Corporate Venture Capital

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Key Program Objectives

- Define “Corporate Venture Capital” (“CVC”)
- Identify ideal role of in-house lawyers at companies contemplating or deploying CVC programs
- Impart understanding of key stages of CVC design and execution
- Describe critical organizational shifts necessary for successful CVC program
- Review basic CVC term sheet mechanics
- Share key takeaways

What Is Corporate Venture Capital?

- Corporate venture capital has been around for decades, but market factors are spurring increased interest and activity among large corporates
  - Reality of current corporate landscape is fueling increased focus on innovation
    - Large corporates and entire industries are facing competition and even obsolescence in the face of disruptors (think Uber, Airbnb, Netflix, Tesla, Dropbox, WhatApp and more)
    - Pressure for large corporates to innovate, understand and participate in the startup ecosystem

What is Corporate Venture Capital? (con’t)

- Typically, CVCs make investments into privately-held companies to achieve one or more specific objectives
  - Objectives may include:
    - Achievement of financial returns
    - Development of corporation’s technology ecosystem
    - Formation of commercial partnerships
    - Attainment of strategic or marketplace goals
    - Acquisition of target technology or target corporation

What is Corporate Venture Capital? (con’t)

- But, CVC is a broad term that encompasses a range of investment theses and motivations
  - All about staying on top of innovation and competing effectively in the marketplace
  - Goal is to take small bets and create a portfolio of new ventures
- CVCs disrupt “from the inside out” by incubating home-grown ideas and innovations that emanate from within the mothership or “from the outside in” by investing in existing startups outside the mothership

