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Never Leave Serendipity to Chance

Accelerating Innovation and Growth through Corporate Venturing

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by Scott Bowman, Partner at Clareo

Today, in nearly every sector, change and disruption are becoming the new normal. In the insurance industry, sensor technologies, machine-to-machine interaction and the potentialities of big data are changing the way we think about quantifying risk, opening up totally new business models and enabling new entrants. In the energy sector, new technologies for micro-grid, distributed energy and storage are going to have massive impacts on the ecosystem. In consumer durables, we are seeing powerful new innovation and new business models emerging in the areas of the connected consumer, connected car and connected home. Even mainline manufacturing industries are in the crosshairs of innovation: 3D printing, new materials, additive manufacturing, analytics and other major shifts are radically altering the landscape. Virtually every sector is experiencing change and disruption, and the rate of change is only increasing.

With so much change, how are leaders to respond and prepare for the future? How do they accelerate growth in new areas, create optionality for the future and build resilience?

Earlier this month, we explored this topic with leading practitioners at an executive forum at the Chicago Mercantile Exchange (CME Group) global headquarters, entitled "Enabling the Next Horizon: Accelerating Innovation and Growth Through Corporate Venturing." Designed & curated by Clareo, in partnership with the Global Midwest Alliance, the forum generated powerful insights on the role and use of corporate venturing as a vehicle for innovation and growth in new areas. The program included presentations by Scott Bowman, co-leader of Clareo's corporate venturing practice, keynote by Roy Williamson, head of Castrol innoVentures, a panel of corporate venturing leaders and a trialogue with venturing executives from the CME Group.

Houston: We Have a Problem

It has been said that as human beings we find the things for which we are looking. For large, established corporations, often the innovations they are seeking are those that protect and serve the core while delivering the highest possible net present value with the lowest conceivable risk profile. Generally speaking, they are not as effective at exploring new horizons and cultivating and building totally new innovations—especially those that may be perceived as risky and potentially disruptive. There are exceptions of course, and we've written about models and leading practices in our work.

For these and other reasons, the data suggests there is an anxiety among senior executives surrounding innovation. Nearly all CEOs believe innovation is vital to long-term success and 70% label innovation as a top-three priority for their firm. Yet, nearly half of all CEOs are dissatisfied with their return on innovation investment, and only one in five believe innovation is giving them a competitive advantage. Internally led innovation efforts are perceived as slow and less than effective. Borrowing the now-famous line from the Apollo 13 disaster, "*Houston, we have a problem.*"

Executives globally are wrestling with serious questions. How do we foster unconventional thinking? How do we accelerate growth in new areas for our firm? How do we gain a window into new markets? How do we reduce what we don't know we don't know?

70%
of CEOs that name innovation as top 3 priority

93%
of CEOs that say innovation is vital to long-term success

Nearly 50%
of CEOs dissatisfied with return on internal innovation investments

1 in 5 CEOs
believe their innovation is enabling them a competitive advantage

#1 Obstacle
for innovation is slow development cycle times

Only 1 in 3
CEOs believe they have a well-defined innovation strategy

Sources: Business Week; BCG CEO Most Innovative Companies Survey; Accenture CEO Survey, 2014

Corporate Venturing: A Powerful Tool in the Innovation Arsenal

As my business partner and friend, Robert C. Wolcott, professor at the Kellogg School of Management and an expert on innovation says, “Never leave serendipity to chance.” Corporate venturing allows companies to create conditions conducive to identifying the best path forward.

While corporations are generally optimized for protecting the established quo, the venturing and startup community are optimized and incentivized for challenging the status quo by bringing new ideas, new thinking and new business models. Corporations seek the predictable; startups seek out the *possible*. Corporations are about managing known risks; startups are about embracing and eliminating uncertainties. These are radically different paradigms. For these and other reasons, forward-thinking companies are increasingly seeking ways to source innovation from *outside-in* as well as from inside-out. And, they are designing organizational structures and models to engage, partner and invest in startup companies in order to: *access external thinking*, *ideas and business models*, *translate ideas into growth options and convert options into opportunities for the firm*. This is the essence of corporate venturing.

Today, corporate venturing is on the rise. In 2013, corporations invested more than $3 billion in startups, and as of mid-2014, 18% of all U.S. venture capital deals have corporate venture involvement. Over the past 10 years, nearly 7,000 venture-backed companies have been funded in part, by corporate venturing units. Corporate venturing is more than a passing fad. It is here to stay and for good reason. Corporate venturing is a powerful tool for innovation because it can:

1. **Enable a faster response, or cycle time, for totally new innovations.** Swisscom invested in and later acquired the startup company, Matrixx Software, which provided a faster path to market for real-time mobile services & billing solutions.

