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Successful strategies for new venture development

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Capital strategy is the strategic planning foundation that supports a new venture, from conception to exit. Capital includes funding, intellectual property, human capital and strategic alliances. This article explores how successful companies leverage capital, plan a new venture and make sure each strategy and tactic is prioritized to meet the exit goal. That goal may be a spin-off to a separate entity, a strategic alliance with (or sale to) an outside partner, or the development of a new profit center within the corporation.

When a corporation engages in new venture development, different kinds of risks will confront both corporate and new venture management. New ventures can include R&D incubators, new divisions to exploit lateral, untapped markets, and licensing divisions all established to extend the corporation's reach into new markets and territories, or to create additional revenue and profits from its existing assets.

These new ventures often demand that the corporation learn to leverage outside capital investment, strategic allies and outside experts, and handle the "stepchild" problems created by a division that is in many ways outside of the traditional corporate structure and chain of command.

Furthermore, new venture management must understand (early in the planning stage) what it means to handle the venture's success to bring it inside the corporation, or to manage its appropriate exit strategy.

Careful consideration for strategies

Corporate strategies that support the success of internal new venture development must carefully be considered as the new venture is initiated and sustained throughout its launch and growth. These success strategies include:

- Define capital and exit strategies.
- Align with highest corporate goals.
- Maintain corporate commitment.
- Engage experts.
- Create strategic alliances.

Strategy 1: define capital and exit strategies

From the beginning of a venture until its exit, capital strategy is focused on accepting the best kind of capital from the best source at the best time to create the highest valuation.

Capital is more than the allocation of line-item resources to a venture or outside funding in the form of cash and/or debt for equity. Building a strategy around capital means considering all sources of capital:

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- Funding from various sources.
- Intellectual property, patents and copyrights.
- Human capital, including expertise in market segments, product lines, technology and worldwide territories.
- Strategic market alliances, including those that bring access to customers, distribution channels, markets, territories, co-branding and co-marketing, and endorsements.
- Strategic product alliances, including those that provide product and technology synergies, such as licensing opportunities and/or integration with strategic products to create and deliver new products to target new markets.

Any venture's success requires access to each of these capital sources and an effective strategy for their combined use. Beyond this, experience is required to manage intellectual property, attract experts, form successful alliances and, most critically, control the capital strategy and valuation at all stages of the venture's development.

Essence of capital strategy

Leveraging all these capital sources is what allows a corporation to launch, grow and sustain what is required by a new venture as well as gain its ultimate return on investment (ROI). This is the essence of capital strategy.

To plan a capital strategy means to begin with the end in mind; that is, knowing whether the corporation will keep the venture as a profitable in-house division or whether it will create an exit for the venture outside the corporation. It continues by creating (first) the best initial valuation and (later) the best exit valuation and by directing all strategies and tactics towards that exit and valuation. The discipline of capital strategy is to avoid the distraction of any opportunities that divert resources and focus from exiting at that valuation.

Exit strategies include:

- Evolution of a venture from incubation to a profitable division within the corporation.
- Spin off of a venture to become an independent company, bringing an ongoing ROI to the corporation.
- Spin off of a venture to become a joint venture with a strategic partner, bringing an ongoing ROI and strategic leverage to the corporation.
- Spin off and sale of a venture, bringing ROI to the corporation.

Capital strategy also involves making a determination of the best kind of capital to accept, including:

- *In-house funding.* Assumes total ownership of the venture by the parent corporation.
- *External investments.* These include equity and/or debt from individual investors, angel investment groups, banks or venture capital groups. The investment group shares the ownership with the parent corporation and all other investors.
- *Strategic contributions and funds.* These do not require an outlay of equity or a commitment to debt. These strategic partnerships may involve revenue- and profit-sharing, and they connect the venture to its strategic partners for mutual gain and market presence.

