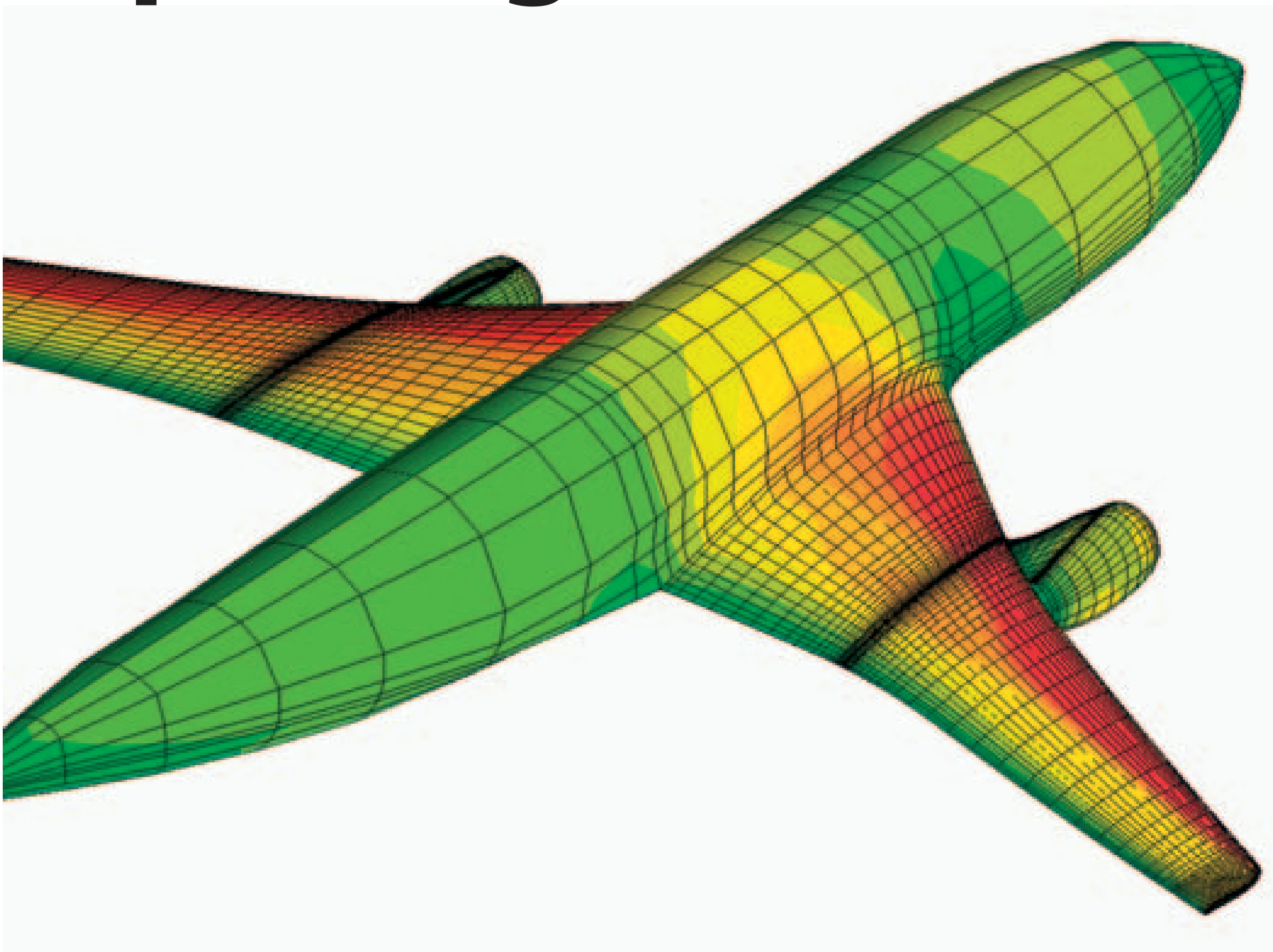
A powerful business model for **capturing innovation**



Michael O'Leary-Collins explains how organisations can boost potential while minimising risk.

With European corporations devoting fewer resources and capital to research and development (R&D), how will they maintain a competitive edge on the innovation front? According to Andrew Dearing, secretary-general of the European Industrial Research Management Association, Europe is under-investing in R&D to the tune of €100 billion ($120 billion) per year compared to the US. Philippe Larédo, director of research at the Centre de Sociologie d'Innovation in Paris, believes this discrepancy is the legacy of a traditional difference in public sector support for R&D in America and Europe.

