

UNLOCKING CORPORATE VENTURE CAPITAL



**Finding success in
the startup ecosystem**

500

LETTER FROM BEDY YANG



Bedy Yang
MANAGING PARTNER

“As one of the most active, early-stage investors in the world, 500 Startups has a unique perspective on the innovation economy.”

How has corporate venture capital changed?

In the decade since the Great Recession, we have seen digital upstarts – taking advantage of disruptive technologies from AI to IoT – reshape the economy and the corporate pecking order.

Conventional wisdom dictated that incumbents should focus their innovation efforts on R&D and growing their cash cows while investing in a few startups. But the rate of change has accelerated and with it, the balance of internal versus external investment. We believe the new corporate landscape calls for new strategies.

As one of the most active, early-stage investors in the world¹, 500 Startups has a unique perspective on the innovation economy.

Since 2010, we’ve invested in over 2,200 startups through our funds. Through our ecosystem building initiatives, my team and I have educated more than 500 venture investors, including corporate venture capital (CVC) units. We’ve also advised leaders of some of the largest companies exploring this challenging environment on the creation and development of their corporate venture investing programs and funds.

We anticipate that corporates have an increasingly outsized role to play in the startup ecosystem, and our conversations with C-Suite executives have revealed the extent of the challenges they face while also highlighting new opportunities for growth.

This report is the result of an extensive survey we conducted on corporate venture capital units. We surveyed over a hundred practitioners on the changing role of the corporate venture investor. Today, we’re excited to share the story behind that transformation.

We thank those that were able to participate in this report and look forward to continuing this conversation and driving our industry forward. We hope our 2019 CVC Report guides your innovation journey. Go to our website at innovation.500.co to take the first step.

¹Based on Pitchbook analysis as of June 27, 2018, of all equity investments made into privately held companies from 2013 to 2017, excluding governmental organizations.

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EXECUTIVE SUMMARY

Corporations are investing in venture capital deals at an unprecedented rate.

Over \$60.8 billion was invested in more than 1,065 deals in 2018 alone, according to Pitchbook². Last year, corporates accounted for over 23% of all venture deals.

What is fueling this growth, and where is the industry headed?

From May to July 2019, 500 Startups surveyed over 100 corporate venture capital investors (CVCs), across key industries and geographical locations, to explore these trends and further understand the industry's pain points³.

Combining that with our corporate knowledge and proprietary data, we sought to determine how CVCs have been faring and to identify areas where they are seeking to improve. We asked questions like:

- *What were important motivators for your parent organization to start its venture activities?*
- *How are strategic and financial returns weighed against each other?*
- *At what stage do you make the most of your investments?*
- *Which markets, technologies, and sectors do you anticipate will be the most important for your industry in the next two years?*

Instead of prescribing a one-size-fits-all approach, we identified two particularly successful profiles of CVC personas navigating the startup ecosystem: The "Hunter" persona who operates as a financially-driven investor with an entrepreneurial culture, and the "Explorer" who is more strategically-focused and embraces a more corporate culture.

These CVC units usually start pursuing CVC as a hedge to the core business, but the successful ones soon learn to act more aggressively.



Last year,
corporates
accounted for
over

23%

of all venture
deals.²

² Pitchbook Analyst Note, "The Golden Mean of Corporate Venture Capital" September, 2019

³ Refer to page 40 for further details on our survey methodology.

As such, securing timely, internal approval for investments was the biggest problem area that CVC units shared with us.

Building on these findings, there are five guiding principles – values and strategic insights that we believe set the top Hunters and Explorers apart from the rest of the pack – captured in this report:

1 Start by accelerating your rate of learning,

to maximize your team's efficiency and aim for quick wins

- Time matters to CVC units, with ~40% of our respondents having mandates of ≤5 years, or half of a typical VC fund. To hit the ground running, new firms can find the right partner to share their expertise, network, and best practices in venture investment and deal flow. This can be particularly valuable in the first year of operation before flying solo.

2 Prioritize financial or strategic returns

and design the CVC unit accordingly

- This is a key principle to establishing a CVC unit, which should be determined by what returns matter to the parent organization, and what type of returns can be tracked and quantified. 55% of our respondents say they are strategically inclined, versus 28% who claim to be financially motivated. After this is decided, all other aspects can be optimized (organizational structure, incentive scheme, investment thesis).

3 Measure your Return on Innovation,

and design the CVC unit accordingly

- For multi-billion dollar corporates, the return on investment of their CVC vehicle, no matter how good its performance is, will unlikely affect the bottom line of the parent business. Therefore, although possibly harder and more abstract, it is important for companies to measure their 'return on innovation'. We propose measuring three aspects: exploration and learning, financial gains, and cost savings from the activities.

From our survey, we found that almost 80% of CVC units come from industries facing high levels of disruption today.

Only about 30% of the survey respondents believe CVC units have the freedom to make deals with a single investment committee.

There are five guiding principles – values and strategic insights that we believe set the top Hunters and Explorers apart from the rest of the pack.

4 Provide Smart and Strategic Capital,

bringing capital and scaling capacity to get into the top deals (even if prioritizing financial returns)

- Today we are experiencing an era of seemingly abundant capital within the market. To differentiate and access the top deals, traditional financial VCs typically offer “smart money”: capital investment plus the time, advice, knowhow, and networks. Similarly, corporates that would like to access top deals should aim to provide “smart and strategic capital”; bringing capital and scaling capacity in the form of distribution networks, technical and business expertise and know-how, R&D co-development, and/or new market access.

5 Integrate your corporate venturing activities

to maximize your team’s efficiency and aim for quick wins into the wider innovation activities of your parent organization.

Despite the promising trend lines, there is no silver bullet when it comes to navigating your corporate venture journey.

Corporates need to develop a portfolio of startups – from seed to late-stage – which they can acquire, partner, or invest in to accelerate innovation and transformation.

CVC is an important tool, but ultimately one of many available to corporates in their open-innovation toolkit.



02



THE 5 W'S AND HOW TO START CORPORATE VENTURING

The rise of corporate venture

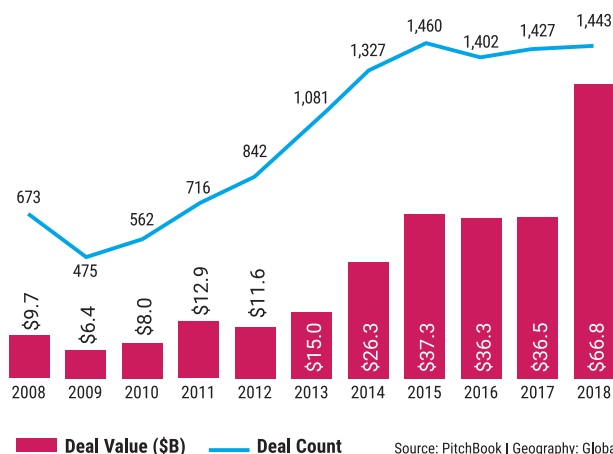
Corporate venture capital (CVC) or Corporate Venturing is the investment into an entrepreneurial venture by an established corporation in exchange for equity.

Corporate venturing has been growing rapidly over the last decade, and corporations are funding venture units at an unprecedented rate. In total, Pitchbook reports that over \$60.8 billion was invested in more than 1,065 venture deals in 2018 alone, representing an increase of 103.4% (explained in large part by investments by Softbank's Vision Fund) and 11.3% respectively. 23.1% of the deals were led or solely backed by CVC units⁴.

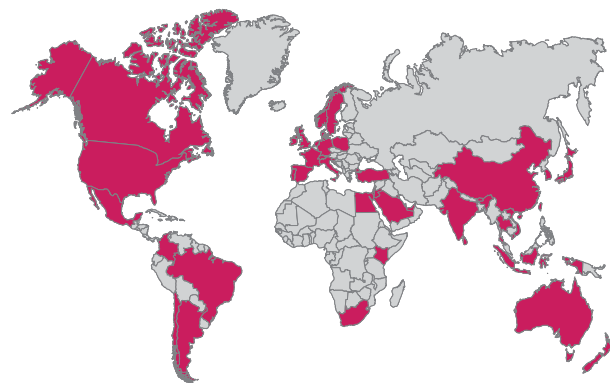
CVC IS AN INCREASINGLY GLOBAL PHENOMENON

68% of our respondents' parent companies were from outside the US. Cross-border investments have enabled corporations to establish international units in thriving ecosystems.

CVC INVESTMENT ACTIVITY HAS RISEN 11.3%: US DEALS WITH CVC PARTICIPATION



OUR SURVEY RESPONDENTS REFLECT THE GLOBAL CVC LANDSCAPE



KEY: Pink = CVC respondents, Grey = No CVC respondents

⁴ Pitchbook Analyst Note, "The Golden Mean of Corporate Venture Capital" September, 2019

Starting a CVC unit isn't for the faint of heart. The venture industry is opaque and educational resources can often be hard to come by.

Most CVC units may need to wait roughly eight years to evaluate their performance. It's often difficult to know where to start.