After determining the best kind of capital, the capital strategist then determines the best time to accept that capital from its source, at the highest valuation possible. Options include:

- *Staying "self-funded".* Rather than accepting other sources of capital, the corporation contributes funds until certain benchmarks are reached.
- *Accepting debt to preserve equity.* It helps to know when revenues or corporate cash will be available to offset the debt.
- *Accepting only non-equity strategic capital.* This refers to intellectual property (IP), human expertise or co-marketing in the early stages. Oftentimes this non-equity capital has a cash value for the IP, the expertise, or the marketing access, and is accompanied by a "strategic marketing" cash contribution.
- *Accepting outside equity.* This occurs only at later stages (when the investment "costs less" in equity) and when the outside investors bring more than funding (e.g. access to expertise or new markets, and/or synergies with other companies in their portfolios, etc.).

Launching a product or service into the marketplace and creating initial revenue raise the venture's valuation. The growth of the venture continues to increase its valuation, attracting more strategic partners and investors to support its expansion. At each benchmark, the valuation increases, and new capital costs less. For example, the company loses less of its ownership for the same amount of incoming capital when its valuation is high. The parent corporation may prefer to set the venture "outside" the organization (while maintaining majority ownership and control) to create a greater strategic reach to new partners and markets. Careful control of capital strategies can ensure the growth, flexibility for new opportunities, and success of a venture.

Strategy 2: align with highest corporate goals

It is critical to understand what goals the parent corporation values most highly and to align the venture's success accordingly. This may sound self-evident, but sometimes the goals are not articulated clearly, or the reason for the formation of a new division is not clearly defined in the hierarchy of the corporation's priorities. It is essential to understand the new venture's standing in this hierarchy and how it fits in with these larger goals.

If the corporation's goal is to capture and maintain increased market share, profitability and shareholder return, the new venture must contribute significantly to that goal. If the corporation has certain cultural success models and expectations of time frames for reaching those success models, the new venture must be able to adapt to those cultural expectations.

If the venture's success model falls outside the corporate mindset, or if its timing is too severely challenged by the culture's understanding of when success should be attained, there is a high likelihood that the new venture will fail by the corporation's standards, even if it succeeds in its own right. In other words, the corporation may look beyond any positive signs and shut the venture down. The success, failure and closure of new ventures (even the closure of successful ventures) offer insight to the importance of aligning with corporate goals:

- "Why do we have to care about this?".

Imagine this attitude spoken (or not spoken) with a growl and exasperated hand gestures. Handling this attitude is a critical element in aligning a new venture's goals with the larger corporate goals, and avoiding political death at the hands of colleagues or competitors.

Need for early buy-in

A telecommunications company once set up an in-house division to market software for the banking industry. A sister company created the software on time and on budget. The software marketing division was true to its promises to identify and build the value-added reseller channel to market the software.

Come budget review time, the head of the division reported to the budget committee that all was well and that channel expectations predicted $2 million in revenue in the upcoming first year of sales, during which the channel would be built and training and selling would begin. This was considered high revenue for a niche-market product sold through an indirect sales channel for its first year. Nevertheless, it was too small a line item for the telecommunications company. Its message: "If the division can't bring in at least $4 million in year one, it won't even become a line item on the larger budget, as the division will be closed down." By making this decision, the parent company abandoned this two-year effort and the intellectual property and paid severance to 26 employees.

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Perhaps the division head warned the budget committee what to expect in terms of the first year's revenue, perhaps not. Perhaps new personnel sat on the budget committee. Most likely, the division head had not succeeded in making the budget committee understand the niche nature of the software, nor the delayed revenue expected when an indirect sales channel must be built. Clearly, no one discussed the sales surge that would occur in later years if the software became a standard in the banking industry (and other industries to which it could be applicable). All of this needed to be made clear as the initiative began, not two years later, and it needed to get buy-in at every budget approval session.

Profitability, no scalability

In the days before private banking evolved, a major US bank created a division to provide personal-wealth financial planning services to key executives within the bank's client corporations. The client companies paid the bank to provide these services as part of their executives' benefits packages, so the service was free to the executive employees. It was a strategic way to open new business for the bank, leveraging its relationships with its corporate clients and their lists of executive management. The division was profitable for several years, but could not "scale." That is, as much as it profited, it was never to the point of any significance to the bank. As professional malpractice insurance rates rose, the bank's risk versus the small profit gains led the bank to close the division.

