Why Do So Many Corporate VCs Die Young?

Specific staffing choices and high investment levels can prolong the lifespan of corporate venture capital units.

At any given time of the day, somewhere on this planet, a C-suite executive is losing sleep over one simple question: "Will our business be disrupted before I even know it?"

No industry is safe from disruption now. With each start-up wave turning up the heat, plenty of incumbents seem to have reached one conclusion: If you can't beat them, engage them. A popular means of engagement has been to create a corporate venture capital (CVC) unit. Before 2004, fewer than 200 such units existed worldwide. By the end of 2015, their number had grown to **more than 1,500**.

CVC has become a crucial tool for big firms under pressure to innovate faster. It gives them a window into new technologies and a way to access novel ideas – especially the kind that could throw a wrench in the works. Companies like Apple and Intel have also used CVC to nurture whole ecosystems around their products, boosting demand. Financial returns on investments often sweeten the deal, though in general, gaining strategic benefits is a priority.

Staying the course to reap the benefits

Despite the obvious benefits, CVC units tend to have a short lifespan. Historically – and CVC has been around since the 1970s – the average unit in the United States has stayed in operation only **one** year. Between 1980 and 2006, the life cycle of a corporate venturing programme has been estimated at about **four years**.

In our paper, **"Learning to let go: Social influence, learning, and the abandonment of corporate venture capital practices"**, Gina Dokko and I considered factors that led firms to abandon their CVC units. Based on a study of 70 U.S. IT firms which had started corporate VC units between 1992 and 2008, we concluded that firms wanting to sustain their unit over the long term should think carefully about the implementation choices they make, in particular staffing, as they may be inadvertently sowing the seeds of abandonment.

After controlling for multiple variables including the dotcom collapse of 2000, we found that hiring at least one team member with prior venture capital experience makes firms less likely to abandon their CVC unit. We defined abandonment as the absence of VC investments for at least four years.

Former venture capitalists bring deep practice knowledge

Our data revealed a surprising twist. We had theorised that a CVC unit would have a higher chance of survival if it was staffed with more internal hires, that is, people intimately familiar with a firm's strategy and resources, as opposed to former venture capitalists brought in from outside. The idea was that the success of the unit would hinge on the internal hires' inherent ability to integrate start-up technologies and manage top management expectations. Instead, we found that units with a higher proportion of internal hires were more likely to be abandoned.

It turns out that having at least one team member with venture capital experience on-board brings deep practice knowledge, such as a better handle on how to look for new ideas, how to evaluate early stage start-ups and create contracts, etc. Without the full know-how and mind-set, teams lacking experience with venture capital tended to adapt the VC practices in unhelpful ways.

More skin in the game builds confidence

It would be easy to think that practices are kept or abandoned simply based on performance, but it's not that simple. Corporate VC units are often run for their strategic benefits, which are much harder to assess than pure financial returns. This uncertainty makes internal hires – who tend to focus on such intangible benefits – more open to the influence of others, namely their competitors.

CVC, like any other practice, waxes and wanes. An analogy could be the stock market, with its ups and downs. When a practice is on an uptrend or a downtrend, firms tend to accordingly jump on or off the bandwagon, no matter what their own data tell them. Our research found that a high level of investment in start-ups created a buffer against such irrational social influence (termed 'social contagion').

Specifically, we found that CVC units that made more than the median number of investment rounds across firms were less likely to be abandoned, even after accounting for negative social pressure. We theorised that more investments allow managers to hone their experience and increase their self-confidence, dulling their instinct to follow the crowd.

Trade-offs must be evaluated

Firms should pay attention to the long-term, unintended consequences of staffing decisions. People don't just bring specific skillsets to the mix. They also come with certain mental models, or ways of looking at the world. This outlook conditions what they focus on as well as how they sell the benefits of a given practice.

Staffing comes with trade-offs that need to be balanced with the firm's objectives. Apart from ensuring that VC investments are done right, team members with venture capital experience are more likely to emphasise financial returns. If the firm cares about strategic returns, internal hires will bring value as they will keep the spotlight on the links between VC investments and existing business units.

While hiring people with real venture capitalism experience is essential, they don't come cheap. If senior management is not comfortable with the typical VC pay scale, an alternative could be to close deals in partnerships with traditional VC firms. Such mixed deals are hardly unusual.

In a sense, corporate VC is not for the timid. Firms need to assess their willingness and ability to commit to it. Aside from the high remuneration costs, a CVC unit must invest regularly enough so that its managers accrue expertise and self-confidence, reducing their natural propensity to blindly follow the crowd.

Corporate VC programmes can play a strategic role in keeping up with the disruptions in your business and ensuring business longevity. Properly implemented, they can probably also help top executives sleep more soundly at night.

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