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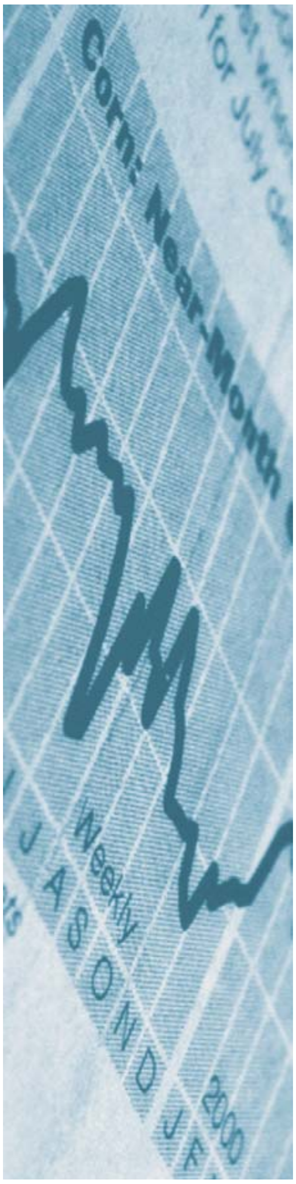
Corporate Venturing:

Managing success in challenging times



Netherlands

BAIN & COMPANY

Corporate Venturing in the Netherlands

By Barbara Arnst, Geert Postma, Rebecca Sherer & Martijn Thierry

Executive Summary

Corporate venturing was a hot trend during the Internet boom when scores of companies thought quick money could be made simply by setting up their own venture capital fund to invest in promising companies. In 2001, the stock market provided the unpleasant reminder that creating real value is never that easy. Today companies are faced with the question, "Jump ship or paddle harder?" And many companies are choosing to retreat from CV. Those that never had strong strategic reasons for being involved with CV should indeed stay off the boat. For the others, however, CV can still be a very valuable growth tool, given the right strategic conditions, which are:

1. Significant uncertainty exists about the "winning" technology, distribution or business model being considered
2. Technology or business models are developing at a pace faster than the company can keep up with alone
3. There is value in being involved early as opposed to simply waiting for uncertainty to disappear
4. Investment will present a win-win situation by adding value for both the investor and the investee (target company)
5. Investment is related to the company's core business in the appropriate manner

Making CV work is not easy, but by adhering to the following 5 key operational guidelines, companies can minimise the most common organisational difficulties:

1. Find the proper balance between strategic and financial objectives and ensure that mechanisms are in place to measure both
2. Obtain and maintain full Board commitment over the long term
3. Ensure effective co-operation between the investee companies, the CV department and the Business Units of the company
4. Set up a CV team which can collect both the business knowledge and the venture capital (VC) knowledge necessary
5. Recognise and manage the tensions between corporate-based and VC-based compensation schemes

Defining Corporate Venturing

"Corporate Venturing" (hereafter referred to as CV) knows many definitions, and in its broadest sense can encompass any minority investment by one company in another. Such a wide array of definitions warrants focus. Which is why, in this study, we use the term specifically to describe temporary, minority stakes in ventures that are managed outside a company's normal operating structures. This means that long-term strategic partnerships, among other things, do not qualify as corporate venturing.

Jumping ship

2001 was a rough year for many corporate venture portfolios, and their parent companies reacted accordingly.

Some companies chose for dramatic change:

- **Compaq - disbanded its CV group and returned investment decisions back to BU's**
- **Lucent Technologies - spun off 80% of its main venture unit**

While others ceased their CV activities all together, including:

- **AT&T**
- **News Corporation**
- **Starbucks**
- **Accenture**

Paddling even harder

However, some companies even saw the slow-down as an ideal time to push harder for CV success

- **Agilent Ventures (AV)**

AV has decided that a downturn is the perfect time to invest, and plans to make 10-12 investments this year (compared to 7 in the previous year). Agilent wants to take advantage of what their management estimated as a 60-80% decrease in valuations - allowing them their pick of investments.

