Global Scientific JOURNALS

GSJ: Volume 8, Issue 1, January 2020, Online: ISSN 2320-9186
www.globalscientificjournal.com

CORPORATE VENTURE CAPITAL AS A CONTRIBUTOR TO COMPANY INNOVATION

Author Details (optional)

Gladstone Stanley is currently Monitoring and Statistics Officer in Ghana Education Service, Ghana, PH - +233543029089. Email: gladstanley@gmail.com

Karim Philips is currentlythe President of Young Heart Foundation University, Country, PH- +233560698801. E-mail: dephil54@gmail.com

Keywords
Corporate venture capital, Competitive Advantage, Investments, Innovation, Parent corporation, Units, Venture capital

Abstract
This article aimed at clarifying the factors accounting for the success of corporate venture capital as a source of innovativeness of the parent corporation. The article further pointed out the key factors in the structure and goal setting in corporate venture capital units and also in the qualities of the parent corporation affecting the success. They also unearth the factors behind the competitive advantage of corporate venture capital investment in the innovation process compared to the traditional venture capital investments.

Introduction

Stiff competition among businesses due to limited constomersand change in tastes and preferences of these customers over time have caused companies to frequently develop new products and services to meet the evolutional needs of these customers. This innovation has become necessary because it is a critical driver of company's survival and promote country's long term growth (Chemmanur et al., 2014).

The main problem is that in this 21st century where success of company is based on knowledge, information and innovative economy, lack of adequate finance and idea has made most companies stuck with exisiting products and technologies while these companies have to invest in research and development to be abreast with the new business models and technologies arising all the time (Urbancova, 2013).

The popular ways of conducting research and development have been joint ventures and acquitions, but during the last decades, corporate venture capital investment has increased its reputation as a promoter of companies innovation. Corporate venture capital achieved this through external research and development projects to bring expertise, intellectual property and know-how. (Fulghieri and Sevilir, 2009).

Though corporate venturing was developed in 1960s, it operates as venture capital. The development of these two can be divided into three cycles. The first cycle occured when CVC invesments started to arise in 1960s. The second cycle began in 1970-1980s mainly because of the fall in capital gain taxes. In 1987 as the stock market crashed, the venture capital lost its grace for a while. The third cycle of venture capital can be considered to have started in 1990s because of the boom of telecommunications and Internet-related companies. The venture capital forms a significant part of corporations‘ investment portfolios and its popularity keeps increasing all the times (Gompers & Lerner, 2000).

This paper examines the key success factors of the CVC as a source of parent corporation's innovation growth. Wadhwa (2016) stated that companies are forced to look for external sources of innovation to be able to keep growing and stay competitive.

2. Literature Review

2.1 Definition of Venture Capital

Gompers & Lerner (2000) defined venture capital as a firm that focus on financing high-risk potentially high-reward projects. Compared to banks, which only monitor the financial activity of the firms they lend to, venture capitalists also keep their eye on the investment decisions and the strategy of the firm, and advice the firms by providing for example consultants and lawyers to them if needed (Gompers & Lerner, 1998). The most common life-time of a VC fund is ten (10) years, but often they raise new funds every few years (Gompers & Lerner, 1998). In the end of the life-cycle, venture capitalists look for a clear exit, such as public listing or third party acquisition for the investment (Singhall, 2015).

2.2 Corporate Venturing and Corporate Venture Capital

Corporate venturing exists in the field of venture capital and is generally seen critical for corporation's strategic development (Burgers et al. 2009). Corporate venturing is defined as a process in which already existing corporations develop new business and it is generally divided into internal and external venturing (Sharma & Chrisman 1999, MacMillan et al. 2008) Internal corporate venturing refers to a process of creating entrepreneurial firms inside the company. When the corporate venturing leads to the arrangement of a new organizational entity that acts semi-autonomously, it is called external venturing (Sharma & Chrisman 1999, MacMillan et al. 2008)

The focus of this article is on a specific form of external corporate venturing, corporate venture capital (CVC). During the last decades, CVC has become an important actor in venture capital industry, covering 15% of all venture investments in 2000 (Dushnitsky, 2011).

Even though CVC is considered as a form of venture capital, it differs a lot from the traditional venture capital funding for example in organizational structure and in the nature of services offered to portfolio companies (Gompers & Lerner, 2000). While the goal of a traditional VC investment is to benefit from the investment purely financial, CVC units are established to fulfill both strategic and financial or just strategic objectives of their parent corporation (Chemmanur et al. 2014).

