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Corporate Venture Capital Investing

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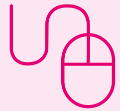
Why do corporate venture capital (CVC) companies make investments?



Accessing new technologies to enhance the CVC's core business or create new growth opportunities

Gaining insights into emerging trends to inform the CVC's innovation or decision-making processes

Building partnerships that can create synergies or value for both parties

Generating financial returns, diversifying their portfolio, or enhancing their corporate reputation or brand

How does a CVC value a start-up?

- The amount of money that the CVC is willing to pay for a certain % of the start-up's equity.
- This determines how much the CVC will own after the investment, and how much their ownership will be diluted.
- There are no fixed rules on valuation – usually it's based on the following:
  - the market size and growth potential of the start-up's product or service
  - metrics – revenue, customer base, retention, unit economics, growth rate, and profitability
  - the stage and risk of the start-up, and the expected return and exit scenarios for the CVC

Types of Investment

- Equity (where price is fixed upfront):
  - Ordinary Shares
  - Preference Shares (typically 1x non-participating preference)
- Convertible Instrument (where price is confirmed at a later date):
  - Convertible Loan Notes
  - Advance Subscription Agreements/SAFEs
- In the UK investments which qualify for SEIS/EIS are tax efficient (many investors will want this); in Germany investments which qualify for INVEST are subsidised.

Investor rights and protections

CVC is to have rights and protections to give it control and influence over the company’s decisions and operations/protect their investment from being diluted or devalued by future events or actions.

- consent rights
- board representation
- information rights
- anti-dilution rights
- warranties

Exit Strategy

- The plan and timeline for the CVC to realise their return on investment, by selling their shares to a third party (i.e. M&A/secondary sale) or IPO
- CVC should be given a consent right as to whether an exit occurs (and drag not to be triggered without their consent)
- CVC should get tag/co-sale rights
- Differing expectations between a founder/CVC re exit ambitions – worth discussing at the outset

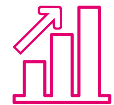
Leaver provisions

- Leaver provisions determine what happens to the shares or options of a founder or key employee who leaves the company.
- Lots of approaches here – simple one is as follows:
  - Good Leaver – founder ceases to leave due to matter outside their control. Gets to keep all their shares
  - Intermediate Leaver – usually where the founder resigns. Typically subject to a vesting schedule (i.e. they keep what's vested, they lose what's unvested)
  - Bad Leaver – founder dismissed for gross misconduct/fraud/criminal offence etc. They lose all their shares.

Option Pool

The option pool is the portion of the company's shares that are reserved for current and future employees, advisors, or other stakeholders.

The option pool is typically created or increased before the valuation of the company is determined – the existing shareholders (founder(s) and previous investor(s)) bear the dilution of their ownership.



This will need to be topped up as the company keeps on growing – in the UK certain types of options can be tax efficient / in Germany recent changes in statutory law to enhance option pools.

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