- **Siemens**

Instead of collapsing during a difficult year, Siemens gathered its strength and sent in reinforcements. In October 2001, Siemens reorganised its multiple efforts into a single, strong CV unit, Siemens Venture Capital (SVC). SVC has investments in over 70 start-up companies and 25 VC funds, and this number increased in 2001 as compared to 2000 (a trend that only a handful of other CV arms was able to duplicate). Current investments are over EUR 500 M and will continue to grow.

Rise and fall of CV?

Until the end of 2000, CV growth was spectacular. Between 1997 and 2000 the number of companies world-wide making CV-type investments grew by 75% annually. By 2000 no fewer than 100 companies had CV funds of over US$ 100 million. But when the Internet bubble burst in 2001, this enthusiasm quickly faded. By the end of 2001, investment levels around the globe had plummeted (a 91% decrease in the US vs. 2000, for example), far more dramatically even than in the related Private Equity or Venture Capital (VC) sectors.

Bain's study

Are the CV dikes in the Netherlands also about to break? To find out, Bain & Company Amsterdam decided to investigate CV in the Netherlands. Which Dutch companies engage in CV? Why? How do they rate, and explain, their results, and what can we expect going forward? And finally, and perhaps most importantly, how can they maximise their chances of success? To answer these questions, Bain screened the top 50 quoted Dutch companies (AEX, AMX) and contacted the 40 who were deemed most likely to use CV. Over 25 of these were interviewed.

In the following article we present the results of this study. We start by examining the status of corporate venturing in the Netherlands. Then we discuss the conditions for success. First by examining when companies should deploy corporate venturing as part of their growth strategy. Second by assessing, once companies have committed themselves to corporate venturing, how they can avoid the executional pitfalls[1]. To do so, we establish that companies can maximise their chances of success by following 5 key guidelines. While the Netherlands' situation is in some ways unique, the strategic conditions and operational guidelines laid out in this document are universal.

1 This document addresses operational guidelines unique to corporate venturing, this does not address traditional venture capital issues, which are also very important

Status of CV in the Netherlands

Sizeable CV player

While many Dutch companies make the occasional 'CV-type' investment, less than 10 have set up actual CV funds (a pool of money committed by the company which fund managers invest). However, these companies are not insignificant: together they account for nearly half the Amsterdam stock exchange by market capitalisation. In the past 3 years, this handful of key companies raised over EUR 700 million through their CV funds, of which 25% has been invested so far. On a European scale the Netherlands has become a sizeable CV player, accounting for approximately 10% of total European CV activity, a figure which is in line with the Netherlands' share of the European stock market capitalisation.

Top 3 reasons cited to engage in CV:

- **Gain a window on technology**
- **Improve company's innovation power**
- **Test new business models (i.e. Internet)**

Top 3 reasons cited not to engage in CV:

- **Industry not driven by technology / innovation**
- **Company desires full control**
- **Company not willing to engage in activities which distract from the core business**

Technology is key

No single industry sector dominates, but all companies active in CV are in some way technology-related; not surprisingly, construction and food service are notably absent. Reasons for CV involvement are numerous and range from 'testing Internet business models' to 'improving time-to-market', but the single most cited motivation is to 'gain a window on technology'. Companies that purposely do not engage in CV are those in sectors where innovation plays a minor role or those not willing to relinquish full control through minority stakes.

"The main objective for setting up our CV fund was to increase our innovative power and build a radar on technology."

"Innovation is not a key success factor in our industry, so we play 'wait and see'."

Mixed Picture

The study results paint a rather gloomy picture of Dutch corporate venturing. Investment levels will be significantly lower in 2002 than in the previous two years, confirming that the negative mood prevalent in the US at the end of 2001 has crossed the Atlantic (Figure 1). What's more, more than three-quarters of the companies active in CV that we interviewed do not plan to continue making CV investments, and no company intends to set up a new fund (Figure 2). This reflects the disappointment many managers experienced with past CV results: only a third of those interviewed claimed they were 'mostly satisfied'. Managers attribute their disappointment to two main causes. First, a loss of Board support for CV activities, in turn a reflection of poor financial results. For more than one Board, "the CV bubble burst along with the Internet bubble." Second, many companies experienced organisational issues that prevented them from, among other things, integrating the knowledge gained back into their company.