2.3 Innovation

According to Urbancova (2013), innovation is not only technological changes and inventions, but instead can be defined as something new, originating from research. Gaffard (2008), also defined innovation as a process of creative destruction. This process stands for a building of new productive capacity and at the same time destructing the old one. Lewandowska (2013) was of the view that innovation is seen as a crucial factor in corporations' growth and competitive advantage nowadays. Recently, many entrepreneurs and managers have understood the importance of creating innovations to be able to compete in global markets. Since corporations are not able to create enough innovations inside the company, they have to look for external sources to get access to new technologies and start markets (Fulghieri & Sevilir, 2008).

3. Data Analysis and Discussion of Result
3.0 Methodology
Quality research methodology was used to undertake desktop study to source data from secondary sources to integrate and compare information of multidimensional literature. Various basic theories of venture capital and corporate venture capital were review to combine the knowledge integrated from well-known studies with the perspective of more empirical studies to better understand the development of the phenomenon.

CVC as a tool for Innovation and Growth

3.1 The Choice of corporate venture capital as a source of financing

It was revealed that many start-ups were either forced or willing to look for external financing to promote their development through corporate venture capital because start-ups seem risky and uncertain for banks and independent venture capitalists to invest in. The CVC has become their last option for finance with the intention that having a large corporation as an investor can attract other investors to invest in their firms (Chemmanur & Loutskina, 2014). Since CVC units act as subsidiaries, they have wider knowledge of technology, are more risk-tolerant, and industry than IVCs which enable them to better nurture innovation in early stage (Napp & Minshall, 2011).

3.2 The Key factors

3.2.1 Objectives of an Investment

While the investment made by traditional venture capitalists are purely based on financial objectives, CVCs normally aims to fulfill both strategic and financial goals aim to gain good returns and to achieve growth of sales and profits for the parent corporation (Chesbrough, 2002). This kind of investment is meant to create value-addition through complementary products or processes to promote growth. Emergent and passive investments do not aim to gain strategic benefits for the parent corporation at all, which is why the first two types are beneficial for the innovation growth in companies and the other two do not have effect on corporation’s innovativeness (Anokhin et al. 2016).

3.2.2 The Compensation System

CVC places much emphasis on personnel compensation and thereby ensure supportive and fitting compensation system for the managers of investment to avoid loss of talent, motivation and focus. The lack of a suitable compensation system also often leads to the loss of talented personnel to work on traditional venture capital options, if they are rewarded better there (Lerner, 2013). The CVC units’ rewards are generally based on a fixed salary, sometimes with annual bonuses. This is one of the main reasons leading to the loss of key personnel and it seems to be one of the key challenges in the units (Dushnitsky, 2006).

The compensation model of the traditional funds, where the pay is linked to the success of the investment, it leaves the CVC units with a choice to work hard to achieve better results than the other types of compensation (Lerner, 2013).

3.2.3 The Relationship between the Parent Company and the CVC Unit

The CVC investments are structured as a corporate subsidiaries and where the parent corporation is not fully involved in the operations of the subsidiaries, the units operate with speed, freedom and flexibility needed to achieve success (Weiblen & Chesbrough, 2015). This means that managers of the parent corporation should be there to support and help the unit if needed but at the same time encouraged them to experiment and take risks, and work autonomously (Tushman & O'Reilly III, 1996).

3.2.4 The qualities of the parent corporation

Birkinshaw (2014) state that if firms do not develop existing capabilities and search for new innovations at the same time, in other words if they are not ambidextrous, they will not be able to succeed over a long-term period. This means that corporations need to have skills compete in mature markets and at the same time they have to be capable of developing new products and services (Tushman & O'Reilly III, 1996).

3.2.5 The Long-Term Time Horizon

As stated earlier, the compensation system of corporate venture capitalists differs from that of traditional venture capitalists. The most effective way to motivate innovation is to be able to tolerate early failure and reward success in the long run (Manso, 2011). CVC investments tend to have significantly longer investment horizon compared to traditional venture capital, which enables them to be more open to exploration and experimentation (Chemmanur et al. 2014). Because of the stronger balance sheet that CVCs parent company has, ventures are not either forced to generate immediate financial returns, which allows CVCs nurture innovation process more likely (Chesbrough, 2002).

Gaffard (2008), states that in an innovation process, gains are not instantly realized. The key factor in the successful activity of CVC unit is that corporation bears in mind that fact that the strategic benefits from the investment are generally long-term, insecure and difficult to quantify (Gaba, 2011).

3.3 CVC fostering the innovation

Innovation is crucial for corporations to perform well and have a long life (Wadhwa et al. 2016). According to Ernest et al (2005), external innovation can be managed through an acquisition of companies, by licensing new technology or by investing start-ups. The latter is also called corporate venturing. Besides, Chemmanur et al. (2014), stated that the structure of the CVC fund enable the companies to invest in riskier and more innovative start-ups. CVC is also considered to be more flexible and lower-risk investment than for example joint ventures or other ways of external funding, which strengthens its state as a road to innovation growth in the corporation (Lee & Kang, 2015).