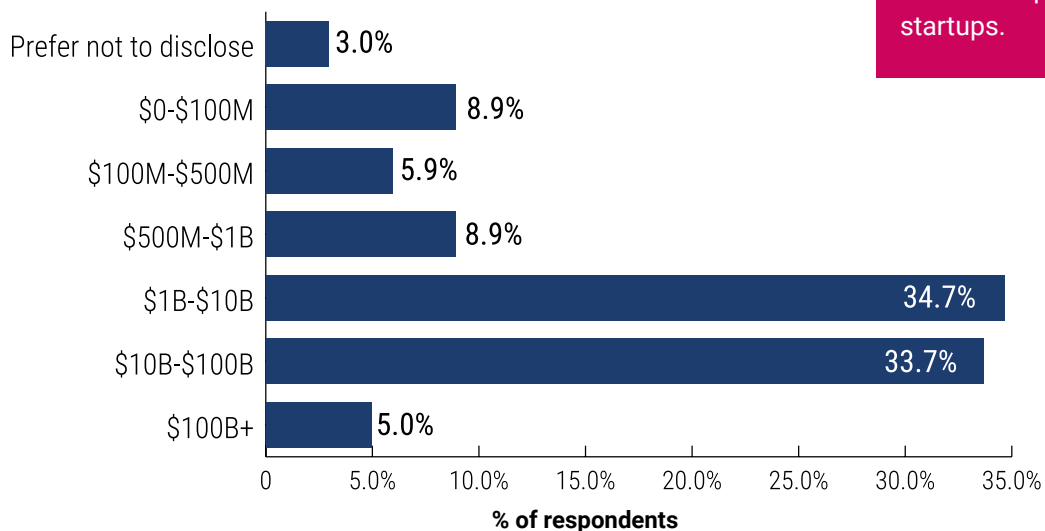
In this section, we'll explore the basics of establishing a corporate venture arm and our take on how to avoid the most common pitfalls.

Who should invest?

Most corporates with over \$1 billion in annual revenue are likely to be comfortable with financing a \$50 million fund. Corporations in sectors classified as volatile or vulnerable should be the ones investing now (see page 12). These companies have the chance to seize competitive opportunities and capitalize on future disruption.

SURVEY QUESTION: *How much revenue did your parent organization earn last year?*

Revenue



500 SAYS

ABOUT FUND SIZE

“\$50 million can get you started”.

An effective CVC unit usually requires significant capital. In our experience, \$50 million is the minimum capital necessary to succeed in this endeavor to have a portfolio of bets. However, most funds may be significantly larger, often investing between upwards of \$100 million per year for added impact. If you're following a typical venture fund model, investments are typically made over the first 2 - 4 years of the fund, reserving significant capital for follow on investments of the best performing startups.

What will you need to start your CVC unit?

Find the right outside partners for guidance.

We've all seen the cautionary tales of corporates seemingly poised for success but that ultimately struggle to find deal flow, add strategic value, or make investment decisions. There are plenty of pitfalls at the planning and execution stages of setting up a CVC fund. Firms are increasingly looking for external help.

1 IN 3 CVCS HIRE EXTERNAL ADVISORS

One-third of CVCs surveyed hired external counselors at the inception of their fund, and one-quarter did this at the execution stage.

TYPES OF SUPPORT PROVIDED BY EXTERNAL COUNSELORS, FROM THEORETICAL TO PRACTICAL

EDUCATIONAL



- Best practices in CVC investment

STRATEGIC



- Value add to the parent organization
- Investment strategy

STRUCTURAL



- Governance and investment committee
- Decision-making structure
- Fund structuring

OPERATIONAL



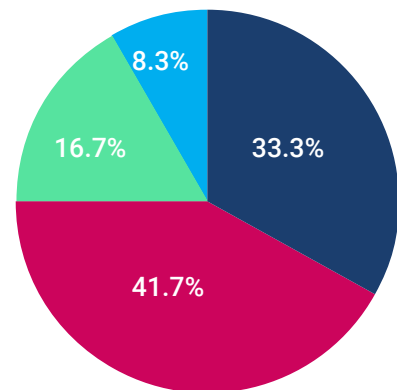
- Process development:
- Sourcing
- Evaluation
- Due diligence
- Team and compensation
- Portfolio management

MANAGEMENT CONSULTANTS

Many CVCs turn to management consultants for help. They tend to be excellent at analyzing the value-add of the CVC unit to the parent organization, but may sometimes fall short when it comes to providing support in key areas. Venture is a relationship-heavy industry, and consultants who lack a strong network in the startup ecosystem may struggle.



SURVEY QUESTION:
What are the types of support you engage external consultants for?



500 SAYS

ABOUT TIME

“Timing is everything. Accelerate your rate of learning.”

Your external partner should ramp up your learning curve and empower you to start investing faster.

Some tips:

💡 Start investing as soon as possible, learn by doing, and aim to do at least 10 deals per year to reach a portfolio of bets that can bring a distribution of returns (30-40 companies invested).

💡 Aim for a few quick wins and plan accordingly. You want to build momentum, support, and reputation for the company's CVC efforts.

💡 Learn from experts to accelerate your rate of learning. Some of the world's leading venture capital firms and select niche firms can open up the opportunity for a few key strategic investors to become strategic LPs. These firms may open their playbook on venture investment, deal flow, network and expertise to these partners. This can be particularly valuable in the first year of operation before flying solo.

WHEN LOOKING FOR A PARTNER, EVALUATE THEIR STRENGTHS IN THESE SIX KEY AREAS:

- Quantity and quality of deal flow (preferably, in the rounds before you invest)
- Alignment with your needs (vertical, technology, geography, etc.)
- Relationships within the startup ecosystem
- Ability to partner long-term rather than taking a transactional approach
- Ability to set the strategy and influence the parent corporation
- Can speed up your rate of learning



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ABOUT DEAL FLOW

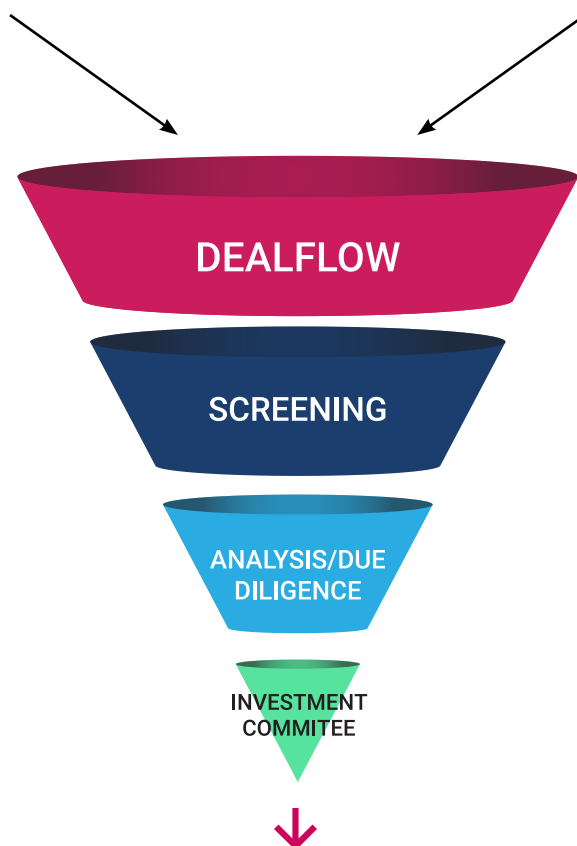
“A key defining metric for success is deal flow”

Deal flow (or how many deals are reviewed per year) is one of the key determining factors, because the more deals that are seen and evaluated, the higher your chances are of finding the right investment opportunity. Developing a strong deal pipeline generally results in a stronger portfolio, but that is easier said than done.

SIMPLIFIED INVESTMENT FUNNEL

The 5 top deal flow sources for CVCs based on the responses to our survey are:

1. Relationships with other investors (non-investment base relations)(29%)
2. Direct relationships with founders (26%)
3. Events (either hosted or attended) (15%)
4. Accelerators (15%)
5. Investing in VC funds (8%)



The 5 least effective sources of deal flow based on the responses to our survey are:

1. PR & marketing & sponsorship competitions (1%)
2. Internal business units (1%)
3. Research (1%)
4. Inbound (1%)
5. Competitions & hackathons (1%)

Expertise
Mentorship

Connectivity to
downstream capital
(network and brand)

Acceleration
Partnerships with
larger companies

Where should you invest?

Your investments should align with your goals and corporate objectives, regardless of whether investments must be made across different technologies, geographical locations, or even outside industry boundaries.

Silicon Valley still holds a significant portion of the world's venture activity today, but it is by no means the only hub.

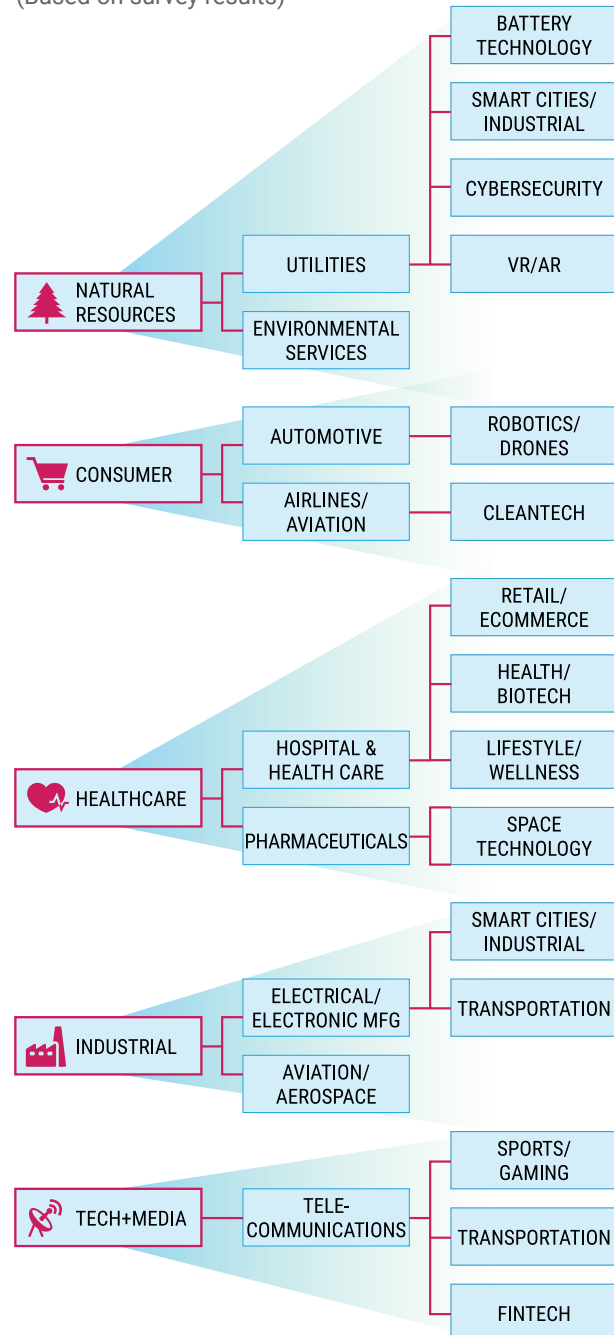
Other contending ecosystems have emerged and specialized leveraging their unique local assets and experience: New York and London are vibrant hubs within the FinTech and Insurance spaces; Boston is often viewed as the home of Healthcare and Deeptech innovation. Israel seems to be paving the way in Cybersecurity and Autonomous Vehicles; China appears to be at the forefront of Artificial Intelligence and the Hardware revolution; and Southeast Asia, Middle East, Latin America, and India are increasingly focused on specialized Marketplace, Logistics, and Payment Solutions for the rising middle class.