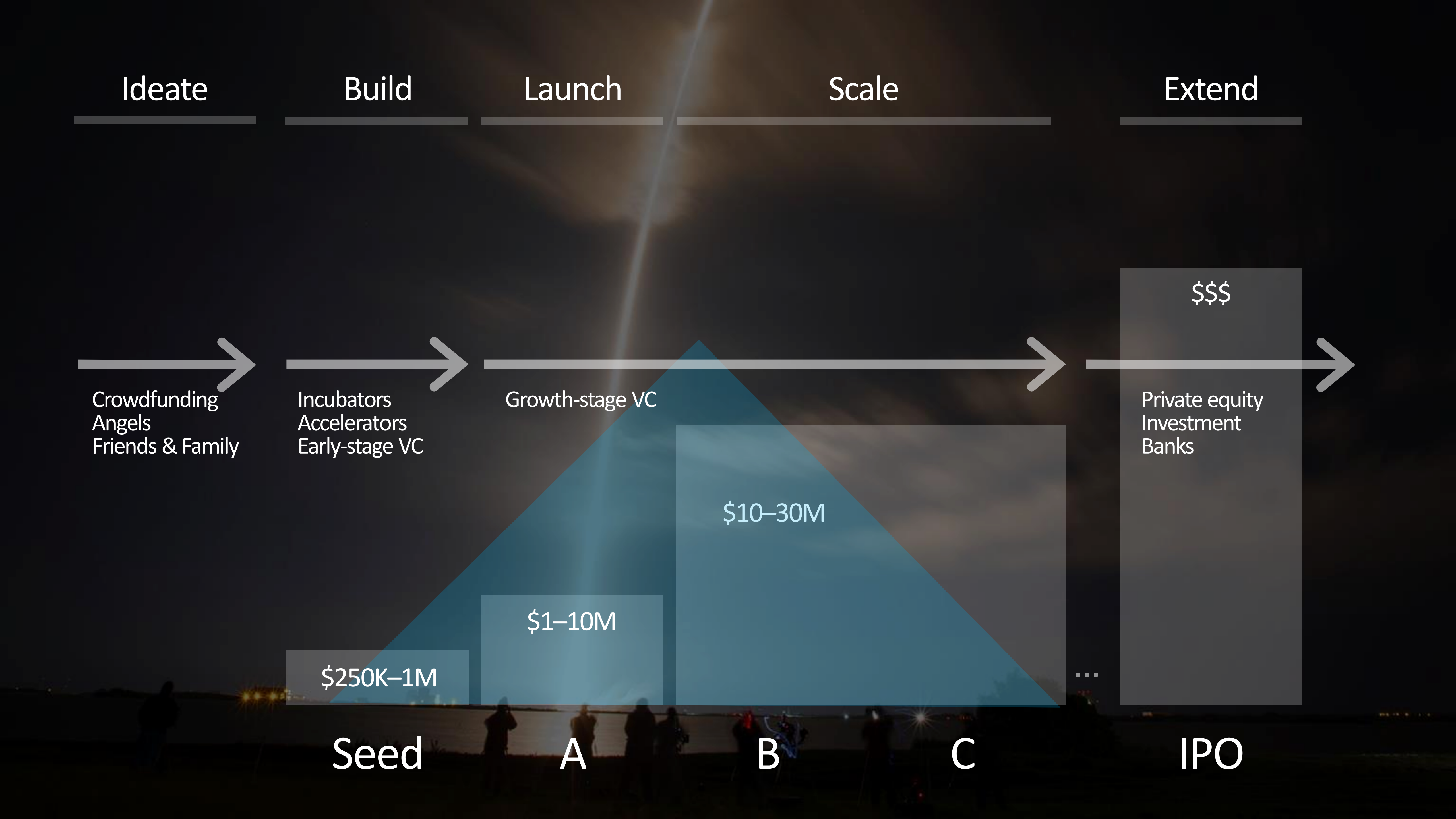
The Two Stages of Forming a CVC Unit

1. Design – Key question to answer is “Why”?

– Mothership should articulate objective(s) of CVC and identify what it brings to the table
  - It isn’t all about how much money the CVC can invest
  - Mothership provides startups with other unique benefits as an investor, such as
    - Market knowledge
    - Access to customers
    - Brand validation

– Development of a mission statement helps mothership frame particular challenges the CVC is designed to address

– CVC should decide at what stage it is going to invest in the venture ecosystem
  - Investment timing and size should correlate with articulated objectives


Ideate
Build
Launch
Scale
Extend
Crowdfunding
Angels
Friends & Family
Incubators
Accelerators
Early-stage VC
Growth-stage VC
$$$
Private equity
Investment
Banks
$10–30M
$1–10M
$250K–1M
...
Seed
A
B
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IPO

The Two Stages of Forming a CVC Unit (con’t)

- CVC “best practices” include
  - Determining key components of corporate venture strategy
  - Building message regarding value add as strategic investor and partner
  - Developing internal communications plan
  - Agreeing upon relevant performance metrics
  - Understanding and determining alternatives for legal structure and governance
  - Building fund/no fund guidelines/criteria
  - Defining internal processes
  - Establishing investment board
  - Creating organizational chart, mapping key constituents and lines of communications and approvals

The Two Stages of Forming a CVC Unit (con’t)

2. Execution – The CVC must “become a venture capitalist”
   - Key undertakings of the CVC
     - Immersion in venture ecosystem
     - Mothership management
     - Recruiting and building the team
     - Sourcing and reviewing leads
     - Assessing financial and/or strategic value of deal flow
     - Conducting diligence and term sheet review
     - Engaging in negotiations
     - Portfolio management

Stage 1 – Design – Building The Team

- Need corporate executives and key players in all relevant constituencies to "lean in" and be part of design process and strategy determination
  - Integrated design with functional buy-in is critical
    - CVC team members must be "sherpas" to help mothership climb innovation mountain and help startups access mothership resources
      - Must be shared understanding of what customer pain points the CVC aims to address
    - Team must include executives, business unit leads, IT professionals, technologists, communications personnel, in-house lawyers, etc.
  - Participants need to step out of their everyday roles and work collaboratively to achieve shared goals of CVC

Stage 1 – Design – Corporate “From-To Shifts”

- Successful launch of CVC program requires corporate culture “from-to shifts”
  - Identify historical roadblocks to innovation and consider new approaches to
    - Compensation models
    - Evaluation metrics
    - Organizational structure
    - Communication chain of command
    - Decision process
    - Term sheet negotiation
    - Drafting protocols
    - Failure tolerance

Stage 2 – Execution – Role of "New Venture Board" and "New Venture Advocates"

- New Venture Board
  - CVC must have agreed upon decision-makers who have authority to make fund/no fund decisions
  - Procedure for decision-making must be in place
    - Weekly board meeting, telephonic approval process – how will decisions be made?
    - Process must be sufficiently nimble to flex to expedited venture timeline
- New Venture Advocates
  - Critical to identify folks within organization who can remove friction in relation to basic CVC needs (i.e., access to funding, markets and channels, customers, corporate core competencies, legal advocacy, etc.)
  - In-house counsel is a critical member of the New Venture Advocacy team

