CORPORATES AND VCS WORKING TOGETHER – SHOULD CORPORATES JUST INVEST IN FUNDS OR COME ALONGSIDE AS A CO-INVESTOR?

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Like Venture Capital investment, corporate venturing – also known as corporate venture capital (CVC) – is a source of investment for start-ups. Essentially, it involves larger companies investing in start-ups to support their internal innovation.

The roundtable, led by **Jim Mawson, CEO, Global Corporate Venturing**, looked at the different ways in which corporate venturers approach investments and partnerships with start-ups – specifically, whether they invest directly or come alongside investment funds as a Limited Partner (LP).

Global Corporate Venturing (GCV) effectively acts as a trade association for 2,500 corporate venturers.

> *"Entrepreneurs backed by a mix of venture capital and corporate venture capital (CVC) are less likely to go bankrupt and more likely to exit profitably. 80% of unicorns and $billion valuation companies have been backed by CVCs."*
> **Jim Mawson, CEO, Global Corporate Venturing**

Jim kicked off proceedings with the first question: "So, the question I wanted to pose today is, **rather than thinking about either or, could we think about corporates being both?** Maybe that way, you get the best of both worlds – work with good VCs, work with good start-ups and collectively learn from the experience. I'd like to invite a corporate venturer to discuss how they approach it".

Arun Aggarwal, Lloyds Banking Group, explained how they approach corporate venturing at their relatively new unit: "At Lloyds, we take a variety of different approaches. Primarily, we work with FinTechs as suppliers and then onboard them. A few years ago, we started trying out FinTechs in more of a partnership perspective. So, as a big bank working with small FinTechs we ran into lots of problems there, which we're starting to work through. That was a big learning curve for the group. Then, last year, we set up an investment pot. We take minority equity stakes in FinTech seed to Series B, with the option of trying to utilise their tech in-house or in a commercial partnership. That's been fairly successful so far. We went in 14 months ago saying we wouldn't lead; we'll just be an investor that follows on or works with VCs, but that didn't work. We had to lead on some of the investments and found them to be really successful. So, our mindset has shifted slightly. We're happy to lead on occasion. We're happy to partner and co-invest with VCs or other corporates. Since we've been out in the market, we've made lots of connections with people that either we've invested in before or met, and our investment thesis lined up. That's where we are at the moment, and we're now looking at how we explore horizons two and three. For anyone who's familiar with that terminology, if you're not, it's investments that seed or precede, but the technologies might be utilised five to 10 years in the future. We're thinking about how we invest in that tech now because you can imagine, within a constantly firefighting bank, that starts all manner of hares running. That's our next challenge. That will force us to work with people who are from traditional corporates, or VCs, but more in the innovation space, more like SETsquared, or the IMPACT-IP work that's going on."

Amanda Phillips, Roke, talked about their established practices: "We're primarily a defence tech and national security tech business. We come from a research background and are owned by a listed PLC. I'm new to Roke. My background is in corporate finance. What we're working on is partnerships with companies that are in our space or wanting to come into our space where we can use our abilities to share tech and evaluate opportunities on the tech stack in terms of whether they work or not. We are about to launch an ecosystem of partners that want to get into the programmes we work on and from that evaluate whether we want to invest in that business or go into partnership etc".

Ryan Gong, Huawei explained how it works in a large corporate setting: "I work for the corporate development team, and we are basically the investment arm of Huawei. There are two sides to what we do. The first side is we invest directly in start-up companies across Europe. The second side is we invest in VC funds similarly to Lloyds."

Jim: "So you also act as an LP in some of the investment funds?"

Ryan continues:

> *"Yes, we're happy to lead, but equally, we have quite a strong network of VC friends across the world. We tend to work very closely with the innovation, especially if there are any synergies across our commercial research centres. We are very receptive to working with local university partners on projects, and we work with spin-outs as well. So that's the research side."*

"In terms of business, probably everyone always thinks of the 5G base station, but that's only 20% of the business. Outside of that, we also have a wide range of products, including mobiles, laptops, and wearables. I saw a few wearables start-ups pitching today, which was great."

We also have high-speed comms networks and automotive. People probably don't think of Huawei manufacturing cars, but we're in the autonomous driving space and also looking at different energy sources. It's quite an important range of businesses that we are operating in."

The responses from each of these corporate venturers show that no one size fits all; they all have different approaches. So, if you're an entrepreneur, you really need to know who you want to work with and their objectives and understand that those objectives will change over time. Being aware of the maturity of the corporate you're approaching and understanding if they invest directly, how much they partner with the entrepreneur, or if they are hands-off is also important. Always be mindful that what they do now won't necessarily be the same as what they do in three to four years' time. It will be a long-term marriage that will probably last 8 to 10 years, so you have to be aware of that change in strategy over time.