"A toe in the water"

Some new ventures and initiatives are ancillary to the primary goals of the corporation. One major computer company once built a division to explore a new technology that was fast creating a new marketplace. The long-established *Fortune* 100 company wanted to "keep up" and "know something about it." It wanted to "put its toe in the water." The division created product, released it into the marketplace and succeeded to profitability, but the marketplace was still minor in comparison to the larger business of the corporation. Some years were spent expanding the division, and value was gained by playing in that market segment. Yet, the ultimate impact on the business was minimal. The division was closed, and the parent company returned its focus to its core business.

Is the initiative in the annual report?

A significant corporation in the computer-aided design (CAD) market created a division to extend its lowest-end (i.e. least expensive and least powerful) product line into new markets with value-added resellers (VARs), leaving its direct sales force to sell the majority of the product line to major corporate accounts. The division head wanted the VARs to have access to the major corporate accounts, to sell in the lower-end products. Checking the annual report, and the CEO's letter to shareholders, she found no mention of this new initiative, nor projections marked out for its revenue contribution. The division head was not surprised when the CEO turned down the request for access to the corporate accounts, which would have created conflict among the direct sales force and the VARs and confusion within the accounts. The division head understood that her division was built to "not leave money on the table," in opportunities ancillary to the core focus of the business. She built her division accordingly, and it succeeded.

Can the venture be independent of the corporate structure?

The most successful in-house ventures are often those that can exist outside of the hierarchical corporate structure, in an independent sphere where the division head reports directly to a very senior executive, the president or the chairman. This removes the division from competition for turf- and resource-allocation that exists within the corporate structure. Also, it removes the "chain of command" that demands that the division head "sell" his vision to several executives in the chain. An in-house venture cannot succeed if reporting is required at multiple levels. Such bureaucracy can paralyze a new venture and suddenly the chance to react quickly to its marketplace is gone. And the "why do we have to care about this" syndrome will become prevalent in at least one of the multiple bosses as soon as he or she gets under pressure to perform or to compete for resources.

Strategy 3: maintain corporate commitment

Also critical is the corporation's commitment to the long-term view of the venture's development, success and contribution to the higher goals. It is important to have a realistic sense of the venture's true time to market, time to ramp and time to ROI. Missing such projected benchmarks invites closure. Easy to say, far more difficult to achieve. It helps to get a real-world outside expert to help predict this timing, one that has worked in the market segment and built comparable businesses on the outside.

In light of these timing issues, the division head must assess how long the venture is sustainable before the corporation's goals become benchmarks for the division's performance. These expectations, if handled up front and presented and documented clearly, can lead a corporation or division head to decide against launching the new venture. If it is doomed to fail, short-changed in appropriate capital, or set up to fail by cultural expectations of quick success or early contribution to revenue, perhaps it is better not to begin.

Remember the telecommunications division head? He was a 20-year veteran of the corporation, had his next appointment within the corporation lined up and packed his desk after the budget committee told him to shut down the division. He left a voicemail message for his "number two guy" to shut down the division and disappeared on an extended vacation in preparation for his new in-house position. Clearly, it would have been better not to begin.

Other issues about sustainability of a new venture include:

- Changes in top management.
- Acquisition of the corporation.
- End of a dynasty's era, when there is no strong heir to accept the leadership void left by the departing CEO.
- Market timing and business model changes that critically affect the conditions of entry and growth.

The commitment and sustainability issues become even more complex once the strategy of contra-cyclical development is well understood. Contra-cyclical development strategy maintains that the best times to build new ventures (inside or outside of the corporation) are during the "down years" when the market is suffering and corporate revenues may be low. These down years are the optimum time for creating, building and testing new products and services, preparing the plan and negotiating for early capital investments. Given that most products actually take a year or more to develop and package for the marketplace, beginning in the down cycle indicates that the product will be ready to launch as the market and the economy begin their next cyclic rises.

It is difficult to achieve this sustained commitment from the corporation to build a division during the down cycle, without expectation that the division will present substantial contributions to the corporation's goals for many years. But to build in the rising cycle may have the division's product or service ready just at the next down-cycle arrives – taking the new venture with it into failure.