Stage 2 – Execution – New Lawyer Advocate

- CVC needs in-house lawyer advocate(s) who can drive CVC mission by
  - Sourcing and evaluating deals
  - Reviewing term sheets
  - Negotiating terms (and being creative in deal structuring)
  - Conducting diligence
  - Understanding chain of command and planning ahead for approval process
  - Embracing risk tolerance mindset
    - Must see failure as acceptable outcome
    - Must be encouraged by proper alignment of evaluation metrics
    - Must be given latitude to execute Silicon Valley style deals
      - “The one page term sheet and not the 20 page term sheet”

CVC Deal Mechanics

- The venture deal “is a complicated dance with everyone having a particular role to play”
  - Institutional venture capitalist is often the existing lead startup director
  - May be multiple venture capital directors representing existing insiders
- CVC is frequently newcomer lacking complete information about proposed financing
  - What are proposed deal terms?
  - How big is the round?
  - Who is participating?
  - Will existing investors take a pro rata share of new financing?
  - How much will be available for CVC investment?

CVC Deal Mechanics (cont.)

- Typical CVC deal excludes the right to a board seat
  - CVC board seat often viewed as negative signaling risk to the industry
    - CVC’s board level access to startup proprietary information can prevent interest from other potential corporate partners, investors and would be acquirers
  - Board observer rights are more common
    - CVC is often given access to board meetings and discussions via “observer status” subject to the company’s right to exclude the CVC in certain circumstances
    - Observer access can be highly beneficial to the startup which has much to gain from the guidance and experience of the mothership
- Information rights are common
  - CVC is typically given the right to receive certain periodic information of the startup post investment
    - Access to financial data (historical and projected) is most common
- Commercial/Services agreement can be part of the deal

CVC Deal Mechanics (con't)

- Deal diligence
  - Scope depends on stage of investment
  - Is usually run in principle by the lead investor
  - CVC usually tags along lead investor efforts
    - Later stage deals involving bigger investment rounds may warrant deeper diligence efforts, including by the CVC
- Right of First Refusal/Right of First Negotiation
  - ROFR is a huge negative for the startup
    - Presents an enormous impediment to getting a third party acquisition offer since the CVC would have the right to match terms and coopt the deal from a potential buyer
    - Equal if not more negative signaling risk if CVC declines to step in

CVC Deal Mechanics (con’t)

- ROFN can provide the CVC with advantages in a possible M&A context
  - Advance notice to the CVC that the startup may put itself on the market
  - An opportunity for the CVC to negotiate with the startup for the purchase of the business before the company pursues a sales process
    - Different flavors of ROFNs depend on specific mechanics and can vary depending upon
      - Required notices
      - Time periods
      - Processes
      - Expiration

CVC Deal Mechanis (con't)

- Other mechanics that provide the CVC with a potential M&A advantage
  - Veto right over acquisition
  - Special information rights regarding acquisition offers
- Ideal outcome is for the CVC to be first call by the startup in the face of an acquisition offer irrespective of protective mechanisms negotiated up front
- Critical that in-house counsel be creative problem solvers in deal context
  - But know when to involve outside counsel
    - Outside counsel's broad experience can be value additive to deal negotiation
    - Lack of in-house experience in negotiating term sheet can kill a deal and leave a negative impression among company executives and startup investors

Zooming Forward – Possible Exits at the End of the Investment Cycle

- Three categories of outcomes:
  - IPO
    - Rare but often very positive outcome
  - Startup fades and shuts down
    - Most common scenario
    - Embrace the opportunity to learn from successes and failures alike
  - Acquisition
    - Can provide excellent liquidity opportunity for the CVC
    - Mothership may be most obvious potential acquirer

After the Deal Closes…Key Takeaways

- Invest in the startup relationship
  - Be responsive to startup questions and needs
  - Visit the startup and invite the team to visit the mothership
    - Exchange of ideas is key to value creation
    - Critical to learn from each other
  - Stay mindful of investment objectives in doing the deal in the first place
- Be a strategic guidepost
    - CVC return depends on startup success
- Help the startup reach “escape velocity”