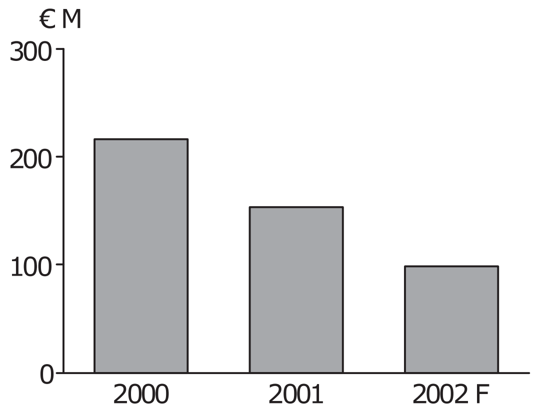


Figure 1: Amount invested in CV, Netherlands

"We are not in the business of developing technology, but the role technology plays in our business is crucial. We do not want to own the technology, but we certainly need to make sure it develops in the best manner possible for our business."

-Reed Elsevier

However, a few of the CV fund managers we talked to still held a generally positive outlook on the future. Two key factors differentiate this particular group from the majority. First, they are involved with CV for strategic reasons and, second, they have ensured long-term support from their Boards. "CV has a genuine strategic importance for us, so we do not expect to see a decrease due to current economic trends," says one manager. Another notes, "Despite a decrease in enthusiasm, our Board will not exit CV due to the current bear market. Our Board understands that results will take a long time to materialise."

The above results suggest that the future of CV in the Netherlands is bleak. Many companies with a history of corporate venturing are deciding to stop. However, Bain believes that, given the right strategic conditions and execution, corporate venturing can still be a very effective tool for strategic growth. Below we discuss what these conditions are.

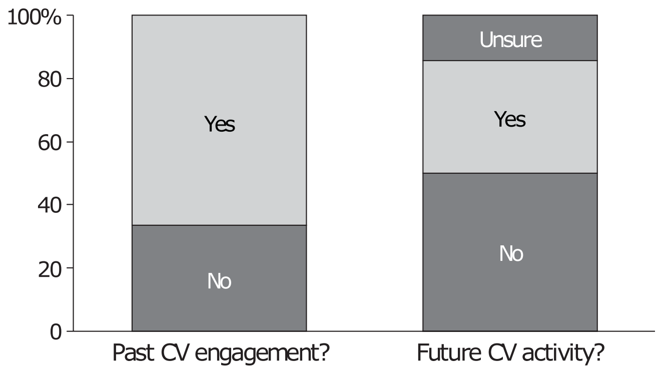


Figure 2: Activies in CV now and in future

When to use CV versus other tools for growth

Finding sustainable growth

As any CEO knows, sustainable and profitable growth is difficult to achieve. To do so, a company must have a growth strategy that balances the goals of dominating its core business and aggressively expanding into profitable adjacencies.

An effective growth strategy can be made of multiple components. Innovation is just one of these components, and CV is simply one of the tools for innovation[1]. Thus, it is important to determine when CV is indeed a viable means for innovation and thus growth. In general, this is the case if five conditions are met:

1. Significant uncertainty exists about the 'winning' technology, distribution or business model being considered as a means for growth. For example, a mobile phone producer who does not know which type of communication standard will dominate in the future but needs to think about future production, or a stock brokerage that feels threatened by on-line trading and wants to experiment.

2. The technology or business models are developing at a pace faster than the company can keep up with alone- meaning it is incapable of developing and testing them all in-house.

3. There is value in being involved early as opposed to simply waiting for uncertainty to disappear (and then becoming a client). For example, if the mobile phone producer better understands the possibilities and limitations of each standard, he can better exploit them when the time comes. Similarly, if the stockbroker does not at least begin testing Internet trading options, he may find himself losing clients.

1 Other examples of tools for innovation include internal research and development units or the launching of new business units.