Expect brutal honesty from consultants

One multinational entertainment conglomerate hired a consultant to determine the actual time to market, cost of re-entry, cost of channel and deals, and time and predicted amount of ROI for three of its related divisions, all of which had failed in the first three years of their attempts to gain market share during boom times. The consultant was an independent expert in this field, having spent the past several years launching similar companies into similar markets. The larger think-tank consultants could only offer "trends analysis," whereas the conglomerate needed "real world street data" and "brutal honesty."

Also, the market had changed during the past three years, had shaken out many of its unusable new business models and was entering a down cycle. So the strategy had to address the "time to" issues in light of the current, changed conditions. The conglomerate got what it was looking for – current clear strategy on what investments to make in each of these divisions, when to expect successful market penetration, the cost of that entry and penetration and the time to and amount of projected ROI, which could be expected from each of the three divisions. This outside entrepreneurial expertise and knowledge of the specific product and markets was the planning information necessary for the CEO to create his own strategic plan for re-entry or abandonment of each division.

Strategy 4: engage experts

If the division does not have an internal staff with the requisite entrepreneurial expertise in start-up growth and business development, it must recruit the talent. What is encouraged is to bring together the best minds called for by the venture, as early in the planning stages as possible.

Next, gather experienced support that is specific to the product, technologies (if applicable), markets and channels. Nothing will save as much time and error, nor speed success like applying human capital to the venture from the earliest planning stages. Most new ventures will benefit by having access to expertise in entrepreneurial ventures as well as to expertise in venture-specific markets, channels, services, products and technologies.

Entrepreneurial expertise should provide:

- Screening tools and analysis of the venture's chances for success, as seen through the eyes of the marketplace and of the investment and valuation communities.
- Risk analysis and a willingness to predict and define the possibility of early failure and suggest discarding the venture if no fix is available.
- Long-term business planning for growth, projecting three to five years out, including market expansion to lateral and international markets, extended product line development, and future capital needs.
- Predictions on the realistic defensibility of the product or service in the marketplace, and the subsequent sustainability of the venture within and outside the corporation.
- Refinement of best practices, and implementation of changed practices as needed due to corporate or market changes.

> **“ When a corporation engages in new venture development, different kinds of risks will confront both corporate and new venture management. ”**

- Access to and/or expertise with outside capital and strategic partner sources.

Expertise in venture-specific markets, channels, services, products and technologies should provide answers to the following questions.

Current product analysis

- Is the product as market-ready as it seems?
- What is the next release schedule, cost, and time to market?
- Are the documentation, packaging and other go-to-market preparations complete?
- What lateral products are required, if any?
- How old is the underlying technology?
- What new or external competition is on the market, or due for release? Is there any such competition inside the corporation?
- What development for strategic partners has been promised and is ready for delivery?
- In light of what's been promised, what is the true time to market release?

Current service offering analysis

- Is it as market-ready as it seems?
- Is the service packaged, priced and ready for the sales team training, with all supporting documentation and sales materials?
- How long will sales training and materials dissemination take?
- How will the new service get appropriate mind share from the sale force?
- How is it positioned against external competitive service offerings and how will the sales team handle customers' objections? Does the service compete or appear to compete with any other in-house division's offerings?
- What strategic partners are ready to launch the service?

Current market, channel and pricing analysis

- Is the product or service as market-ready as it seems?
- Does it solve a market need ("market push") or is it a solution to a problem not yet defined ("market pull")?
- How much time is required to educate the market in need of the product or service?
- Does a direct or indirect channel exist to receive it?
- If yes, has the channel been signed up and trained?
- Can the corporation's direct sales channels and other divisions cooperate with an indirect sales channel without conflict?
- Are these channel issues resolved?
- Does the product or service offering cannibalize any existing products or services carried by other divisions of the corporation or carried by any channels that intend to resell it?
- Does the channel selected actually target the intended markets, or is market development needed prior to initiating sales?
- Is the pricing appropriate to the target market, to the channel, to its real and perceived competition?
- Will the channel actually accept the product at the price to customers and the margin offered to the channel?
- In light of all this, what is the true time to market, price, channel strategy and ROI?