We see leading CVC units building global networks and finding opportunities in each of these hubs.



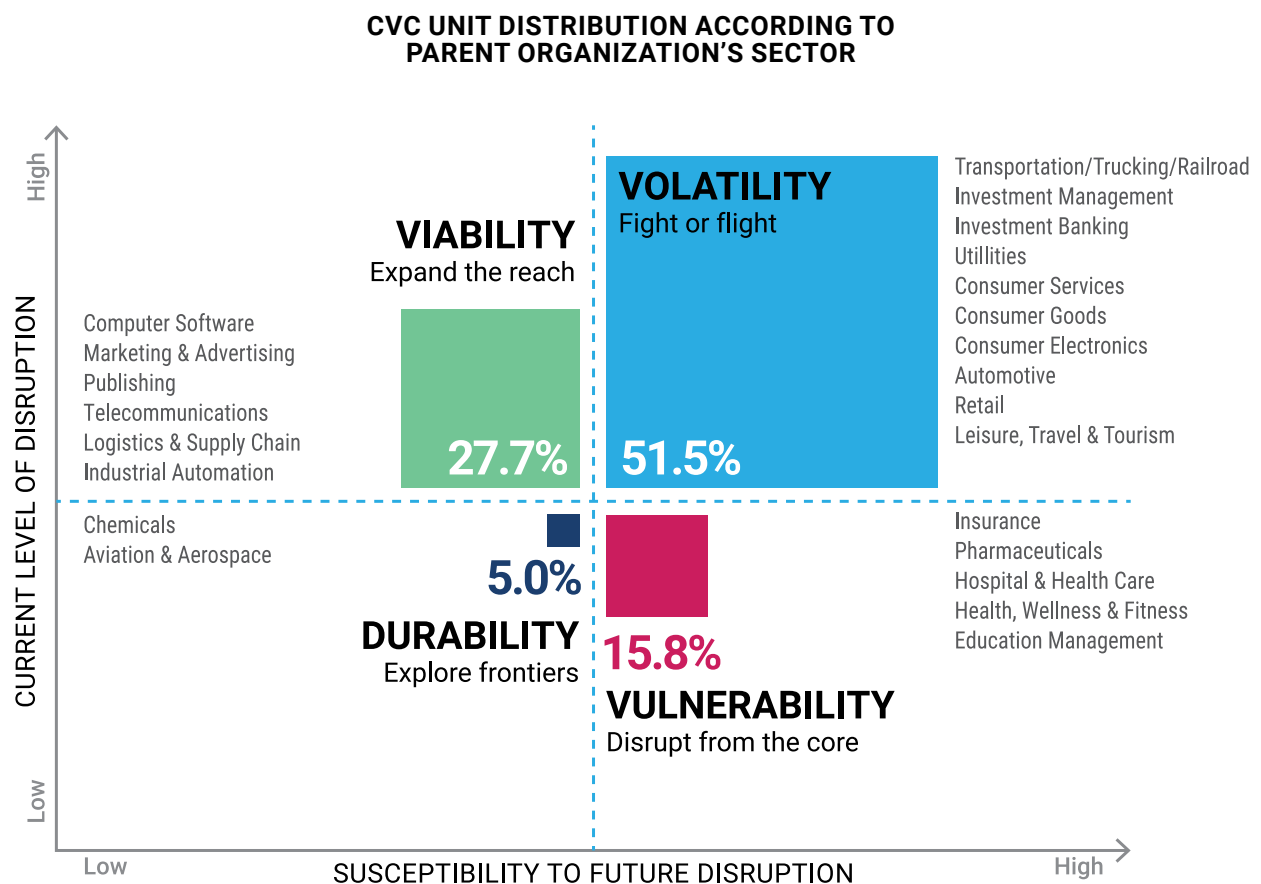
INVESTMENT SECTORS ACCORDING TO THE PARENT ORGANIZATION

(Based on survey results)



When should you invest (and How)?

Different industries have varying timelines and venture strategies depending on the sector of their parent organization. When and how they invest may depend on their susceptibility to disruption today and in the future.



⁵ The definition and classification of industry sectors within the four quadrants was identified by 500 Startups based on internal analysis.

27.7%

VIABILITY
Expand the reach

Industries within the **viability** sector who place innovation bets today will help consolidate their position tomorrow.

Companies whose industries fall within the viability quadrant are likely to be experiencing a fast pace of current disruption, and if they are able to capitalize on the opportunity that innovation presents, we predict that they will be able to stay ahead of the game—and their competitors. Our survey data shows that 28% of units fall within this sector, and come from industries such as Software & Platforms, Media & Entertainment, and Retail & Communications. The strategy followed by these corporates is to use innovation and technological advantages to expand their core business and reach, often by building services around their platforms. The innovation bets that they are placing today can help keep them ahead of the curve tomorrow.

51.5%

VOLATILITY
Fight or flight

Industries experiencing **volatility**, consistently high levels of disruption, need to continuously innovate (**fight**) or pivot to other spaces (**flight**).

It shouldn't come as a surprise, but the largest group of CVC units come from industries facing high levels of current disruption (80% of survey responses). Particularly active are companies operating in the volatile space (52% of survey responses). Sectors that classify as "volatile" generally face high rates of current and future disruption. Low barriers to entry and low innovation costs mean disruption is the norm, and corporates within these sectors are pressured to continuously innovate and disrupt themselves from the inside out. This includes sectors like banking and utilities, where technological advantages tend to be short-lived and soon become the status quo. We expect that companies in this space must be prepared to either continuously innovate in the long-run or consider how to pivot or partner to capture more viable spaces



5%

DURABILITY

Explore frontiers

Industries within the **durability** sector are likely shielded from the effects of innovation but tend to use corporate venturing to place bets in frontier technologies.

Companies whose industries fall within the durability quadrant are somewhat shielded from the effects of innovation, facing both low rates of current and future disruption. These industries include consumer goods, chemicals, and industrial equipment. Only 5% of respondents within this space reported venture activity, and their strategy appears to be placing bets further on in the horizon; into frontier technologies that could power the future of the industry. Returns on these investments are expected to follow a much longer time frame for their results, leveraging the relatively shielded disruption rate of the industry.

15.8%

VULNERABILITY

Disrupt from the core

Industries within the **vulnerability** sector are expected to face the biggest threats in the future and need to place their innovation bets today.

To our surprise, only 16% of CVC units came from the vulnerability quadrant based on our survey. These industries may be experiencing lower levels of disruption today, and incumbents are still within the “business as usual” environment; without seeing the imminent threat that startups could bring. These industries may have been fairly shielded from innovative disruption, due to higher innovation costs and barriers to entry. In the upcoming years, we expect an increasing number of startups and dollars in these spaces and expect more CVC units to emerge in insurance, healthcare & life sciences, utilities, and capital markets. Startups are hungry to acquire your customers. If your company is within this quadrant and hasn’t started your venture unit, you are already behind!

500 SAYS

About CEO-BACKING

“Support from your CEO won’t necessarily help you.”

CEO support is essential to establishing a corporate venture capital unit, with about 33% of units reporting that they have CEO-backing. Without the CEO’s blessing and backing, a CVC unit may struggle to get off the ground, but too much oversight from the CEO can potentially lead to a fund’s underperformance. Our survey data shows that CEO-backing is less prevalent in units that are more than seven years old or who have higher success metrics (strategic and financial). Since the CEO turnover rate is shorter than many mandates, winning over the CEO won’t necessarily protect CVC units in the long run.

