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## IN-HOUSE FOCUS



CORPORATE FINANCE

# The Current Trends in Corporate Venturing

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**CORPORATE VENTURING TYPICALLY** involves a minority investment in an early-stage company by a larger corporation. Corporate venture capital, or CVC, transactions often represent strategic opportunities for these large companies to leverage cash to support their existing products and services, or expand their businesses (particularly in relation to innovative technologies), by investing in and forming alliances with startups in a manner that spreads risk for the corporate venturer and provides potential upside for both parties. Companies may look to strategic CVC transactions as a supplement or alternative to internal research and development activity because these minority investments can involve lower costs and risk, while startups may value securing a commercial ally in addition to a source of funding. The following explores some of the key current trends relating to CVC transactions.

**CVC Activity Continues to Grow.** The popularity of corporate venturing



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continues to grow, both in terms of dollars invested and number of deals, with 2017 activity reaching the highest levels in the last five years. The average size of corporate venturing investments is growing as well, with record investments such as the \$1 billion investment in Lyft Inc. led by Alphabet's CapitalG in October 2017. In addition, CVC transactions

continue to expand across numerous industries and geographies.

**Disruptive Technologies Are a Significant Reason for Increased CVC Activity.** While some companies have utilized CVC investments as a part of their business growth plans and overall corporate development strategy for decades, the broader, renewed interest

in corporate venturing over the last several years appears to be driven by a number of factors, the most significant of which is the proliferation of disruptive technologies. The fact that disruptive technologies, such as artificial intelligence, virtual and augmented reality, blockchain, autonomous vehicle/drone and security technology, have the potential to impact numerous industries has been a significant driver of growth in CVC deals, with investments in artificial intelligence particularly attractive across industries. Although corporate venturing may be most readily associated with the technology sector, the broad application has resulted in the continued expansion of CVC transactions in other industries as well, including the transportation, telecommunications, health care, energy and financial industries, as companies seek innovative solutions to improve and progress their businesses.

**Number of CVC Entities Continues to Rise.** Corporate venturing can be executed in a variety of structures, ranging from a very active separate CVC entity, which essentially operates as a captive investment fund for the corporate parent, such as Intel Capital or GE Ventures, to a discrete, direct investment by a corporation in an adjacent emerging business. The structure preferred by a particular organization may be influenced by numerous factors, including the anticipated frequency of investments, the amount of funds available for investment, the overall objectives of investment (which may include strategic alignment and growth, financial returns, ultimate acquisition of a portfolio company or a combination of one or more of such goals) and the industry, size, breadth and growth plans of the parent corporation.

**ALTHOUGH CORPORATE VENTURING MAY BE MOST READILY ASSOCIATED WITH THE TECHNOLOGY SECTOR, THE BROAD APPLICATION HAS RESULTED IN THE CONTINUED EXPANSION OF CVC TRANSACTIONS IN OTHER INDUSTRIES AS WELL.**

While separate CVC arms may not be the right structuring solution for all companies, the number of companies pursuing corporate venturing through a separate investment entity continues to rise, and a significant number of new CVC arms have been established by companies in various industries over the last two years.

**Evolving Structure of CVC Arms.** Unlike traditional venture capital (VC) investors that often invest with a sole focus on financial return, one challenge that CVCs continue to face is the inherent tension between investment for purposes of strategic growth and investment for purposes of financial return. In response to this tension, the characteristics of separate investment arms seem to be evolving, as more organizations experiment to try to find the right mix of emphasis on strategic fit, financial returns, personnel and decision-making authority.

**Increased Variety of Investments.** The configuration and variation of corporate venturing investments also continues to evolve. Although CVC investments have traditionally involved a minority equity investment (typically between 10 percent and 20 percent) in seed, Series A or Series B rounds, more CVCs are seeking larger stakes in their portfolio companies and investing in later rounds as the startups mature. The form of investments is also expanding, and CVCs may look to a combination of equity, equity-related rights, commercial arrangements and debt instruments to maximize the potential for strategic growth and financial returns.

**Impact on Other Investment Activity.** Because corporate venturing typically involves taking a minority stake in a start-up at a relatively early stage, continued expansion of corporate venturing has the potential to displace some institutional VC activity, although in practice much corporate venturing activity takes place alongside VC co-investors. As a result of the increasing interest in corporate venturing, and because CVC investments typically involve larger dollar amounts than VC investments, the proportion of CVC investments relative to all venture capital activity is rising. However, the more interesting question may be how the trend of increased corporate venturing activity over the last few years will impact private equity investments in the coming years. If CVCs are effective in acquiring their most successful portfolio companies because of the investment relationship formed at an early stage and the strategic synergies achieved over the life of the investment, traditional private equity activity could eventually be impacted by the increase in, and expansion of, CVC activity.

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