The CVC investment does not only bring new technological skills and knowledge of the markets but also help the parent corporation to strengthen the entrepreneurial culture in the corporation (Ernest et al. 2005).

Conclusion

The study found out four key factors affecting the success of CVC as a source of innovation. These factors include;

I. The qualities of the parent corporation;
II. The goal setting of the unit; and
III. The compensation system of the unit and the relationship between the unit and the parent company.

The key qualities in the parent corporations seem to be the ambidexterity of the corporation, a well-developed internal research and development activities and the ability to give up the excess control. The three key factors in the goal setting of the investment are;

I. The clearness;
II. The diversification; and
III. The good amount of goals

The findings on the compensation system of the CVC units was that the unit should be performance-based to motivate the personnel to stay in the corporation and work efficiently and further highlight long-term success.

The key findings in the relationship between the unit and the parent are sufficient autonomy of the units and support of the parent in its operations. The concept of innovation was discussed in the context of organizational ambidexterity, which refers to corporation's ability to exploit existing business and explore new territories.

This study further helps the managers of large companies to understand the concept of CVC and the factors needed to take into account when aiming to the successful innovation growth through this kind of investment.

Even though the focus of the study is on factors influencing the success of CVC as an innovation contributor, this study throw more light on the benefits that a corporation derive if it chooses to establish CVC activity.

Acknowledgement

The authors are grateful to all the respondents to the questionnaires, other authors of secondary data and the Global Scientific Journal for accepting to add our work to their journal to showcase of findings to the world. This research was funded by the authors.

Reference

Chemmanur, T.J., Loutskina, E. & Tian, X (2014). Corporate venture capital, value creation, and innovation. *Review of Financial Studies* 27 (8), 2434-2473.

Chesbrough, H.W. (2002). Making sense of corporate venture capital. *Harvard business review* 80(3), 90-99.

Dushnitsky, G. (2011). Riding the next wave of corporate venture capital. *Business Strategy Review* 22(3), 44-49.

Dushnitsky, G. & Lenox, M.J. (2005). When do incumbents learn from entrepreneurial ventures? Corporate venture capital and investing firm innovation rates. *Research Policy* 34(5), 615-639.

Dushnitsky, G. & Lenox, M.J. (2006). When does corporate venture capital investment create firm value? *Journal of Business Venturing* 21(6), 753-772.

Ernst, H., Witt, P. & Brachtendorf, G. (2005). Corporate venture capital as a strategy for external innovation: An exploratory empirical study. *R&D Management* 35(3), 233-242.

Gaffard, J. (2008). Innovation, competition, and growth: Schumpeterian ideas within a hicksian framework. *Journal of Evolutionary Economics* 18(3), 295-311.

Gompers, P. & Lerner, J. (2000). The origins of ownership structure: 1. The determinants of corporate venture capital success: Organizational structure, incentives, and complementarities. In:
Morck, R.K. (ed.). Concentrated corporate ownership. *University of Chicago Press*, 17-54.

Lee, S.U. & Kang, J. (2015). Technological diversification through corporate venture capital investment: Creating various options to strengthen dynamic capabilities. Industry and Innovation 22(5), 349.

Lerner, J. (1995). Venture capitalists and the oversight of private firms. *Journal of Finance* 50(1), 301-318.

Lerner, J. (2013). Corporate venturing. *Harvard business review* 91(10), 86-94.

Lewandowska, L. (2013). Opportunities for funding innovation. *Comparative Economic Research* 16(4), 57-78.

Macmillan, I., Roberst, E., Liyada, V. & Wang, A. (2008). Corporate venture capital (CVC) seeking innovation and strategic growth.

Napp, J.J. & Minshall, T. (2011). Corporate venture capital investments for enhancing innovation: challenges and solutions. *Research Technology Management* 54(2), 27-36.

O'Reilly III, C. A. & Tushman, M. L. (2013). Organizational ambidexterity: Past, present, and future. *Academy of Management Perspectives* 27(4), 324-338.

Singhal, R. K. (2015). Venture capital financing. *SIES Journal of Management* 11(1), 10-16.

Stringer, R. (2000). How to manage radical innovation. *California management review* 42(4), 70-88.

Tushman, M. & Nadler, D. (1986). Organizing for innovation. *California management review* 28(3), 74-92.

Urbancova, H. (2013). Competitive advantage achievement through innovation and knowledge. *Journal of Competitiveness* 5(1), n/a.

Wadhwa, A., Phelps, C. & Kotha, S. (2016). Corporate venture capital portfolios and firm innovation. *Journal of Business Venturing* 31(1). 95-112.

Weiblen, T. & Chesbrough, H.W. (2015). Engaging with startups to enhance corporate innovation. *California management review* 57(2), 66-90.