There needs to be sufficient support from upper management, but not necessarily oversight. Units that need to report deal-by-deal and lack the independence to take contrarian bets can struggle to develop a portfolio of bets. If the structure, team, mandate, thesis, and value proposition are all aligned, the venture unit ought to be able to operate and run fairly independently, with CEO backing not being necessary

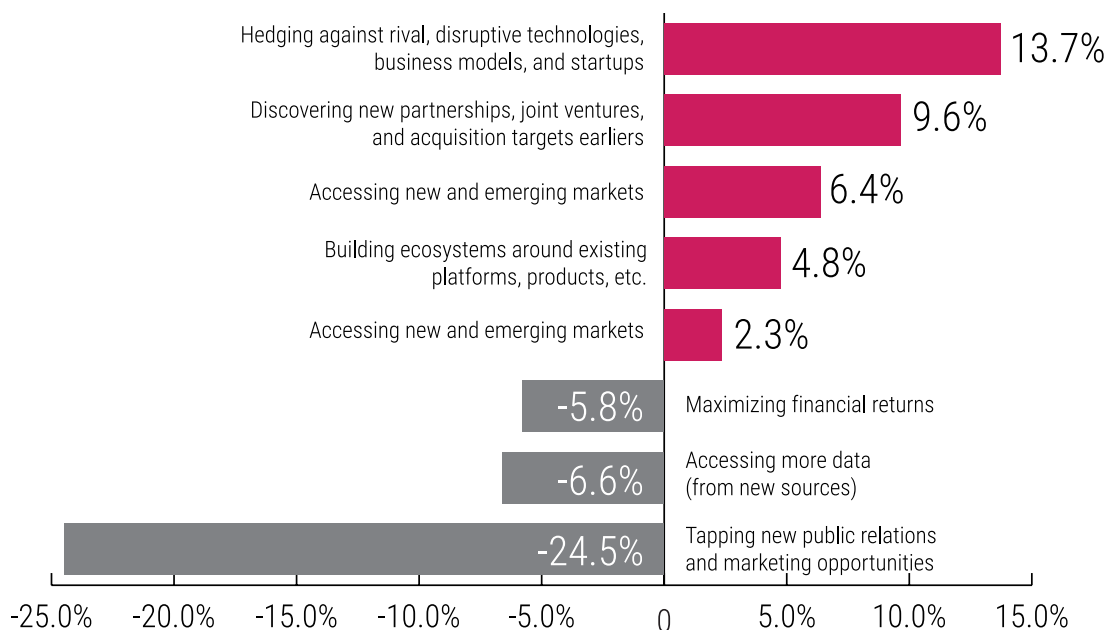
Why venture into the startup ecosystem?

The initial motivation to start a CVC is often defensive. These units are often built to hedge against unknown threats and protect their parent company in the long term.

Based on our survey, the biggest motivator within the first two years after establishment is “hedging against rival, disruptive technologies, business models, and startups.” In short, this indicates that units are protecting themselves against the unknown. Hedging is seen as a defensive strategy to safeguard the business from emerging innovation and head off the competition pursuing the same startups. However, as units mature and evolve, the motivations for corporate venture may change over time.



SURVEY QUESTION: *What are the most important areas to see returns in the first two years?*

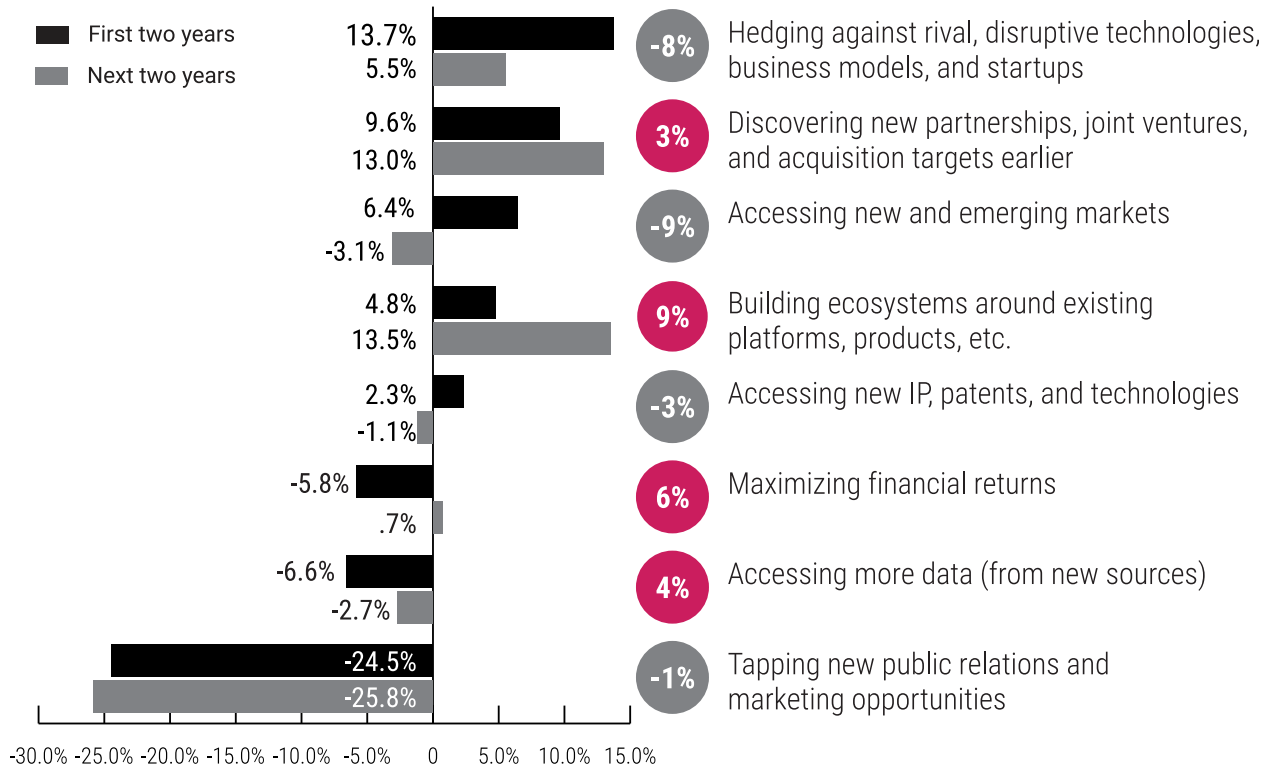


As time goes on, CVC units expect to eventually start taking the offense.

Based on our survey, units are first concerned about hedging, but that instinct appears short-lived. In time, units look more and more towards “building ecosystems around existing platforms and products” We predict that units will eventually begin to focus on their strengths to expand into a new business adjacency and invest in a relatively unknown future.

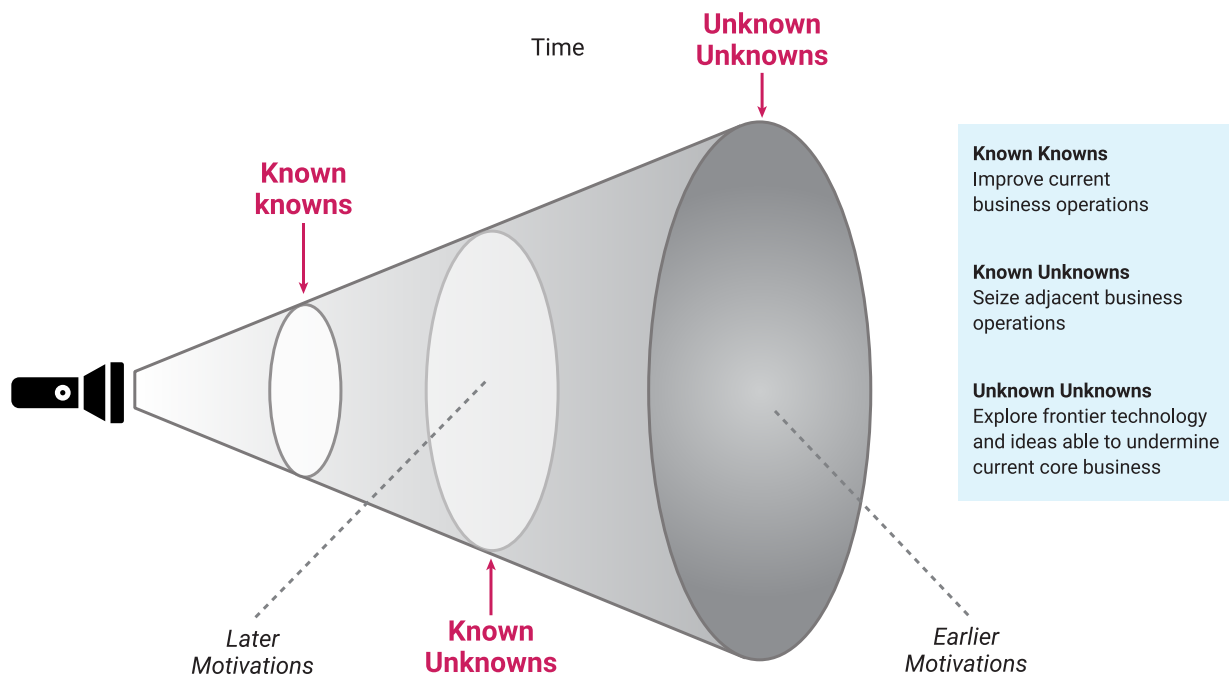


SURVEY QUESTION: What are the most important areas to see future returns?





As CVC units begin to turn “unknown unknowns” into “known unknowns,” we anticipate that they will stop worrying about threats and start to build on existing businesses, exploring adjacent business opportunities and experimenting with frontier technologies.



HOW TO WIN TODAY: BE THE BEST YOU

There's no single way to approach CVC, but we believe there are three critical dimensions that you'll need to position yourself within. Misalignment in these dimensions may lead to tremendous disappointment. Alignment can bring huge success.

BEFORE YOU START, ASK YOURSELF THESE THREE QUESTIONS:

1 Are you financial or strategic?

RETURNS SPECTRUM

- You have to choose what returns are measured (either strategic gains or financial returns), and if they are measured directly or indirectly.

KEY CONSIDERATIONS

- What returns matter to your parent organization?
- What type of returns can you track and quantify?