The roundtable then shifted to get the views of VCs in attendance. **Jim Mawson** posed the question: **"Should corporates invest directly, or should they be LPs and buy VC portfolio companies?"**

Jo Slota-Newson, Venture Capitalist, provided the following insights: "Some of my colleagues complain that they have corporates that invest in their funds as LPs. The corporate sees how it works and then go off and do it themselves and it doesn't work out."

James Mawson picks this up: "Two-thirds of corporates fail, by the way. They start doing CVC and stop within three to four years. Doing it well is really hard."

> *"Corporate investors come in so many different flavours, shapes, and sizes. If you have a corporate parent, then that unit is purely for financial return and not strategic interest, so why not be like any other VC? I see corporates trying to do everything at once, rather than trying to decide which stage they will invest in and what type of investment they want to go for and then doing that really well."*
> **Jo Slota-Newson, Venture Capitalist**

Tom Weatherall, Amadeus Capital, added: "We're a deep tech investor that invests from seed to series A. So, it's difficult for us with CVCs as what we do is so niche and deep tech. We get a number of CVCs doing market research to understand what's happening in industries. I'm seeing that further down the line with Series B and Series C investments, it is really good to get a strategic investor, and that's where getting CVC can be really helpful."

Chris Hill, Investment Manager, SETsquared Partnership, talked from the perspective of supporting start-ups to raise investment: "SETsquared supports a pipeline of innovation-rich companies, much of which comes from our university network of six research-intensive universities. It's a fantastic cohort of companies that are always looking for investment".

"In my role, I've effectively got two customers. I've got investors that I want to showcase these investment opportunities to and companies that want to engage active investors".

"I would love CVCs to be more directly engaged with SETsquared and our companies. We've worked closely with the team at Global Corporate Venturing and have done so for a number of years. We hear every year at the Symposiums that CVCs want to get involved in companies at the earliest stage, far earlier than you would historically and traditionally expect them to get involved. In reality, that's not always easy. So, from SETsquared's perspective, we want to do whatever we can do to facilitate that and iron out the process between CVCs, VCs and everyone else".

Now that the participants had heard the perspective of both corporate venturers, VCs as well as SETsquared, the roundtable moved on to taking questions and comments from the floor.

Mark Scibor-Rylski, ex-VC, felt that start-ups could get more than just investment from corporates: "Entrepreneurs could use going through the corporate venture route to get access to the main corporate, hence developing their business relationships more easily because, ultimately, the CVC units are trying to reach out to entrepreneurs. By going through them, you can access the main corporate at a later stage."

Jim Mawson built on this: "Very good point. If you think about it from the entrepreneur's point of view, they want five things. They want to develop a product or service; they need capital, customers, and people, and eventually, at some point, they want to exit".

"Can the corporate or investor help in all or any of those areas? The answer is yes, and then the key question is, can VCs, in collaboration with corporates, help? If you look at the data, entrepreneurs backed by a mix of VC and CVCs are less likely to go bankrupt and more likely to exit profitably. 80% of unicorns and $billion valuation companies have been backed by CVCs. There is clear evidence and data that if you find the right partner and build a board and investor structure that supports you over the longer term, you are more likely to have the outcomes you are looking for. That then helps the investors because the VCs get the financial returns".

"It's worth asking all VCs what their LP base is. Most of the big VC firms such as NEA, Sequoia and Andreessen Horowitz have corporates as LPs or partners because they realise the value of helping their portfolio companies.

> *"It's important to think about alignment, finding investors you're interested in and understanding what you're trying to achieve."*

It's important for entrepreneurs to know who's providing the VCs with money – it helps understand what strings come attached and potentially what value it can bring".

Neil Pitcher, LGF Partners, posed the next question: "Do corporate investors have a far longer time horizon for their investments, particularly in R&D?"

Jim commented: "You do find different operating models. Some corporates have a specific fund like a VC, in which case they're looking for financial returns in a certain period of time. Sometimes, they act like an evergreen fund and recycle the money, and that's about the balance sheet. But usually, once a corporate portfolio gets above £250m, the CFO or the FD will pressure them to say, how are we managing these assets over what period?"

"The timelines can be longer, but ultimately, the better corporate funds, like VCs, are looking for a return somewhere between five and 10 years, sooner if they can. But it depends on the industry as well. For deep tech, if it's early-stage, you won't see much traction within 15 to 25 years".