As the R&D abyss between Europe and the US continues to grow, 'corporate venturing' may provide a valuable bridge. This proven business strategy has the potential to furnish reliable, practical, near-term solutions to the innovation challenge.

Corporate venturing means any form of business development activity that leverages corporate mass to create competitive advantage in core businesses, or to grow related strategic markets. There aren't many situations in business where the heart of the deal is a win-win premise. But corporate venturing has the potential to be one of them.

Corporate venturing goes for the jugular. Scale is its fuel.

The idea behind corporate venturing is very simple. For many major organisations, the kind of innovation that most interests them is related to technology. Organisations can become more efficient by carrying out other less dramatic types of innovation, such as by deploying new administrative systems, new ways of working and, of course, by recruiting new people, but these are minor types of innovation and not what corporate venturing is all about.

A risky business

Everyone knows how important innovation and differentiation of offering are in today's highly competitive business environment, where competition is as likely to come from abroad as it is from a domestic market.

But innovation has a downside; it's risky. Time and energy spent on innovation and research into, say, new technologies, is of its nature a highly speculative and time-consuming process.

A classic example of the innovation risk is the pharmaceutical industry, which is in fact one of corporate venturing's founding fathers. The major drug companies spend billions of dollars every year on new product development. The wastage is high: most ideas and formulae for new drugs either don't make it past the testing process or even when they do, may not win official approval. Drug companies are continually lobbying government for more privileges and extension of patent time. After all, the hugely expensive process of speculative research has to be recouped somehow.

But innovation is of critical importance for all kinds of major organisations, not just for those involved in the pharmaceutical industry. Those few well-known stories about individual inventors who have succeeded in bringing a major innovation to market while working on a shoestring are not, in fact, especially representative of how innovation usually does come to market. Accounts of how James Dyson invented his bagless cyclonic vacuum cleaner and Trevor Baylis his clockwork radio that transformed communication in locations far from a reliable electricity supply, are exciting. But, in practice, innovation is conducted in the intense and not especially glamorous atmosphere of laboratories, think-tanks, garages and other places where talented people toil together long hours to try to bring an innovative dream to fruition. Today, significant innovation tends to occur as the result of a mighty and concerted team effort.

The trouble is that few major organisations can afford to employ a team of full-time innovators. Furthermore, modern business thinking has led to the conclusion that organisations should focus on what they do best: that is, the day-to-day money-making activities that have won them their principal 'customer mandate'.

For most organisations, the most sensible course of action is for them to stick to what they do best. After all, that is why customers come to them and are prepared to pay them money.

But how should an organisation pursuing a sensible policy of sticking to what it does best and fulfilling its customer mandate deal with the danger that if it does not innovate it may sooner or later lose its customer mandate to more innovative competitors? One possible answer to this dilemma is to make use of corporate venturing.

Going for the jugular

Corporate venturing goes for the jugular. In effect, the underlying strategy of corporate venturing says: if non-organic corporate growth is largely based on innovation, the engine for innovation is the creation of an efficient connection between technologists, funding, and scale is its fuel.

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Alexandra Scott, president and chief executive of International Business Forum Conferences, the business intelligence group, explains: "What corporate venturing does provide is a business model and framework that allows corporations to reach out to emerging technology companies which have great ideas and make judicious and well-informed investments in, or provide an essential distribution channel to, technology companies that are in the early stages of their growth curve."

This is precisely the point. Corporate venturing is ultimately an extremely sensible and practical way of extending the strategy of a major organisation into innovation and new technology through its access to scale while minimising the overall risk.

The corporate venturing strategy complements and adds to an organisation's internal R&D. Of course, major organisations will tend to have R&D departments, but these are usually focused on extending the core technical capabilities of the organisation (which are, in turn, derived directly from the organisation's historical strengths) not in advancing the 'blue sky' kind of innovation that can catapult an organisation forward in dramatic strides.

As Professor Henry Chesbrough, of the University of California at Berkeley, and author of *Open innovation: the new imperative for creating and profiting from technology* says: "Companies that don't innovate die. While the key to successful innovation once lay in the controlled environment of the corporate laboratory, today the widespread distribution of useful knowledge makes such control unfeasible. Competitive advantage now often comes from leveraging the discoveries of others."