After you decide what returns you want, you can look to optimize organization structure, incentive scheme, and expertise. You can develop an investment thesis, which is essential for alignment with your parent's corporate strategy. If you correctly align your returns and thesis, you should be prepared to capitalize on future opportunities, even when you don't know what exactly will happen in the future.



An investment thesis is essential for alignment with your parent's corporate strategy.

RETURNS SPECTRUM: STRATEGIC TO FINANCIAL

| STRATEGIC | MORE STRATEGIC | MORE FINANCIAL | FINANCIAL |
|--|--|--|---|
| 50/50 | | | |
| <p>Primary goal is to maximize any strategic gains and financial returns are only measured indirectly. Investing is a tool. It augments business unit and corporate development activity.</p> | <p>Primary goal is to maximize any strategic gains and financial returns are measured both indirectly and directly. Corporate venture units include a minimum requirement on financial returns necessary. Often, at the very least, these units are required to finance themselves.</p> | <p>Primary goal is to maximize financial returns and strategic gains are measured both indirectly and directly. Corporate venture units include a minimum requirement on strategic gains. Often, these maximize financial return on investments in pre-selected technologies, and verticals (that are strategic to the organization).</p> | <p>Primary goal is to maximize financial returns and strategic gains are only measured indirectly. Investing is a revenue stream. It can augment business unit and corporate development activity.</p> |

500 SAYS

ABOUT STRATEGY

“50/50 mix of strategic and financial returns can be a bad idea to begin your activities. You will struggle between offering carry or bonuses, making direct or indirect investments, and/or forming a dependent or independent entity.”

Some firms choose to utilize both. However, we observed that “50/50 mix” strategy units tend to struggle to establish themselves, structure a team, offer incentives aligned with the team, or justify that their returns to the parent are enough. Many 50/50 mix strategy units may structure in a self-defeating manner to try and capitalize on both strategic and financial returns. But in our experience, they often fail to succeed in either regard

We believe a better strategy is the checkbox strategy. Units determine what returns are “enough” in a single area and maximize the other area. For example, a financial CVC unit will try to maximize financial returns and only ask “is it strategic enough?” with pre-selected “yes or no” criteria on what enough is or isn’t.

Many 50/50 mix strategy units may structure in a self-defeating manner.

ABOUT COMPENSATION

“Incentive compensation should be fixed or variable, based on the strategic versus financial returns desired.”

Compensation varies by unit and depends on the results desired, team experience, and fund structure. This can oftentimes include a range of fixed and variable incentives spread out across the short and long term and involves a set of “real” measures that mimic compensation in VC counterparts, as well as more “synthetic” measures that are adapted to the corporate reality.

| | FIXED | VARIABLE |
|------------|---|--|
| Short-term | <ul style="list-style-type: none"> • Salary • Management fees | <ul style="list-style-type: none"> • Annual Bonus: <ul style="list-style-type: none"> » Dependent on the performance of the parent organization » Can be aligned with the number of deals completed or reviewed |
| Long-term | <ul style="list-style-type: none"> • Corporate Stock Grants | <ul style="list-style-type: none"> • Direct carried interest on deals: <ul style="list-style-type: none"> » Sometimes above a certain threshold, e.g.: >2x • Synthetic vehicles to mimic carried interest: <ul style="list-style-type: none"> » Phantom carry » Shadow stock » Portfolio performance return |

Units that form part of the parent organization are more restricted to existing corporate practices in terms of compensation and tend to rely on well-established incentives for corporates (salary, bonus, and corporate stock grants).

Fully independent units usually have more flexibility in their incentive packages, sometimes mimicking their VC counterparts in offering management fees and direct carried interest. Increasingly popular are hybrid compensation models that mimic carry via a set of synthetic structures that fit the restrictions of the corporate reality (such as phantom carry, shadow stock, or portfolio performance return).

2 Is the team culture corporate or entrepreneurial?

CULTURE SPECTRUM

- You should decide how to optimize your compensation, process, and people to deliver returns.
- If we bundle these characteristics into two distinct groups: Corporate (closely oriented to the parent organization) or Entrepreneurial (more like a venture capital firm), we start to develop a spectrum that units can land on.

KEY CONSIDERATIONS

- What expertise does your organization have?
- Do you hire an experienced outsider or corporate veteran? Should deals be sourced from investment professionals? Should employees be paid carry?
- These questions can be answered in many different ways because there are trade-offs with each angle.



Culture is important to determine leadership, compensation, and team composition. Leadership crafts the vision and is responsible for hiring and developing the team's foundations. Issues with culture can have profoundly negative effects such as failing to source startups, deliver the right returns, or even follow the parent organization's directives. When expectations are misaligned between the unit and parent organization, successful financial units may "break off" or be shut down.

One example is how culture relates to compensation and incentives. Carry attracts traditional venture capital professionals and incentivizes financial returns. Many corporate venture units with carry have a better chance of success in recruiting and retaining investment professionals. Paid salary, often with a bonus, are more likely to incentivize units focusing on strategic gains as it's based on the corporate parent. Many units develop more hybrid structures. While often not as lucrative, these hybrid structures mirror a carry structure or a threshold model (with a bonus after a certain return). These require long-term tenure in the team to capture these kinds of gains.

CULTURE SPECTRUM: CORPORATE TO ENTREPRENEURIAL

CORPORATE

ENTREPRENEURIAL

50/50

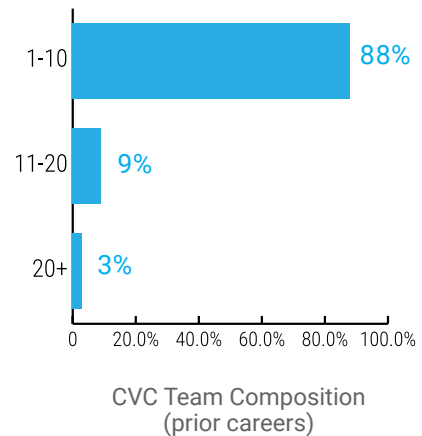
Corporate culture resembles a "top-down" culture. Decision-making tends to be more hierarchical and systemic in nature. Leadership, compensation, team composition "flow down" from the parent organization.

Entrepreneurial culture resembles a "bottom-up" culture. Decision-making tends to be more flat and trial-and-error-based in nature. Leadership, compensation, team composition "flow up" out of the entrepreneurial ecosystem.

Don't hire more than you need.

CVC units, as well as their VC counterparts, tend to have lean teams, with ~90% of CVC units being between one to ten members based on our survey results. A larger team means more operating costs, so don't hire more than what you need. Typically, we see a ratio of one partner per \$50 million in committed capital and a ratio of 1-2 non-investing partners per GP or equivalent. Many of these units have far more in capital that they might deploy over a three to four year period. Additionally, investing for strategic returns tends to require more personnel as those units are focused on bringing financial returns to increase cooperation with the parent company.

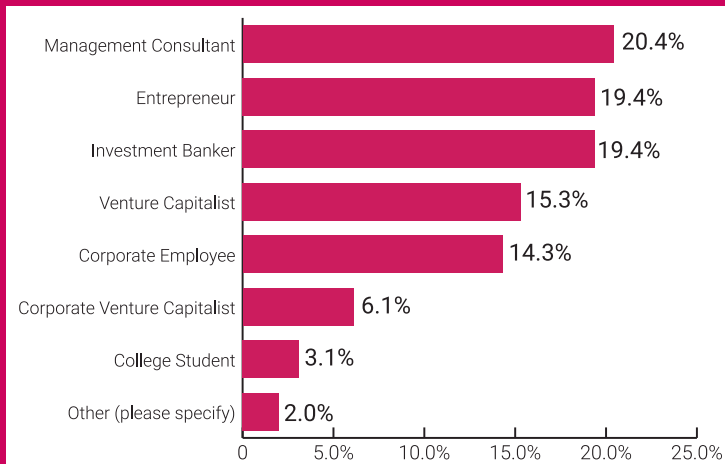
NUMBER OF EMPLOYEES IN THE CVC UNIT (BASED ON SURVEY RESULTS)



500 SAYS

ABOUT TEAM COMPOSITION

“A team of consultants is not for everyone.”



One of the most crucial decisions you'll have to make is who is on your team; their previous experience, network, and clout will largely determine the direction of the unit. Based on our survey, we have identified the following members within CVC units, according to their prior careers. The exact team composition is dependent on the objectives of the fund, stage of investment, and team dynamics.

From our experience, strategic CVC units tend to have more prior CVC and corporate employees, whereas financially driven units tend to attract ex-traditional VCs and investment bankers. If investing

at the seed stage, this is often led by relationships and reputation, attracting previous founders or those with significant networks in the startup ecosystem (media, accelerators, and VCs). Later stage venture investment aims to attract ex-investment bankers and consultants, which bring in the knowledge of structure in later-round deals.

Aside from external hires, many CVC units tend to have some senior corporate involvement that can bring insight into the needs of the organization. They can provide internal navigation knowledge of who knows what, and act as a bridge to the corporate reality, particularly if leaning strongly to strategic returns. Given what we will see later on regarding the effectiveness of integrated units, this is not optional, but critical for success.

3 Are you autonomous or integrated?

RETURNS SPECTRUM

- You will have an inherent trade-off between “asking for” and “giving up” resources or freedom to your parent organization.
- Some units are closely connected to the parent organization whereas others decide to create separate entities with relative independence

KEY CONSIDERATIONS

- What resources will you have? (Time, Funds, etc.)
- What stakeholders must be involved in the investment process?
- How much risk can your organization handle?