2. **Create a window into new innovation and open up new adjacencies.** Warren East, CEO of global chipmaker ARM has said, “We see corporate venturing as an extension of R&D, a tool that offers us a window into new markets and enables us to extend existing businesses.” BMW has a vision to become a leader in mobility, not just cars and uses corporate venturing as a way of combining their brands and capabilities with the speed, innovation and creativity of the startup community, to help create solutions for totally new areas such as location-based services, intelligent parking and usage-based models.

3. **Offer a capital-efficient way to access new ideas and a path to exit.** Josh Lerner of Harvard Business School has pointed out how Analog Devices used venturing as a means of exploring alternatives to using silicon in the development of chips. Venturing provided an alternative to setting up a project team and building a large, multi-year development project (typical approach for corporations). It allowed them to efficiently test new ideas and exit quickly when innovations didn’t panning out.

4. **Support and extend the core business.** Redbox was originally funded by McDonalds’ venture group as a way of engaging consumers in the store between the hours of 4-8pm (historically a dead time for fast food retailers).

5. **Help enable ecosystems.** Intel Ventures has used corporate venturing for years to invest in technologies that consume its computing power. Apple launched the iFund in partnership with Kleiner Perkins to help spur development of the “app ecosystem.” And this year, IBM lauched a $100m Watson Fund to create an ecosystem that can drive and consume Watson’s computing power.

Corporate venturing should be thought of as an extension to the corporate innovation strategy—a strategy that is outside-in as well as inside-out. It is a means of creating optionality and opening up totally new horizons, but it must be linked with the strategic agenda of the company.

A great example of this is Castrol, a global producer of motor oil and lubricants, which is using corporate venturing deliberately to advance the innovation agenda of the company.

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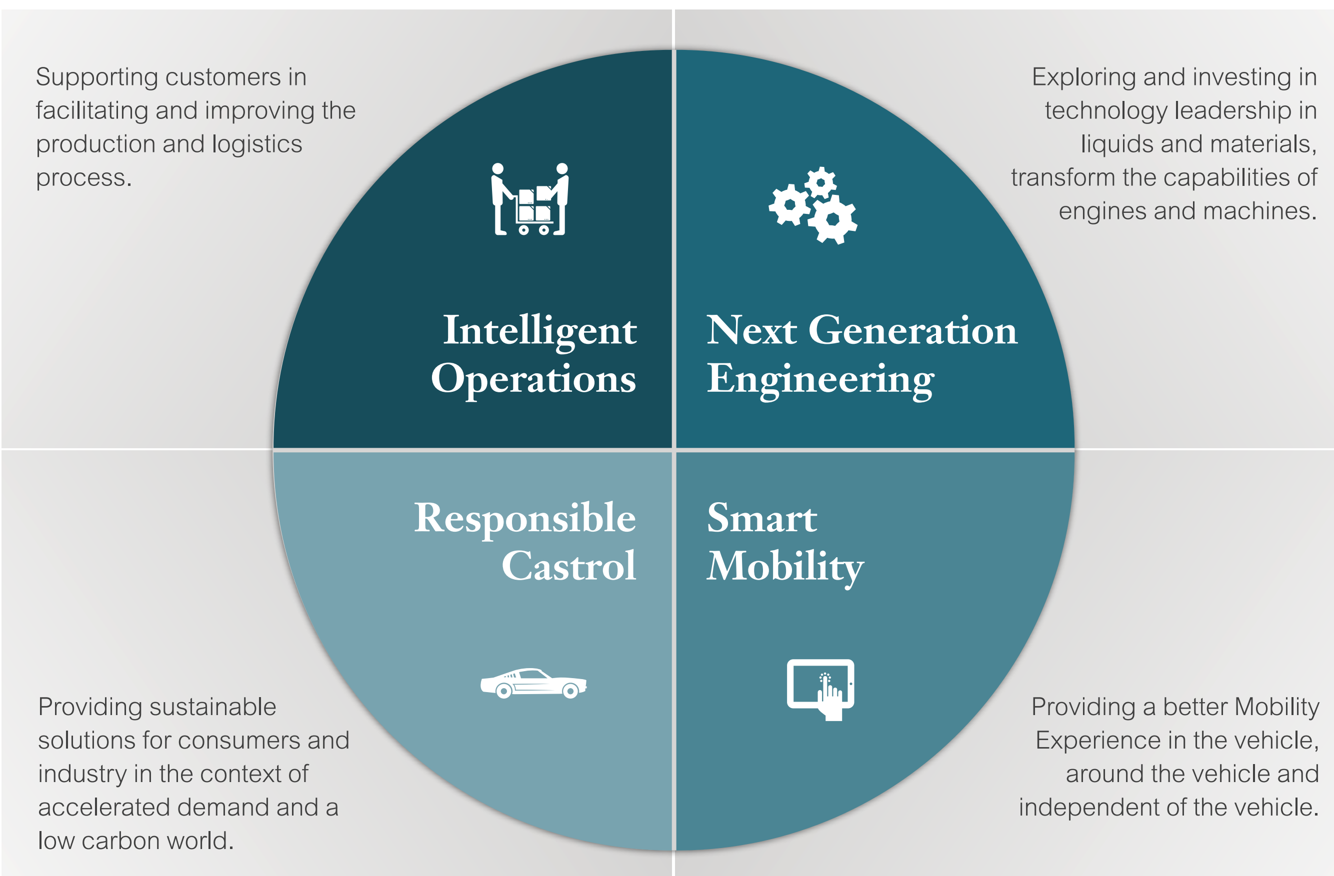
Insights from Castrol 2020: Enabling the Future Beyond Lubricants