"You must bring far more than capital to the party, like a large distribution network, significant buying power, deep knowledge of imports and exports, etc."
"We can explain to our investees how this market works, something that they could never have understood otherwise"

4. The investment will present a win-win situation by adding value for both the investor and the investee (target company). The value-added by the investee to the investor is clear; it becomes an integral part of the investor's growth strategy by, for example, offering access to technology that a company would not have obtained access to on its own. The value-added by the investor can take many forms, including sharing expertise (on technology, markets, or processes) or becoming either an important supplier or a customer. Without this two-way value added, corporate venturing is likely to fail. If investors bring only money to the table, they will typically have to compete directly with more experienced VC funds. And if the value added by the investee is not clear to the company, it can not materialise into a valuable investment.

5. The investments are related to the company's core business in the appropriate manner. CV is most successful when investments are made in businesses that will help defend the core, prepare the core for future changes in the market, or build into adjacencies; not when companies need to grow their core through traditional means or move into a new core entirely.

This last point deserves additional explanation. A company busy growing its current core business must have the necessary skills and capabilities to achieve this growth internally. For example, a magazine publishing company should not use CV to launch a new magazine. This is their current core business; there is no reason to take only a minority stake in the new venture. However, in order to defend their core business by adapting to a changing market place around their core, that same company may need to consider CV investments in technologies that are changing the magazine publishing business. Imagine new methods of delivering the content normally held in their magazines, for example. In these instances, CV can be used to explore the possibilities. The same is true if a company-wishes to test adjacencies that fit the first four criteria above, but does not yet know which adjacency will be a success; a CV-type set up might help make explore the possibilities. In the most extreme case, when a company believes they need to change their core business altogether, CV is almost never an option. This is for two main reasons. First, redefining a company's core takes far more time, energy and commitment (financial and otherwise) than that provided by the multiple, minority investments

Defending the core
Technology is not the core business of a publishing house - words and books are. But with the explosion of media for spreading published material - such as the Internet and e-books - publishers cannot afford to put their heads in the sand and bemoan the downfall of paper any longer. New entrants pose a real threat to their core business - content - unless they embrace new channels quickly and effectively. Many publishers turned to corporate venturing to ensure that they understood the new technology and could shape its development to meet their needs, without having to waste valuable management resources (and money) to do so themselves.

Adjacency play
“Our core business will remain the same," said one CV manager at a consumer goods company, "but it is clear that we need to test new businesses around the edge of our core [adjacencies]."
The company didn't know which direction the new businesses should take (Will clients want Product A, B, or C in the future?) and so used CV as a means to explore the options. "Now we understand these new businesses better and, if need be, can enter them quite easily."

typical to CV. Second, because the new businesses will be by definition unfamiliar to the company, it is unlikely that the company's participation will help turn the businesses into successes.

Given these conditions, the kinds of companies most suited for corporate venturing are likely to be those whose core business is strongly reliant on technology and/or innovation. Across the globe, this means a heavy bias towards computer hardware, telecom, information services, etc., but also more traditional industries, such as publishers exploring e-book technology. On the other hand companies that we don't expect to see active in corporate venturing include those involved in construction, food service, etc.

CV is a tool for growth if:

- **Relatively high levels of uncertainty exists**
- **Technology is developing more quickly than the company can keep up with**
- **Value in being involved early is evident**
- **A win-win situation for investor and investee is possible**
- **Investments have proper relation to company's core business**

Guidelines for success in Corporate Venturing

Many companies struggle to make CV 'work'- there are, it seems, endless pitfalls! Through its research and interviews, Bain has identified 5 guidelines for successful corporate venturing. These guidelines, (which are valid for any type of corporate venture, whether defending the core or testing adjacencies) focus on success factors that are unique to corporate venturing, as opposed to venture capital as a whole. Thus, while traditional venture capital issues - including such issues as deal flow creation, risk management, economies of scale, exit strategies, etc.- are also vital to the success of a corporate venture fund, they are not addressed in this article.[3]

The guidelines are listed below and then described individually in detail:

1. Find the proper balance between strategic and financial objectives and ensure the mechanisms are in place to measure both
2. Obtain and maintain full Board commitment over the long-term
3. Ensure effective co-operation between the investee companies, the CV department and the individual Business Units of the company
4. Set up a CV team which can obtain both the business knowledge and the VC knowledge necessary
5. Recognise and manage the tensions between corporate-based and VC-based compensation schemes

