facilitate its technical integration into the broader

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company. The unit also serves as “a single contact point to guide the interactions of co-innovating start-ups with all other divisions of the corporation”. Internal innovation units may also pull in other resources to assist the start-ups under their wing, such as intelligence from the corporation’s venture operations, and technology-based industry events and fairs.

Corporate accelerators offer highly structured, fixed-term, cohort-based programs that typically last no more than three months. These programs are usually run by large enterprises and provide start-ups with the facilities, resources, and expertise needed to speed up their product development and time to market. The program usually ends in a formal pitch event or “demo day” where the start-ups pitch the corporate sponsor for further investment.

Incubators and accelerators differ in terms of their start-up development stage: incubators bring in entrepreneurs who frequently have only ideas and lack an existing business, while an accelerator works with start-ups that are ready to enter the market, scale or attract investors. Corporations can use incubators and accelerators to identify interesting start-ups to engage with and develop new growth opportunities for the parent company by developing small teams capable of operating in a more flexible and unbureaucratic environment.

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Appendix 1

CVA Models: Execution Approach

There are four key dimensions that define the execution approach of the four CV models:

- **Internal or External to Parent-Co**: In internal venturing, the parent company uses internal ideas and resources to establish a new business, while external start-ups begin and remain outside the parent company.

- **Stage of Development**: Corporate venturing models also engage with start-ups during different stages of development, from idea generation to Series A and beyond.

- **Financial Investment**: The mode of investment in start-ups may also take different forms, from taking minority equity stakes to receiving program fees.

- **Timeframe of Parent-Co’s Involvement**: Different corporate venturing models also allow corporates to engage with start-ups for different time frames, from a short 3-month interaction to longer term relationships from idea generation to exit.

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<td><strong>Execution Approach</strong></td>
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Appendix 2
Historical CVC Data

Exhibit 2: Global CVC activity, 2014 - 2019

Source: CB Insights, CVC Report 2019

Exhibit 3: New CVC firms investing for the first time, 2014-2019

Source: CB Insights, CVC Report 2019
Exhibit 4: Deals with CVC participation as proportion of overall US VC deals

* As of September 30, 2020
Source: 3Q 2020 Pitchbook NVCA Venture Monitor

Exhibit 5: Annual global CVC-backed deal share by continent, 2014 - 2019

Exhibit 6: Top Challenges faced by CVC Units - 500 Startups 2019 Survey

Source: Unlocking Corporate Venture Capital, 500 Startups, October 2019