Autonomy is much more than establishing your unit in a separate location than your parent company. It is also about decisions to capitalize on the entity. Balance sheet investments grant less flexibility and more challenges than operating as a separate entity with a permanent source of capital. Keeping this in mind, whether we are discussing approvals, structure, or resources, they can be conceptually centered around autonomy. Many corporate venture units are apt to argue that the parent corporation only slows them down, but many units also tend to neglect the considerable resources that the parent organization offers.

For example, business units may help with due diligence, sourcing, validating strategic gains, providing commercial agreements, and developing an investment thesis. In return, many CVC units are required to get approval on some or all investments. Business units are allowed to veto investments, some of which may compete or conflict with projects they are working on. Partial autonomy from business units can be more attractive to corporate venture units. Here, business units are roped in only on some deals, and they are sometimes given select veto power.



AUTONOMY SPECTRUM: AUTONOMOUS TO INTEGRATED

AUTONOMOUS

INTEGRATED

50/50

Autonomous units prioritize quick and seamless procedures.

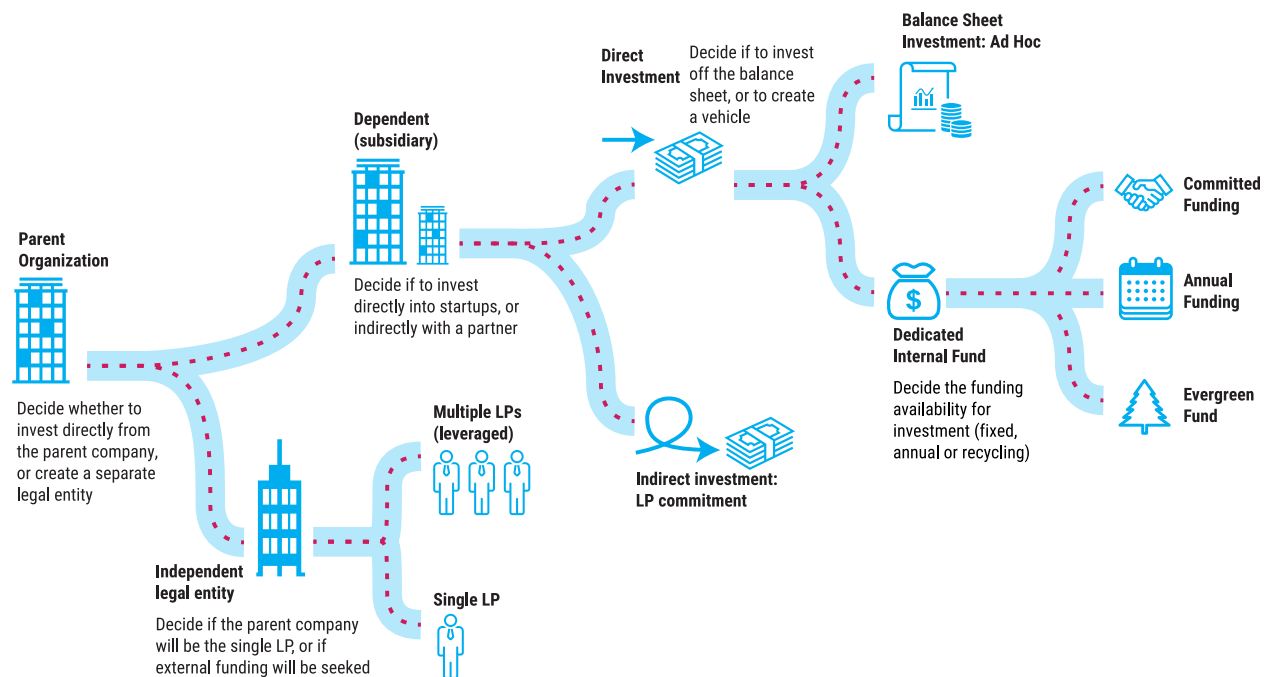
Entity structure, approval process, and resources are built to enable the unit to be self-sustainable. Autonomy is more prevalent in “financial” units.

Integrated units prioritize alignment and access to resources.

Entity structure, approval process, and resources are built to maximize the units impact. Integration is more prevalent in “strategic” units.

Your structure is directly linked to your success or failure.

There are many structures that venture investment can take, all dependent on the objectives with trade-offs in complexity vs. function.



There are pros and cons to forming either dependent entities or independent legal entities.

Organizing venture activities as a sub-organization within the parent organization can be an easier way to begin investment activities and can allow easy communication and collaboration with the parent organization. Setting up an independent legal entity has higher set-up costs, but yet has the potential to reap more economic returns of the investments, as it can provide more interesting incentives that attract better talent and can have fewer compliance issues.

Indirect investment can help accelerate your rate of learning, but it's not for everyone.

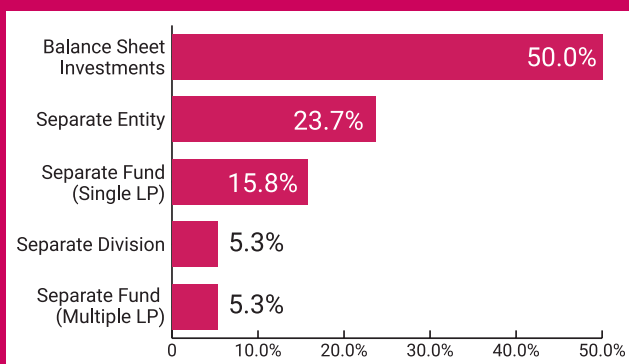
Our survey found that around 10% of CVC units invest externally into leading venture capital firms (as a Limited Partner to their funds), which may offer some form of strategic support. This could be in the shape of accessing deal flow, teaching about venture investment mechanisms, assessment and decision-making, accessing new ecosystems, offering opportunities for co-investment, etc. This offers the opportunity to get some investment performance, but most importantly to learn from leading investors. Over time, if a corporate is serious, it should begin making their own innovation bets via direct investments.



500 SAYS

About YOUR FIRST DEALS









“Most CVC units start investing from the balance sheet, but soon create other entities.”



When beginning venture investment activities, ad hoc balance sheet investments are often seen as the simplest way to get started. In these, each deal is reviewed and approved individually. Direct investment from the balance sheet generally offers a fairly simple and straightforward mechanism to “test the waters” and understand the market before launching a serious and comprehensive investment effort. From our experience, this process is not scalable, is often much slower (which can lead to loss of deals and reputation) and makes it difficult to maximize the benefits that venture investment can have. This is rarely a sustainable strategy in the long run and should be limited to select ad hoc deals, as it can become too complex to manage and report when doing a significant volume of deals per year.

The different ways to set up your CVC

Your model should incorporate consistency with returns and a smooth process with your parent organizations.

| EXAMPLES OF CVC TYPES | DESCRIPTION | RETURNS | TEAM/ CULTURE | LEVEL OF AUTONOMY |
|--|--|-----------|-----------------|-------------------|
| "Traditional VC" Natives  | Career venture capitalist operating with a high degree of freedom from the parent organization | Financial | Entrepreneurial | Autonomous |
| Tourist  | Newcomers with a very thesis-driven approach and focus on fact-finding | Financial | Corporate | Integrated |
| Outsiders  | New arrivals with little connection to the ecosystem and few resources internally | Financial | Corporate | Autonomous |
| Hunters  | Entrepreneurial units that seek the biggest game, but are close to HQ | Financial | Entrepreneurial | Integrated |
| Explorers  | Units that are on a great quest to find a legendary unicorn | Strategic | Corporate | Integrated |
| Survivalist  | Units that operate like special forces with a sense of mission and total flexibility in how to get there | Strategic | Corporate | Autonomous |
| Prospectors  | Units with an intuitive sense of the terrain and how to find the best startups | Strategic | Entrepreneurial | Integrated |
| Scouts  | Independent units seeking their fortune, using simple tools to find gems in the rough | Strategic | Entrepreneurial | Autonomous |

Who are you? Who do you want to be?

If your main objective is to get financial returns, be a hunter. We believe Hunter type CVC units to be the most effective for achieving financial returns.

Based on our analysis of internal data and survey results, we regard “Hunters” as having the following characteristics:

HUNTER

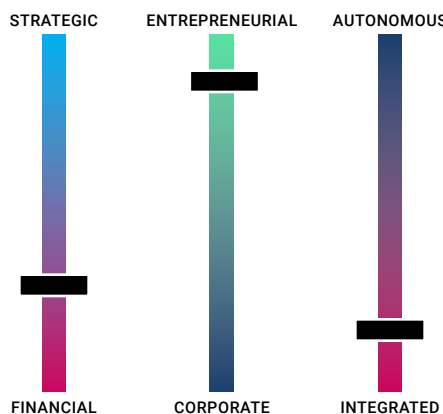
COMMON TRAITS

- Most successful profile identified based on financial and strategic returns
- Hunters are more common in tech and financial services
- Hunters retain employees better than others (it may be because they have carry structures or hybrid structures)

QUICK STATISTICS

- 11 deals per year on average (higher than others)
- Average mandate length is 9 years (longer than others)

HOW DO THEY COMPARE WITH OTHERS?



Returns

Hunters are inclined to chase strong financial returns.

Autonomy

Hunters are often linked to a parent company.

Culture

Hunters generally have a flat, entrepreneurial culture, common to the startup ecosystem. As such, teams are often composed of founders, venture capitalists, and community managers.

How do they usually invest compared to the average respondent?