1. Find the proper balance between strategic and financial objectives and ensure that mechanisms are in place to measure both

When companies engage in CV they must strive to achieve both financial and strategic returns. If the fund is set up for purely financial gains, the company is simply wasting management time on something that should be outsourced to a normal VC fund. Furthermore, there is no guarantee that the returns a company fund generates will be superior! If, on the other hand, investments are made based only on their potential strategic impact, chances are that bad investments will be justified by their perceived "strategic" value. Thus, a CV fund must be judged in both areas. (Figure 3) However, having said this, financial returns are easily measurable, while strategic ones are not. This often results in a bizarre situation in which CV managers are asked to set both financial and strategic goals, yet in practice are rewarded purely on financial results. To make matters worse, since financial results tend to take longer to materialise than strategic ones, CV managers are often given poor evaluations in their first phases, even if they did make sound investments.

3 See for example, "Corporate Venturing: Management Fad or Lasting Trend", Bain & Company, for a fuller discussion of general VC success factors

"It is so difficult to measure strategic success that we gave up trying - all our investments are now judged purely on financial criteria"

"We measure our success on two fronts: returns and strategic relevance. Last year we scored above expectations on both, and have been pleasantly surprised by the active, strategic interest from business units in our investments."

Thus, it is essential that companies not only find the right balance between strategic and financial objectives, but that they also put mechanisms in place to measure both. Financial returns can simply be measured against the VC benchmark. If well-managed, there is no reason a CV fund should under-perform the VC index, an easily mesaurable target. However, strategic returns, by their very nature, are harder to set and to measure. Thus, companies need to set concrete objectives and agree in advance what measurements will be taken to evaluate the achievement of the objectives. For example, a company could decide on two main strategic objectives:

- o Understand the most important technological developments that could impact our core business
- o Apply these new technologies in our own business where appropriate

Once these objectives are set, the company has to measure their success. One solution for the difficulty of capturing "hard results" is to set proxies. In this example, the company might decide to measure "number of presentions made by investee companies to our BUs" and "number of commercial contracts signed between investee companies and BUs."

2. Obtain and maintain full Board commitment over the long-term

To keep CV on its feet, especially in the tough times (during the current economic downturn, for example), it is crucial to have long-term and full Board commitment. Pay-off in corporate venturing only comes through long-term commitment: a successful corporate venturing portfolio must achieve both financial and strategic success, a process that takes years, not months. In fact, the first phase of a corporate venture fund is often marked by negative returns on both fronts, which can cause the organisation to grow restless and uncertain about corporate venturing, sometimes even stopping it altogether. As one manager explained, "Lemons ripen

Measure strategic success…

While strategic criteria are often difficult to agree on, they are even more challenging to measure. One company interviewed solved this problem by using very specific, measurable proxies for each of their chosen strategic goals. For example, when the goal was "invest in companies relevant for the future of our business," the proxy used was "percent of investments with co-funding from a business unit." Having the Board, the BU's and the CV department all agree on the criteria beforehand meant everyone could agree at evaluation time that CV was (this year) a success.

…But don't over-do it

While searching for and rewarding strategic fit is important, one company, Reed Elsevier, also warned against the danger of "strategic fog" - or the willingness to invest in financially less attractive projects simply because there was a potential strategic fit. "If a BU can suggest any project and claim it has 'strategic relevance', and thus should be invested in… it will only lead to a no-win situation. When an unhappy Board sees money flying out the door, it may decide to end CV all together."

Strategic and financial objectives both essential

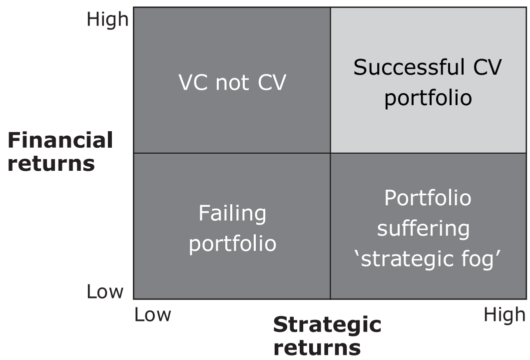


Figure 3: Balancing strategic and financial objectives

Building Board commitment

One CV manager in the media industry managed to build a watertight relationship with her Board by introducing them to CV in stages. She began her investments in companies that had a short-term horizon for the strategic benefits they would provide; and then moved gradually into investments whose strategic value would take longer to develop. Even when the economy swung down, her support from above remained strong. "We need to first prove we're relevant, then we can consider experiments."

