

Corporate venturing, an overview from Taylor Wessing

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Politicians, commentators and analysts agree that innovation, especially in sectors such as clean technology, will be of crucial importance in the UK's economic recovery. As businesses attempt to find growth opportunities to help them in the wake of the longest recession on record, one of the options to consider is corporate venturing, write partner Simon Walker and associate Charles Fletcher of law firm Taylor Wessing.

"Corporate venturing" is a widely used term to describe various different strategies for spinning out or starting up new businesses from established entities.

These strategies can be used by a large company for extracting more value from its existing assets and contacts (in terms of routes to market, partners, customers and intermediaries); for exposing potential new customers to its core activities, through the business of the venture; for entering new markets and diversifying the products on offer; or for hedging against competitor strategies. They can be used to generate organic growth within an organisation by making better use of existing resources.

The history of corporate venturing in the UK has had its highs and lows, not least given the track record of corporates being behind the curve of previous investment cycles (in particular many corporates started venturing at the peak of the technology bubble in 1999-2001). However, on the back of hopes that innovation can spearhead the recovery of UK plc, it may well be the case that a resurgence in corporate venturing is imminent, prompted by reduced activity amongst the traditional venture capital sector and large companies pursuing more imaginative growth strategies in recessionary times.

Two sectors in which corporate venturing is playing a particularly prominent part are biotechnology and clean energy.

Biotechnology: Biotech has some recognised structural problems as highlighted in Sir David Cooksey's report of earlier this year entitled "Review and refresh of Bioscience 2015". The Cooksey report highlighted the problems caused by the shortage of institutional investment in the sector and suggested, amongst other things, that the way forward was for big pharma to make corporate investments in UK biotech companies and to spin out assets to create new companies.

Clean energy: Another good example is the extensive investment in clean technologies by large utility companies – while such activities are currently non-core for these companies, these investments are fuelling activity and innovation in this sector. Corporate venturing is a means for the large utilities to ensure they maintain an interest in and knowledge of emerging technologies.

Therefore, now is a good time for large corporates to be asking themselves whether they are suitably geared up for venturing opportunities: venturing is an underused weapon in the business armoury but one that can be very useful indeed when well executed.

Types of Corporate Venture

Broadly speaking, corporate venturing may be by way of:

(a) **VC-like investment.** Large companies may have a venture capital arm dedicated to investing strategic stakes in smaller companies which are otherwise unconnected to that large company. This type of venture model may be thought of as a large company diversifying into the VC business. Accordingly, companies which are going to do this (sometimes known as CVCs) need to believe that they have better access to dealflow than other independent venture capitalists (or

why would they not just become an LP in a conventional venture capital fund?) and can add value through their existing business and brand.

(b) **Joint venture.** A joint venture is a corporate or contractual collaboration between trading companies. Typically this could be where a smaller company partners with a larger company, allowing the smaller company to benefit from the greater expertise and resources of the larger business and allowing the larger company to gain access to new ideas and technology in areas of strategic importance. Joint ventures are particularly popular in a cross-border context - any number of global companies have formed joint ventures with local partners in order to access overseas markets, thereby benefiting from their local partner's understanding of logistic, regulatory, cultural and other territory-specific issues. However, the advantages of a joint venture should be weighed against the fact that it inevitably involves a sacrifice of the control and flexibility which the parties might otherwise have been able to exercise had they undertaken a business or project independently.

(c) **Corporate spin-out.** Corporate spin-outs enable large companies to extract value from non-core intellectual property assets that are discovered or developed as a by-product of that company's core activities. This is done by spinning out the technology into a new company. In this way, non-core IP that might otherwise have been commercially mothballed can be commercially exploited. Spin-outs can be a disruptive process, in terms of loss of key personnel and know-how to the spin-out, but some organisations have had great success through this model.

The Corporate Venturing Scheme

The Corporate Venturing Scheme is a UK tax break, which aims to promote venture capital investment by companies. It performs a similar role in promoting investments by companies to that which the Enterprise Investment Scheme (EIS) does for investments by individuals. While the scheme has met with criticism from various quarters for not going far enough to incentivise corporate investment, it can provide some useful reliefs when certain conditions are met.

UK companies investing in small trading companies may benefit from the following reliefs:

- (d) Corporation tax relief of up to 20 per cent of the amount invested;
- (e) Relief against taxable income for any losses incurred on disposal of qualifying shares;
- (f) Deferral of chargeable gains on disposal of qualifying shares on reinvestment in other qualifying shares.

The following conditions need to be met by the investor:

- (a) The investor must not own more than 30 per cent of the share capital or voting power in the company or otherwise control the company at any time during the three years following investment;
- (b) The investor must exist wholly for the purpose of carrying on one or more non-financial trades;
- (c) Investment must be for bona fide commercial reasons and not form part of arrangements with a main purpose of avoiding tax; and
- (d) The shares acquired must be chargeable assets (i.e. in principle within the charge to corporation tax on capital gains) for the investor.

The investee company (e.g. the corporate spin-out) also needs to meet some very specific tests, including that at least 20 per cent of the share capital of the investee must be beneficially owned by individuals (other than directors or employees of any investing company or any company connected with it) and that the investee must raise no more than £2m in total in any 12-month period.

Summary

While many see corporate venturing as a means of driving growth in the good times, it is a far more flexible tool than that and has a multiplicity of uses, which include extracting value from non-core assets or stimulating a starved technological ecosystem in tougher times.

The proviso of course is that the venturing activity must have very clear objectives and use both sector specialisation and suitably skilled and experienced personnel – ventures that are carried out on an ad-hoc basis by companies that are not set up to deal with them are less likely to succeed.

When the correct model is employed, venturing can achieve certain corporate objectives for an organisation in a much more effective manner than the blunter instruments of acquisition and disposal, merger and demerger. It is no surprise then that we are seeing increased corporate venturing activity at present.

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