

CAPITAL IDEA

BY TEO YI JING

Corporate venture capital are investments of corporate funds by corporate entities directly into external startups. They are used to advance a company's strategic objectives, and aim to make the most of the synergies between the CVC and the new venture

I WAS at an industry event for venture capital when I first heard the term corporate venture capital (CVC). My interest was piqued as I wondered whether this was a new breed of investors. If so, how different are they from the private equity or venture capital investors?

CVCs, as described by Henry Chesbrough, adjunct professor and the executive director of the Garwood Center for Corporate Innovation at the Haas School of Business at the University of California, Berkeley, are investments of corporate funds by corporate entities directly into external startups.

In contrast with traditional private equity capital which is commonly used to acquire financial returns, CVCs are used to also advance a company's strategic objectives. CVCs aim to make the most of the synergies between the CVC and the new venture with a view of increasing its revenue and profit. CVCs may also facilitate growth in the new venture by providing financial support for the corporate entity as well as infrastructure for the new venture. Although there might be a conflict of interest between the strategic and financial objectives, the two objectives go hand in hand in the long run. This is because, as almost always, strategic investments are geared towards increasing shareholder value.

Are CVCs new to the market? I think not – it is just a new term that has now been coined with the popularity of such investments. I believe that they have become popular because corporations have realised that the experience of established entities in the market and access to relevant technologies against pure financial investors will give them an additional advantage. In addition, the fastest way to grow, sometimes, is to invest.

I think that this is not a game that only big corporate entities can play. SMEs may join in, where appropriate, as the investment ticket size depends very much on what is required by the new venture. If SMEs are to consider such corporate venture capital investments, I propose that SMEs consider the following:

- **Strategy:** What is the strategic alignment between the CVC and the new venture? The CVC should aim to advance its business objectives as well as those of the new venture. This is usually done by investing in startups that make products and provide services that promote the adoption of the



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standard that the CVC is promoting. Although the incumbent could eventually merge with the startup after its establishment, it is usually not the main objective in this strategy.

- **Creating a demand:** A demand for current products may be created through investment in complementary products. The product of the new venture may directly or indirectly create a demand for the CVC's product. It is a win-win situation, and CVCs are poised to take advantage of it.
- **Diversification investment:** In the case where there could be a competing product in the incumbent market of the CVC, an investment in a new competing venture may be both a learning process as well as a process for diversification of risk. Furthermore, by gathering information which would otherwise not be obtained, the CVC could make a shift in its corporate direction if the results are promising. There are also cases where the market may support both competing products of the CVC and the new venture.

The legal process and considerations for CVCs are similar to those of private equity and include the following:

- **Letter of intent:** The importance of a letter of intent is often underemphasised. A letter of intent establishes a common understanding between parties of the terms of investment.
- **Law to be considered:** In addition to compliance with the relevant authority in Singapore, parties should consider whether there are any applicable laws to both the CVC and the new venture that may affect investment transaction.
- **Rights obtained through investment:** The rights obtained by the CVC depend on the type of securities in question and the nature of investment. Some common rights which investors should consider are voting rights, rights to dividend, liquidation rights etc.

- **Exit strategies:** Similar to other investments, an investor will seek to obtain as many alternatives as possible to obtain liquidity for the investment.

In addition to the rights similar to that of private equity capital, there are distinguishing factors which parties of CVCs should consider due to differences in investment objectives between the two. As discussed above, the main reason for CVC investment is strategic. Parties should therefore consider factors such as the right of first look over commercial output and distribution. Each transaction will, however, differ according to the specifics of the product, technology or the market involved.

If you are a new venture looking for CVC injection, you may wish to look out for the following:

- **Opportunities:** The new venture should evaluate the potential market, operational and financial benefits to systems that are seeking opportunities to grow its own business.
- **Sharing:** CVCs bring with them their capital and wish to profit share, but they will also share risk with the new venture.
- **Management team:** The new venture may learn from the established management team of the CVC with its demonstrated relevant experience, depth and capability to assist in building the business to scale.

CVC is a growing trend fuelled by a combination of several factors such as abundant entrepreneurial talent, promising new technologies and various government policies favouring the formations of startups. Therefore, it is attractive for a CVC to launch and support the development of business concepts. CVCs can be beneficial by providing startups with the resources that they need to grow to their full potential. ■

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