For years, Castrol built its growth strategies in the ways you might expect—exploring new channels of distribution, new geographies, new ingredient technologies, etc. However, there came a point when Mike Johnson, the former CEO of Castrol asked a very provocative question, *"What do we do in a world that doesn't need lubricants?"* Multiple trends and forces were impinging on Castrol creating potential future threats and disruptions including the growth in electric vehicles that require no lubrication. The leadership of Castrol launched an initiative called Castrol 2020, designed to explore scenarios, gain insights and create an innovation portfolio for the future.

Roy Williamson, keynote speaker for the corporate venturing event, spoke about the Castrol 2020 journey and the role that Castrol innoVentures, the company's corporate venturing unit, is now playing in advancing strategic innovation.

Castrol explored broad trends shaping its future, engaging with the venture community to challenge conventional thinking and assumptions along the way. They defined futures around areas such as electric vehicles, ownership vs. access, the "fourth space," intelligent factories, designer materials and others. Then, the group engaged in a rich ideation effort to define & articulate four future 'territories' for the business: intelligent operations, next-generation engineering, sustainability and smart mobility (see www.castrolinnoventures.com for more). Castrol innoVentures was then formed with a very clear mandate—to build, invest, partner and acquire businesses for Castrol beyond lubricants and aligned with these future territories. Castrol sees innoVentures as a platform for open innovation with the dual mandate of creating the foundation for emerging business opportunities and broadening its capabilities and understanding in emerging markets.



Source: Castrol innoVentures

The venturing world is very different than the world of internally-developed innovation: development times, risk tolerance, measurements of success, cycle times and other factors.

Roy shared a number of insights and lessons learned through innoVentures thus far:

• Start with a CV strategy that aligns with corporate strategy. By drawing on your company's expertise, the corporate venture will have a better chance of succeeding.

• Think of venture investments as opportunities for gaining early insights into new technologies ahead of your competition and a low-cost way to participate in emerging sectors.

• Leverage industry relationships and partner with organizations in areas outside your company's core capabilities to add value.

• Manage the cost of failure, not the rate of failure.

• Utilize venturing as a means of challenging conventional thinking and assumptions. Engaging the venture community can be a form of "shock therapy" for senior leadership.

• Manage expectations internally. The venturing world is very different than the world of internally-developed innovation: development times, risk tolerance, measurements of success, cycle times and other factors.

Insights from the CV Leaders Panel Discussion

The event also featured a panel discussion moderated by Jason Blumberg, Chief Executive Officer and Managing Director of Energy Foundry, with the following leading venture executives representing energy, healthcare, food & agriculture, advanced manufacturing and technology industries:

Rahul Bhalodia - *Principal and Head*, Venture Capital Investment, Technology Ventures at Exelon

Kurt Estes - Formerly with Motorola Ventures and *Co-founder* of Motorola's Early Stage Accelerator

Dan Phillips - *Vice President*, Sandbox Industries; Healthbox; Blue Cross Blue Shield Ventures, Cultivian Ventures

Dr. Ralph Taylor-Smith - *Managing Director*, GE Ventures

The panel explored the wide range of business objectives for getting into corporate venturing, its advantages and what's happening in the marketplace today:

• While the overriding objective of independent venture capital is financial return, corporate venturing initiatives also have strategic objectives. Constellation Energy Ventures, the venture capital arm of Exelon, believes that by positioning itself to take advantage of opportunities as they arise, it will be in a better competitive position as the utility landscape evolves.

Be clear about why you're getting into the game. What's your objective—Support the core? Enable adjacencies? Create new businesses?