Changing Board priorities

At another media player, the rise of the internet - which seemed to drive major changes in the industry - had initially made CV a top priority for the Board. Later, when the Internet proved to bring no drastic changes to the industry, CV fell down the Board's priority list. CV was no longer a "need to have" but a "nice to have." This change in Board attitude and support had 2 major effects. One, it was no longer clear how much of the committed capital would actually be invested. And, two, despite the fact that CV was still an valid manner to explore changes in the industry, the company was unlikely to participate as actively as in the past.

more quickly than plums. In other words, failures within your portfolio will show up before the winners will. You must not quit while you are down!" …or you are guaranteed the loss of your initial investment and any chance for future gains.

Receiving full Board support is even more of a challenge since many CV managers believe that their Boards do not fully understand CV and therefore make critical mistakes. These range from equating CV with the Internet surge, and deeming it "dead," to believing that pure financial gains are the only valid measure of success. One possible solution to this problem (already used by some of the managers we interviewed) is to phase investment types over time in or to gradually build Board commitment. This means choosing quite simple investments in the earliest phases, whose financial value (on paper, in any case) is expected to increase quickly, or whose strategic value is easy to implement and readily evident to the business units. As time goes by, and sentiment within the company regarding CV improves, the fund can focus on less certain investments and those with less certain, longer-term strategic relevance, confident of Board support.

3. Ensure effective co-operation between all involved parties

It is essential that all 3 parties involved with CV - the CV department itself, the individual BU's and the investee companies - co-operate and communicate well. Particular attention must be made to involve the BU's. This last point is often overlooked - as CV funds can often invest without ever consulting a BU - yet managers agree that failure to involve their BU's in the process can cause the entire CV fund to fail. One fund manager summed up the problem by saying, "Our fund is just too detached from our BU´s to be a success, it just doesn't work!"

Companies can increase BU involvement in many ways. For example, they can appoint 'CV Champions' within their BU's or ask key management members to take advisory seats on the boards of their investee companies. Having BU's suggest and (partially) fund the investments themselves is also a good way to increase their commitment to the success of the CV.

A related element is the question of where to place the CV department within your company. Should it be managed entirely outside the company or, at the other extreme, should there be a separate CV organisation within each BU? Neither extreme is an ideal option. Manage your CV externally and you risk losing buy-in from your BU's, and killing your chances of building strategic value. Manage CV at BU level

"If [the CV organisation is] too internal you do not give enough freedom to the fund managers, if it is too external you lose the knowledge sharing, this the eternal dilemma."

· In this case, a technology-driven CV, but this could also be business model or standard-driven

Blocking out the business units

One CV manager explained in distress what had gone wrong. "We set up an external fund, run by venture capital experts, as we had no knowledge of the topic. In principle, the external fund would make proposals to our internal investment committee, who would in-turn accept or reject the investment. But there was no link back to the BU's. We've now made 5 investments though the fund, and not a single one has resulted in knowledge sharing or co-operation with our current business. And there is still no system in place for this to occur. It's a definite failure on that front. We won't invest any more capital in the future."

A centralised, integrated model is the most effective

Desired characteristics	Independent fund	Centralized VC activities, with integration in business units	Decentralized CV activities at BU level
• Independency and quick decision-making	✓	✓	✓
• Ability to look beyond current business boundaries	✓	✓	✗
• Ensure potential for value addition between parties	✗	✓	✓
• Ensure buy-in from BUs	✗	✓	✓
• Centralise CV skills for economies of scale	✓	✓	✗

Figure 4: Pros and cons of organisational models

and you won't benefit from skill or cost sharing within the CV department. Nor from the advantages of an 'independent outsider view,' nor from ideas that could be of benefit across BU's. Centralising the CV department also allows for quick and independent decision making - an enviable asset in the CV world. Therefore, in most cases, an internal, centralised structure is the most appropriate: the CV truly becomes a part of your company (managed within the existing reporting structure), but the CV skills (and fixed costs!) are centralised in one CV department for all BU's. However, if your company is extremely large and each business unit operates independently- almost as a separate company- it may make sense also to have separate CV units for each BU, especially if strategic goals differ per BU.