Jim then posed the question to **Arun Aggarwal from Lloyds**: "What are the timelines in FinTech?"

Arun, "Well, it depends on the thesis; we invest for strategic gain. So, if it makes money, amazing, but it comes from the balance sheet for us. We would think three years and then reassess for something that is more of a horizon two, three goals. Rather than giving a million pounds to a consultancy firm to give us three PowerPoint decks that are immediately out of date, we want to invest in companies that working in that area. It might be that when that tech and software becomes operational, we as a group aren't going to use it because our strategy has pivoted, but that's OK because at least we've done deep dives into that tech. This is all very theoretical; we were only set up 14 months ago. At the offset, we're looking at three years and then reassess, but it could be longer."

Ryan Gong, Huawei, continued: "Our approach is similar. If it's making money, then great. On the investment side, impact is one of the indicators we look at from a patient capital point of view. Every year, we do a validation across our portfolio to look at different impact indicators. Most of the public companies have been doing this for 10 years, and it's a good way to ensure there are still synergies across your portfolio."

Jim, "Can you give me a sense of the scale of the number of deals you do?"

Ryan, "We probably do 20 deals per year and exit one or two per year."

William Lovegrove, University of Surrey, asked the following question: "Is there any anecdotal evidence around the table about joined-up thinking in large companies to outsource research and development to universities and then marry it up with corporate venture capital?"

Ryan Gong, Huawei answered: "A lot of our research takes place at research centres alongside start-ups and universities. We work with some of the local partners to do what we call 'venture view'. We work with Oxford and Cambridge. That kind of university research is done with us or separately.

We also work with a third party and university TTOs to commercialise that research."

Jim added a supplementary question: "Arun, you were talking about the early stage as well - moving into that area horizon, one and two - that feels like it's lined up?

Arun: "One example is we've got a partnership with a company called Plexal. Plexal is privately held organisation that accelerates cybersecurity and FinTech start-ups. We've worked with them for the last four years. They'll go out and find deep tech cyber, which are presented to us as potential partners. We've seen companies come in through that pipeline, so that's been really successful. Where those centralised groups that have really good knowledge and expertise, this model works well. I'm not sure it would work if it's on the corporate to run that. To go back to an earlier point, our strategy today will change in two months – so it becomes difficult to make those long-term plays."

William Lovegrove, University of Surrey, asked another question: "I work in technology transfer at the University of Surrey and often get industry partners saying they want to commission some research and want exclusive rights to the arising IP coming out of it. When working with a start-up, the corporate will always dominate simply by size, number of experts and amount of data. As an alternative model, wouldn't the start-up provide more value to the economy, society, and its shareholders by being non-exclusive to the corporate?"

Amanda Phillips, Roke, explained how they work with universities,

> *"We collaborate with universities and sponsor PHD students, but it is more around what we consider our established tech, where we have significant expertise. But then we also look at our partnerships and ecosystems and put together a tech roadmap which plots where the tech might be going and work out who might be there as part of the journey. Timing has a lot to do with it and how quickly that particular market is moving"*

Arun Aggarwal, Lloyds, sees corporate venturing moving towards a more open model:

> *"I think the industry is changing a lot. Traditional bankers still find it very difficult to share information and work collaboratively. But we're moving into an age of open banking, open data, open finance, all of that good stuff, where we will have to work with peers, industry players, and competitors to enrich each other. A model like that will work more successfully now than it would have done 10 years ago."*

Jim Mawson continued: "To follow up with an example. Why did Microsoft effectively back OpenAI rather than try to acquire it and build its products, whereas Google acquired Deep Mind and then tried to integrate its products? Which one is arguably more successful so far? It seems to be in a Microsoft OpenAI. Certainly, if you talk to Tencent or its Chinese peers, who are trying to do the same stuff there, they will look at Microsoft's OpenAI and say yes because that strategy in China has been enormously successful. Tencent, for example, one of its three pillars, is gaming. Another is financial services. The third is the cloud. Two of them were effectively built through corporate venturing, and one was built internally using R&D based on what they learned externally. The internal was the financial services."

In summary

The roundtable discussion demonstrated that corporate venturers work in a variety of different ways, both as LPs of venture capital funds and as direct investors in start-ups and their strategies move quickly. Evidence shows that start-ups which are backed by a mix of VC and corporate venture funds are most likely to exit profitably. It can be an important source of investment for start-ups, but founders need to do their research to know who they want to work with and what their objectives are.

To catch-up on all the action from the Investment Futures 24 event, go to **SETsquared.co.uk/investment-futures-24**