A *Fortune* 500 international investment capital firm was contemplating a considerable equity investment in an early-stage technology company, which had the potential for selling its patented technology to multiple markets. The firm hired an industry consultant with extensive technology start-up experience. "Read the business plan, and if it is anywhere close to right, go to the company, spend a few days, assess the risks of our proposed investment, and report back to us. We have asked all the due diligence questions we can think of, but we are not industry-experts nor start-up experts, and we don't know what questions we haven't known to ask."

The consultant read the plan and spent two days with the top management of the company in its corporate headquarters, asking all the questions left unanswered in the plan and unchallenged by the investment firm. Reporting back, the consultant identified three significant risk areas that had been overlooked. An outline was provided as to what needed to be done to control these risks, in order to align the risk assessment with the investment firm's original understanding of the venture's risk. The investment firm re-assessed and made its decision based on the new data.

Strategy 5: create strategic alliances

Strategic alliances lie inside and outside the corporation. Both leverage the success of a new venture. External alliances provide ready-made market reach and access and rapidly create early revenue. These are win-win alliances, including capital partners, channel partners, licensing partners, co-marketing and co-development partners.

Internal alliances provide defense, protection and support. These include top management (remember, can the division exist outside of the corporate hierarchy?), lateral divisions that will benefit from the efforts of the new venture and defend it internally; and politically savvy defenders and other in-house individuals who will use their influence to keep the venture safe, funded, left alone, and understood in the right places.

It is important to understand which people and divisions in the corporation will benefit from an alliance with the new division, as well as have the ability to support it. Make this list first and gather the support while the venture is in its early formation stage. Offer concrete advantages and make direct requests for support.

On the darker side of the force, it is wise to know one's enemy. There will certainly be internal forces divisions or individuals who may stand to lose something (power, recognition, promotion, funding, territory, resources) if the new division succeeds. These divisions or individuals may only perceive they might lose something, when it typically is not so. It is critical to identify such internal (and external competitive) forces and attempt to settle their concerns. One way is directly addressing the issue (perceived or real) and putting forward the new division's position that threat is not an issue. It is surprising how often a straight-up conversation can disarm a potentially negative force.

If true competition exists between divisions, attempt to cooperate before competing; looking for a win-win is useful. It may exist in ways the hierarchy cannot conceive. And, if not, the contact with the division will reveal a great deal of information about how that division thinks and behaves and

Extending a corporation's R&D, market penetration and profitability

A corporation's new ventures are set up to create entities such as:

- R&D incubators to create new ideas or new applications for existing products or services.
- New divisions to exploit lateral markets (e.g. the commercial, government, consumer or international markets) for existing products and services.
- Licensing divisions to create additional revenue for the company's technology, patents and R&D.

might create havoc for the new division. An old adage applies here: "Keep your friends close and your enemies closer."

Speaking of defenders and detractors, territory and politics and the momentum of a new division in a timely manner, this story comes to mind. A computer hardware company (a major competitor to that earlier-mentioned *Fortune* 100 hardware computer company) built a small division to support software development and software marketing for products built on its operating system, to drive increased hardware sales. The new software division was considered a marketing division and reported to the next-highest hardware division in the usual order of reporting.

The office of the president commissioned a comprehensive software strategy, but that office did not follow up to support its dissemination, due to certain political infighting. The strategy was put on the desk of the hardware division head who had not commissioned it. There it sat for ten months, until a new young hotshot employee of the software division literally found it on his boss's credenza, commandeered it, and put it into effect immediately. Nearly a year of strategic initiative was lost.

A personal note to executives

In-house new venture development can offer a stimulating situation to the executive who seeks a new challenge. If the venture is carefully assessed to be in line with the corporation's highest goals, it can be an opportunity for advancement.

" If the corporation's goal is to capture and maintain increased market share, profitability and shareholder return, the new venture must contribute significantly to that goal. "

This venture may not be simply a new division to incubate and grow within the cultural confines of the corporation, but instead a new way of doing business. It demands creativity and political savvy; expertise beyond the corporate corridors; the stretching of the division leader's skill; and a new learning curve. New venture development is not for everyone, but it is the cutting edge of creating new business models within the halls of some of the greatest already-grown ventures in the corporate world. ■