• One of the major advantages that corporate venturing offers is speed. In the corporate R&D lab, engineers are concerned with perfecting technology and are encumbered by corporate processes. Partnering with startups can help reduce cycle times for innovation.

• Corporate venturing offers a way for companies to gather intelligence that can help protect them from emerging competitive threats. Motorola has taken a blended approach— monitoring and investing in disruptive technologies in three categories: those that call for immediate relationships, those that will happen in the future and those that should simply be monitored for their potential impact.

• There is no one-size-fits-all approach to corporate venturing. Some are organized as independent subsidiary companies, while others operate as a group within the parent organization. Some programs operate with a dedicated investment fund while others allocate capital for investments as opportunities arise. Some funding is off balance sheet, some is on balance sheet.

• Successful corporate venturing programs often start by bringing together disparate entities. When launching a food and agriculture fund, Sandbox found that a group of growers of corn, coffee and other crops found value in collaborating with each other.

The panel also shared views about what companies should consider before getting into the corporate venturing game. Among the perspectives shared:

• Be clear about *why* you're getting into the game. What's your objective—Support the core? Enable adjacencies? Create new businesses?

• Consider whether your organization has the risk tolerance required for venturing. Investing and partnering across the venture ecosystem brings risk, and the mindset should be on building a portfolio of bets—some of which will pay off, others that likely will not. Be careful not to burden venture investments with typical internal hurdle rates, payback times and risk parameters.

• Be prepared to deal with "corporate antibodies." You will likely be investing in businesses and technologies that may be competitive and/or simply perceived as a potential threat to the parent company's core business. Resistance is common, and venturing requires resilience and perseverance.

• Build and maintain C-level support. Senior executive buy-in is critical. Venturing must be connected with the strategic agenda of the company. The rationale, objectives and desired outcomes must be clearly articulated. Stay visible, and review progress often.

• Develop a clear value proposition—what you will bring to the table to add value beyond capital—and develop the right tools to manifest your value proposition. Offering access to R&D labs, conducting pilot programs, bringing valuable market and/or customer insight, offering channel access and the like, are all great examples. Define your value proposition, and test it with partners before beginning.

The Past and Future Role of Outside-In Innovation at the CME Group

The program concluded with a powerful *trialogue* with two leaders from the CME Group—David Wong, Senior Director of the Innovation & Acceleration Lab, and Mark Fields, Managing Director of the CME Group's newly formed Strategic Investment Group (SIG). Wong and Fields highlighted the ways in which outside-in innovation has been central to the history of the CME and will be vital for its future.

In 1848, the Chicago Board of Trade (CBOT) created the world's first futures exchange, based in Chicago. The CME Group, and its exchanges, owes its founding and many of its key innovations to outside-in innovation, which is at the heart of corporate venturing. Leadership partnered with entrepreneurs around a common need—to transfer risk. Trading products were developed in partnership with entrepreneurs and they were 'tested' in what one could argue is consistent with the principles of *Lean Startup*. Needs were identified, minimum viable products were developed, market feedback was sought through the trading pit and the product offerings evolved into businesses. Along the way, many of the major innovations in CME's history (the Eurodollar contract, foreign exchange futures and even electronic trading) were also developed in partnership with external partners and entrepreneurs. Although not called "corporate venturing" at the time, this outside-in innovation was an early form of open innovation and venturing.

Looking ahead, we are seeing tremendous change in the financial markets—new possibilities with big data, mobile payment networks and the advent of virtual currencies, to name a few. With so much change on the horizon, the CME has launched its corporate venturing unit, the SIG, to open up new avenues for innovation that extend and go beyond the current core business. The SIG is focused on four broad areas: security, next generation computing technologies, big data and its application to the financial markets and payment networks. The group was designed and structured for efficiency and speed, making four investments in its first six months of operation. Although the SIG is very new, it offers promise for the CME Group, connecting with its history of outside-in innovation and enabling entirely new horizons for the firm.

The Cost of Waiting

Corporate venturing is here to stay, but firms today are still exploring whether or not to get into the game. Forward-thinking CEOs and senior executives should view corporate venturing as a powerful tool for accelerating growth, generating new innovation and strengthening resilience. To be clear, the costs of getting into the venturing game can be significant. However, with rapid change and disruption as the new normal, the cost of waiting can be far greater, perhaps even deadly to the firm. Countless examples exist of firms that discounted emerging trends to their peril. When considering whether to get into the venturing game, be sure to consider the cost of delay or inaction. In the end, the case for corporate venturing will be clear and compelling.

For more information on how Clareo can help your company drive innovation through corporate venturing, contact:

Scott Bowman
Partner and Co-lead Corporate Venturing Practice, Clareo
sbowman@clareopartners.com

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