DEAL SOURCING

- 74% more likely than average to invest in accelerators
- 43% more likely than average to source through investment professionals relationships with founders connections
- 58% more likely than average to source through investment professionals relationships with investors connections

INVESTMENT AREAS

- 1.5x more likely to invest in Series A rounds
- 2.3x more likely to invest in Seed round

INVESTMENT PROCESS

- 91% more likely to require investment board/committee (majority of board members) approval
- 37% more likely to require head of business units approval
- 1.7x more likely to require head of strategy approval

CHALLENGES

- 2.6x more likely to require CEO approval on deals
- 2x more likely to require investment board/committee (majority of board members) approval.
- 21% less likely to require investment board/committee (unanimous vote of board members) approval.
- 2.5x less likely to need approval from the head of a business unit
- No need for marketing approval (unlike some other CVC unit types)

WHERE THEY SUCCEED AND FAIL

Where they may succeed

Hunters are often successful in demonstrating success to their parent company. Financial returns are concrete and relatively easy to hold against other venture capital units. Hunters' proven venture business model offers a clear guide to generate results quickly.

Where they may fail

They can potentially fail in two ways: when they have poor processes between themselves and their parent companies, or when they ignore or are unable to leverage their parent company's resources. Many Hunters believe the only model to venture is like that of a venture capital firm and think of dealing with the parent as an inevitable inconvenience of CVC. This can become problematic.

If your main objective is to get strategic returns, be an Explorer. We anticipate that Explorer type CVC units are the most effective for achieving strategic returns.

Based on our analysis of internal data and survey results, we regard “Hunters” as having the following characteristics:

EXPLORER

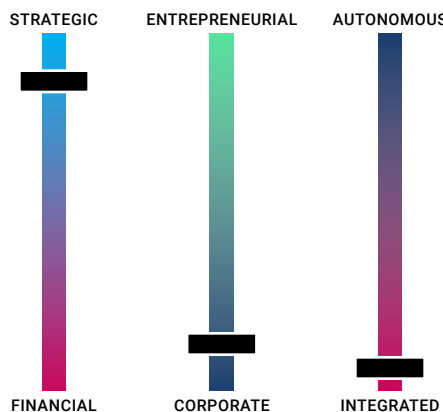
COMMON TRAITS

- Second most successful profile identified based on financial and strategic returns
- CTO-Backed and CEO-Backed
- Successful in helping portfolio companies with global expansion and operational support.

QUICK STATISTICS

- Explorers average 6 deals per year
- Explorers often prefer to hire previous management consultants (they are more likely to hire consultants to get established too)
- They don't usually offer carry on deals (compensation similar to parent corporation)

HOW DO THEY COMPARE WITH OTHERS?



Returns

Explorers are inclined to chase strong strategic gains.

Autonomy

Explorers are often closely linked to a parent company.

Culture

Explorers usually comprise of business unit heads, corporate development employees, and consultants; they have a corporate systematic culture.

How do they usually invest compared to the average respondent?

DEAL SOURCING

- 100% more likely than average to source through investments in VC funds than others
- 63% less likely than average to source through investment professionals relationships with founder
- 55% more likely than average to source through events
- 46% less likely than average to source through accelerator

INVESTMENT AREAS

- They tend to invest in every round!
- They are 10% more likely to be motivated by new IP, patents, and technologies
- They are 10% more likely to be motivated by new and emerging markets.

INVESTMENT PROCESS

- 91% more likely to require investment board/committee (majority of board members) approval
- 37% more likely to require head of business units approval
- 1.7x more likely to require head of strategy approval

CHALLENGES

- 10% more likely to find setting expectations of future liquidity events to be a challenge
- They report higher issues in providing portfolio support (related to tax compliance or internal controls)!

WHERE THEY SUCCEED AND FAIL

Where they may succeed

They are often successful in demonstrating success to their parent company. They are very well aligned with corporate development and strategy units.

Where they may fail

These units may face more difficulties in aligning with startups. They tend to struggle with startups whose direction begins to pivot from those use cases directly aligned with the strategic mandate put forward by the parent.

5 TRAPS AND PITFALLS

Based on the results of our survey, we've identified 5 common challenges that most CVC units face - and propose some solutions to overcome these challenges:

1 Securing timely internal approval for investments

About 30% of corporate venture units have the freedom to make deals with a single investment committee by a majority vote

The majority of CVC units require either two (21% of respondents) or three (24% of respondents) entities to get approval for an investment. 25% of our respondents require over four entities. 8% of CVC units require a unanimous vote by the board to make an investment decision. We are of the view that having several different entities who need to sign off on these investment decisions potentially prevents companies from making contrarian bets.

Corporate venture units have to be somewhat contrarian at times, and unanimous voting could be preventing it.



TAKEAWAY

Set up a system in which decision-making is clear and there is **no need for consensus**, to be able to secure timely approval for your investment decisions.

500 SAYS

ABOUT TIERED INVESTMENT STRUCTURES

“Tiered investment structures could help secure timely approvals for investments.”

For CVC units that are experiencing slow decision-making due to the involvement of many stakeholders, introducing a ‘tiered’ deal approval process can help address this bottleneck. With a tiered approval process, small deals (under a certain predetermined threshold) can be fast-tracked, whereas deals above a certain threshold can be further scrutinized—avoiding delays in regular investment activities.

Based on the results of our survey, we've identified 5 common challenges that most CVC units face - and propose some solutions to overcome these challenges:

2 Evaluating strategic returns to the parent organization

Our survey respondents placed "evaluating strategic returns" as the second biggest challenge they faced.

500 SAYS

ABOUT MEASURING RETURNS

"Measure broader impact to your organization by measuring the Return on Innovation of your CVC unit's activities."

For multi-billion dollar corporates, the return on investment of their CVC vehicle—no matter how good its performance is— will most likely not affect the bottom line of the business. Therefore, although possibly harder and more abstract, it is important for companies to measure their "Return on Innovation", rather than their return on investment. We propose the following quantitative and qualitative parameters as an initial guide to start measuring strategic returns of the investment efforts.

| EXPLORATION & LEARNING | GAINS | SAVINGS |
|--|--|---|
| <ul style="list-style-type: none"> • Number of deals and technologies: sourced, due diligence, and tested • Consumer trends extracted • Customer insights identified • Technology trends detected • M&A candidates evaluate | <ul style="list-style-type: none"> • Growth to existing business lines • New customers gained • New revenue generated • New markets entered • Reputation gained | <ul style="list-style-type: none"> • Strategic challenges solved • Cost savings • Time saved • Pitfalls avoided |

TAKEAWAY

You have to measure strategic returns.

While some units don't target financial returns, they tend to pivot towards them more as they mature. Why? In part, it is because they need to showcase measurable success. Return on investment is an easily quantifiable measurement that is objective, simple to capture, well-understood, and easily benchmarked.

Strategy on its own is subjective and has no clear way to be measured. Strategy varies according to the business environment, actions of competitors, and other externalities. Furthermore, a company's strategy is not always verbalized, nor made apparent to company employees that are concerned with day-to-day operations.

3 Running timely pilots and proof of concept projects

The third struggle faced by CVC units is establishing collaboration ties with startups.

500 SAYS

ABOUT FAST TRACK PROCESSES

“Establish a fast-track process and system to interact with promising startups.”

One way to address this is by having a fast-track process and system to conduct proof of concept projects. With this, companies can drastically reduce the time taken to do diligence, test, and evaluate startup solutions within the corporate environment. For example, one leading bank established a fast track process by which it organizes key pain points and opportunities globally through its “Open Innovation” team. It then brings together “shapers” from key areas such as engineering, risk, legal and compliance to give startups a quick answer within two weeks. Few organizations of any industry commit to this level of transparency and speed, but more should in the future.

Commercial deals and pilots are important to help evaluate investment into a startup and to ensure there is synergy between the company and the startup. However, securing timely pilots is one of the most difficult things to do. So it doesn’t make sense to always require commercial deals to make an investment decision, as a business unit (BU) may not be ready to work together with a truly disruptive startup. This can be mitigated by roping in a BU champion and having them assist in due diligence. However, it should ultimately be up to the investment professional whether to invest or not.

4 Maintaining a parent organization’s long-term commitment to investing activities

Roughly 33% of newly established CVC units have mandates ending within less than five years, meaning their results will be evaluated over an extremely short amount of time. This is surprising, taking into account that traditional venture capital funds typically tend to have mandates that are 10 years or longer, including extensions.

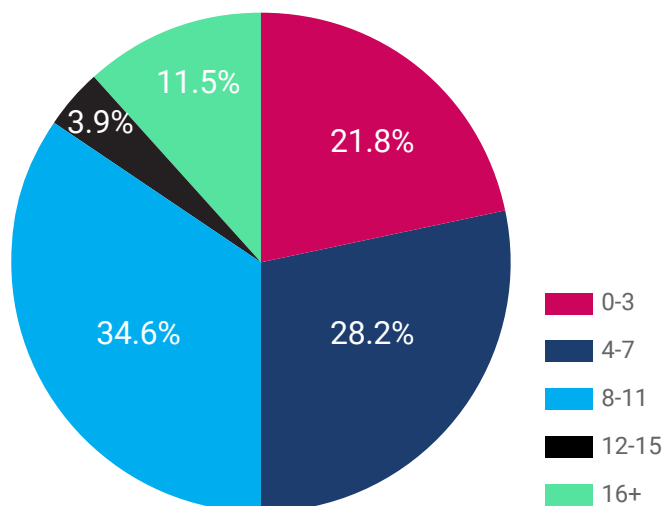
Many CVC units are only making a handful of investments, with over one-third of CVC units completing five deals or less per year.

~40%
mandates are
≤5 years, which
is half of a
typical VC fund

However, even with short mandates and timelines to show results, our study found that most CVC units are modestly active. About 36% of units only do five deals per year or fewer. Given that these CVC units are required to generate impact (be it financial, strategic, or a combination of both) this limited throughput will make it problematic to show a portfolio of bets and large scale impact.