Corporate venturing has been around for over two decades. Examples of corporations with corporate venturing programmes include Unilever, Motorolla, Eastman Chemical, Rolls Royce, Intel, Lucent, American Express, Shell, Dow Jones, Volvo, Procter & Gamble, Siemens, Sun Microsystems, Cisco, ChevronTexaco and many other major companies which find this to be an effective and efficient element of their strategies. These programmes are proving to be effective in ushering the corporations into new areas of technology and previously untapped markets. In altering the process of innovation for profitable growth, these firms have clearly moved beyond the traditional scope of internal R&D.

At the height of the 'internet bubble' many companies jumped into the corporate venturing game. Unfortunately, a large number of their programmes were poorly conceived and aimed at short-term financial gain without recognising the unique venturing skills needed to manage those risks. In many cases the programmes were not integrated into an overall technology/business strategy. Not surprisingly, when the bubble burst so did many of these programmes.

However, it's important to bear in mind that well-structured programmes continue to survive and thrive as part of renewed corporate venturing initiatives. The impressive list of corporate members of national venture capital associations in the US and Europe bears testimony to this fact.

Moving forwards

How can an organisation advance a corporate venturing initiative? Many large organisations find that a highly effective way of doing so is to make judicious private equity investments in carefully-selected technology start-up companies. Inevitably, no matter how well selected these companies are, not all of them are going to flourish. Ultimately, developing new technologies is a risky business, and it is impossible to know exactly what technical pitfalls might arise and prevent a once-promising initiative from coming to fruition.

Generally, it is good advice to suggest to a major organisation that it diversifies its investments across a

The Apple iPod: An example of world class innovation.

range of technology companies to increase the probability that some of the innovations will deliver profit. Note that the idea behind the investment is not so much to buy stock of a private company that might go public, as to be in at the beginning of a promising technological or service initiative that the major organisation may be able to take on board and make a great deal of with its own scale.

The diversification not only gives the major organisation access to a range of emerging companies, but also to a range of technologies, only some of which are going to prove successful and relevant as the future evolves. In venture capital terms, the management of financial risk arises from the syndication of the investments.

This approach will dilute the financial returns. However, operational influence can manifest itself in a number of other non-financial ways through inputs (corporate supply chain) and/or outputs (corporate distribution networks and customers) which collectively contribute to risk reduction. So, here we have two differing dimensions to corporate venturing – venture capital and venturing.

Venture capital programmes

Reference points for establishing corporate venture capital programmes abound from both venture capitalist and various corporations such as IBM, Intel Corporation and DuPont. This involves the creation of a stand-alone entity with access to either a 'ring-fenced' pot of capital or the corporate balance sheet. In both instances, control is applied through an investment board comprising board level executives making the investment decisions with a small team of venture capital professionals staffing the unit. This is a long distance run as performance is usually measured on the internal rate of return (IRR). This basically equates, in today's value, to a series of cash flows from the venture over a period of time against the organisation's initial investment.

Corporate venturing can be rocket fuel for the pursuit of excellence and creativity in innovation

In pure venture capital terms, funds run for seven to 10 years before success can be determined. During this period, the corporation may have a change of senior management. In order to withstand these corporate reshuffles, a direct connection to corporate strategy is fundamental. After all, if the corporations' shareholders wanted to invest in venture capital, they would do so in their own right.

When a corporation engages in more conventional venturing, there is usually a substantial operational team behind it and the focus is all about delivering new product and services which can be funded through a sales and marketing or R&D budget. All ventures are either discreet profit and loss centres or wholly owned entities seeking to make the most of a corporation's non-financial assets; brand, distribution, technology and customers.

There have also been a number of cases where activity aimed at enticing new ideas from employees has been successfully deployed, although experience shows that repeated trawls through the organisation rarely produces consistent quality. And so relationships with external venture capital groups, other corporations and venturing intermediaries based on joint interests and/or capability will become necessary to maintain a flow of useful opportunities.

In the case of IBM, one of the venturing group's roles is to plug solutions gaps it encounters in competitive situations. It contacts external venture capital partners around the globe with an urgent GAP request and once found IBM applies its scale to great effect. Motorola applies both financial and human resources to ensure its investments achieve scale and relies mostly on external sources for innovation.

Building sustainable competitive edge in a period of global competition is challenging corporations to utilise and leverage all available resources, whether internally or externally sourced. Corporate venturing, as an arrow in the corporate quiver, provides the opportunity for sourcing complementary and strategic intellectual property, additional financial resources and skills. In short, it can be rocket fuel for the pursuit of excellence and creativity in innovation.

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