4. Set up a CV team which can obtain both the business and VC knowledge necessary

It is essential that the CV team have both business and VC skills. This is because corporate venturing requires a range of different skills throughout the investment process. From deal generation, to deal selection, to deal execution and on-going investment management, a mix of skills are needed. Internal people have in-depth knowledge of the business, allowing them to potentially better recognise investees of strategic interest to BUs (deal generation and selection), and a strong network within the company giving them an advantage in making the investment an on-going strategic success. External hires (almost always from venture capital funds), on the other hand, have contacts in the VC world, giving them access to exciting deals (deal generation), and understand the intricacies of the VC world allowing them to be sharper judges of business plans and drive tougher deals (deal selection and execution). Given this reality, it would seem that a mixed team would be ideal in capturing the best of both worlds. However, this rarely occurs in practice: only one of the companies we interviewed had such a mixed staffing, the rest tended to go for either extreme. Why do companies tend to use just a single type of CV staff? Cultural and compensation differences between the corporate and VC worlds make a cohesive and happy mixed team quite difficult to achieve. There are several option for acquiring the necessary VC skills: hire staff from external VC funds and bring them to your CV department, teach VC skills to your internal staff, work together with an external VC fund, or hire VC experts on a consultant-like basis for tricky deals. You can also decide not to hire internal people to provide your CV department with the necessary business knowledge but instead to teach VC experts about your business.

"I don't see only one winning organisational model. Leave it all to the BU's or centralise it all; it depends on your business"

"Our business is complex, outsiders do not understand it; so we've hired every CV investment manager from the inside. Since we lacked VC skills when we began, we first invested only through external funds. Now that we have experience, we are considering venturing out on our own"

-DSM

"You must have both CV and VC experience, so we hired both immediately; half of our team is external and half internal."

"Venture capital knowledge is key. We hire purely externally and then spend 40% of over time internally, so they can learn the business

-Reed Elsevier

It can generally be said that the more complex your business (in terms of technologies, organisation, processes, supplier relationships, etc), the more the emphasis should be on an internal team, especially as the difficulty to integrate an external team becomes greater. In the case of an external team, the business skills can be acquired by, for example, having CV managers spend 6 months working within the company to familiarise themselves with the business before starting to invest. Conversely, it could also mean that internal fund managers first invest via external funds where they can learn about VC, and only at later begin investing directly.

5. Recognise and manage the tensions between corporate-based and VC-based compensation schemes

A point related to the previous one is the issue of compensation. Recognising and managing the tensions between corporate- and VC-based compensation is essential, and one of the most delicate issues facing the company. As mentioned above, compensation methods are linked to the issue of staffing, a company must choose between the normally highly lucrative VC-type compensation (base salary plus carried interest) or a lower, more conservative corporate compensation (base salary plus corporate performance bonus). If the team is to be brought in

"All our CV team is internal, outsiders don't get our business and wouldn't fit in with our corporate culture!"

from the outside, VC-type compensation is often essential in order to attract and retain talented VC experts. However, while VC compensation is extremely performance driven, it can also result in financial objectives dominating strategic interests and may alienate other corporate employees (including those of the very BU's CV is supposed to be supporting!). Corporate compensation, on the other hand, has two key advantages: it eliminates rivalry issues with other employees and it allows investments to focus on your company's strategic interests. On the other hand, it may decrease risk awareness and may not place enough attention on financial objectives.

It is important is to manage the tensions between the two compensation types in an effective way for the company. Companies must consider where they want their CV staff to come from and where they will go in the future. Thus, companies have three basic options: 1) a completely internal team with internal compensation (plus a larger percent bonus, perhaps) so staff can come from and later return to the organisation 2) an external VC team with VC-type compensation to assure the a high level of VC skills, or 3) a mixed team with mixed compensation. The last option is the best (as described above) in terms of knowledge and skills, however, in order to choose the last option, a company must first be wiling to accept a situation in which similar work is being compensated significantly differently. If this is not acceptable, a company may decide to "rent" VC-like skills on a case-by-case basis, as needed.

"Our company just won't pay what truly exceptional external VC managers expect. So we hire exceptional people internally, and teach them about VC"

-DSM

DSM: Specialty chemicals and Corporate Venturing

Although only officially active in corporate venturing for less than 2 years, DSM's experience in the field dates back far further; with ad-hoc CV investments as early as 1992 and a long history of internal ventures. Though it is too early to claim that the current CV fund is a success (as these are long-term investments), it does appear that DSM is on the right track, given both the market conditions and operational approach.

DSM focuses its CV activities on 3 main areas:

- Life science food ingredients
- Life sciences pharma
- High performance materials

Each of these areas easily meets the market conditions necessary for CV to be a successful tool growth - there is significant uncertainty in a rapidly changing market where there is value in being involved early and an opportunity for both parties to benefit.

But beyond the favorable market situation, DSM has also managed to successfully execute CV, a challenge to many of the companies around them. First, DSM has a strong system in place to measure both the financial (against a VC benchmark) and strategic (using a proprietary measurement system) success of their investments. Second, Board support for CV has been built up gradually - and remained remarkably strong even in economic downturn - by actively involving a few key members of the Board in the entire CV process. Third, in order to remain in close contact with their business groups (BGs) and to better understand how to add value to them, DSM has set up "venturing support teams" within each relevant BG to regularly discuss CV and the BG's opinions or ideas about various (potential) investments.

One of the major challenges DSM overcame was staffing. Being a complex business, DSM truly felt that it needed to hire internal staff - who understood both the products and the internal network - to run the CV department. However, these same people - by definition - did not have the VC skills necessary to negotiate solid deals. Thus, DSM came up with a practical middle ground: invest via external funds until you have learned enough to do the deals yourself. And this is the point where DSM stands today, gradually but clearly making the shift away from investment via funds to direct investments (with a goal of an 80:20 ratio of direct investment to fund investments by 2003). To do so won't be easy. DSM is betting that their policy of placing some of their own staff physically at the external funds has created VC-savvy investment managers where there once was only internal DSM knowledge. But to hedge this bet, they've also decided to co-invest with existing VC funds for the time being.

Thus, the challenge that lies ahead will be two-fold. First, DSM will have to ensure that their investment team is indeed savvy enough to close attractive deals with the likes of the best VCs. On this front, they seem to be well on their way, moving intelligently, one step at a time. Second, they will need to ensure that once they have a team full of expert dealmakers, that their compensation package for these investment managers is aligned not only with the fund's strategic and financial goals, but also with DSM's desire to keep these new experts on board.

Conclusion-
Future of Dutch CV

We end by returning to our original question, "Are the CV dikes about to break in the Netherlands?" Looking back over the several months it took us to complete our study one thing is absolutely clear - the hype is indeed over. As well it should be. CV is not and should not be for every company. While CV can indeed be a valuable growth tool, this is only the case given the right strategic fit and the proper execution. The great majority of companies in the Netherlands which attempted CV were not able to master these two requirements. In some cases, we say, "all the better, CV was ill-conceived or a poor strategic fit for that company anyway." However, in other examples we see companies that have definite strategic reasons to consider CV as a valuable growth tool but were unable to execute it according to the necessary guidelines. Boards withdrew support, missed financial targets overshadowed any financial gains, or knowledge gained never made it back to the business units. Often, it seemed that one market downturn caused companies to forget that CV is a long-term game and to exit at the lowest point in the market.

We hope that some of these companies will reconsider their decision and that some new companies will take a serious look at CV. A strategic review - Is CV right for us? - must come first. Followed by a tough, but fair evaluation of how to succeed executionally. If the company has sound answers for both of these phases of questions, it may be time for CV again.

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Rembrandt Tower, 20th Floor
Amstelplein 1
1096 HA Amsterdam
Netherlands
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