AVERAGE NUMBER OF DEALS COMPLETED PER YEAR



500 SAYS

ABOUT QUICK WINS

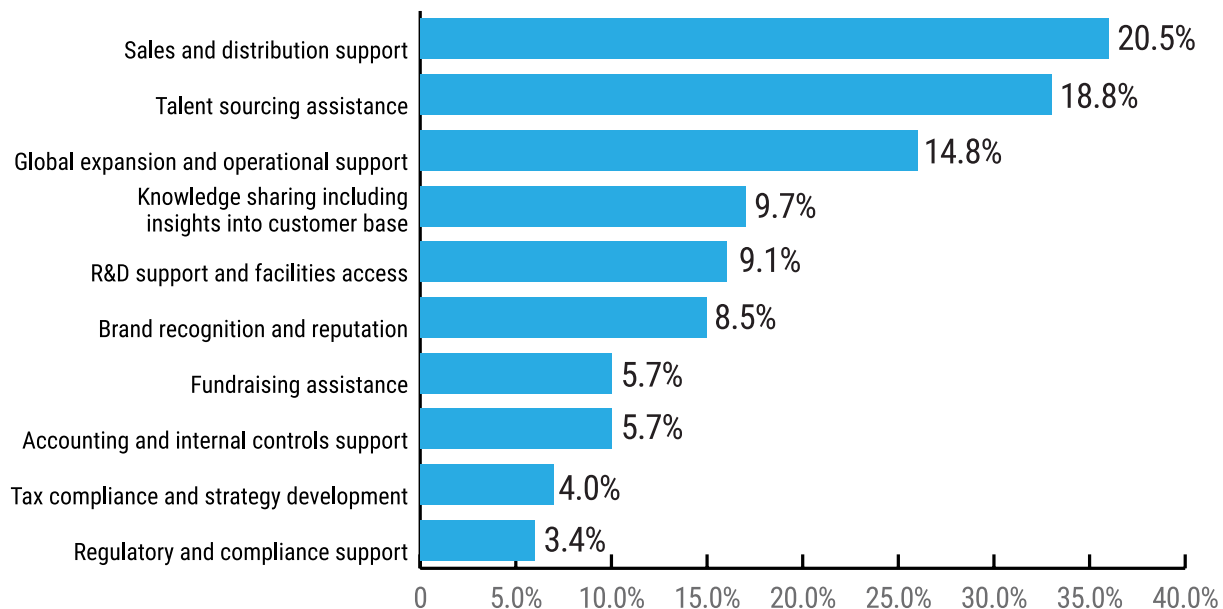
“Quick wins buy you more time.”

Strategic investments—particularly those not addressing imminent business challenges—will probably show returns in an even longer timeframe than traditional venture investments do. This means that CVC units must hit the ground running from the time of establishment to prove the value of the venture efforts to the parent organization. A lack of these early signals can mean corporates shut down their CVC units prematurely. One way to create early signals is to aim to achieve a few quick wins that build momentum, and secure support, and reputation for the company's CVC efforts. This should help in maintaining the parent organization's commitment to investing activities in the long-term, and allow for units to focus on a longer-term horizon.

5 Providing useful portfolio support

CVC units do and should worry about portfolio support. Many startups don't just want money, they want sales and distribution, talent, global expansion, and R&D.

CVC UNITS STRUGGLE THE MOST TO PROVIDE PORTFOLIO SUPPORT IN THESE AREAS.



500 SAYS

ABOUT SMART & STRATEGIC MONEY

“Aim to provide smart and strategic money.”

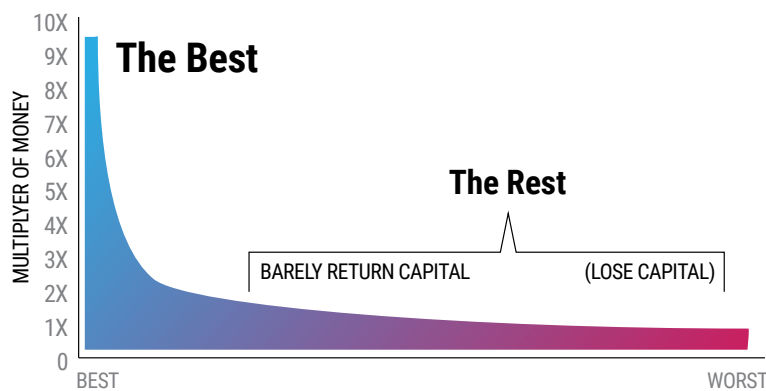
Today, there is ample capital in the market. To differentiate themselves and access the top deals, traditional financial VCs typically offer “smart money”: capital investment plus the time, advice, know-how, and network. The corporate equivalent is “strategic money”. Corporations able to provide capital plus additional value (distribution networks, technical and business expertise and know-how, R&D co-development, and/or new market access) have a higher chance of getting access to the best deals, even for non-financially motivated investments.

While you should avoid these “5 traps and pitfalls”, remember that some failure is necessary.

How often should you be failing? Let's put it this way, you will fail. You will fail on deals, partnerships, returns, value, and just about everything. You should not be avoiding losses, but rather minimizing the losses. Relax, invest, learn. Failing is learning, so don't be afraid of certain failures.

INVESTING WELL TAKES CALCULATED RISKS.

VENTURE INVESTMENT HAS POWER OF LAW DISTRIBUTION



A lesson to learn from venture is the economics of fund performance. VCs build a portfolio of bets within a given thesis, and out of these investments, the VC anticipates that the majority will end up being write-offs or barely returning any capital. In most cases, the distribution of returns is highly skewed, with a few of the investments made returning spectacular returns.

The same holds true for corporate venture investment: most of the investments made will likely have insignificant impact on the bottom line of the business, but a few key bets will potentially have transformative effects. Picking winners is an extremely hard endeavor, and rather than seeking that one transformative investment, we are of the view that CVC units need to take on a portfolio of bets risky enough to allow for this portfolio distribution to occur. Often this number is about \$100 million. \$100 million is above what most people can get to start, but that should be a goal to build a genuine portfolio.



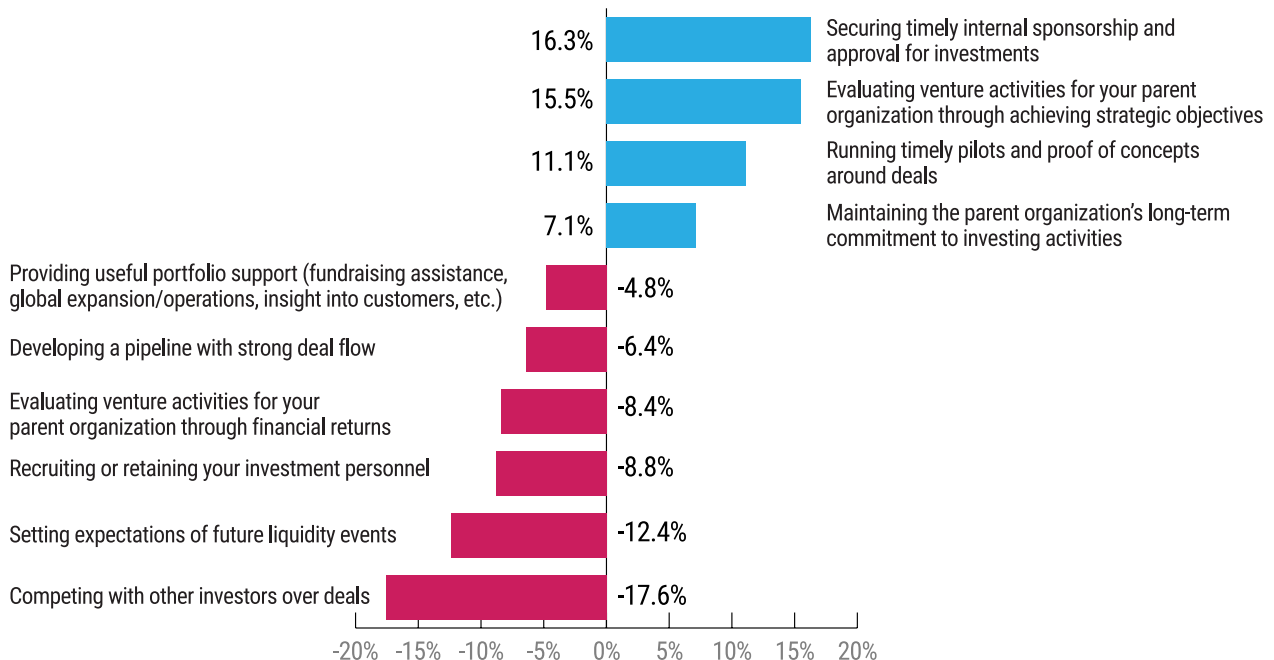
For multi-billion dollar businesses, return on investment is fairly insignificant, however the opportunity to learn, advance into a new business opportunity, improve operational efficiencies, or avoid a wrong strategic direction has an impact several orders of magnitude larger. We call this the 'Return on Innovation', a different type of ROI, but much more relevant to corporate counterparts. As described on page 32, this includes learnings extracted, growth to existing business lines, new customers gained, new markets entered, or even cost savings or time saved.

Although it is normal to lose money on bets that don't work, losing money per se isn't strategic. CVC units that burn through cash too quickly risk jeopardizing their long-term survival. Portfolio design and predicting capital reserved for follow-ons and other purposes are two actions that could help mitigate this.

TAKEAWAY

If you're not failing sometimes, you're not taking enough risks or pushing hard enough.

TOP CHALLENGES FACED BY CVC UNITS



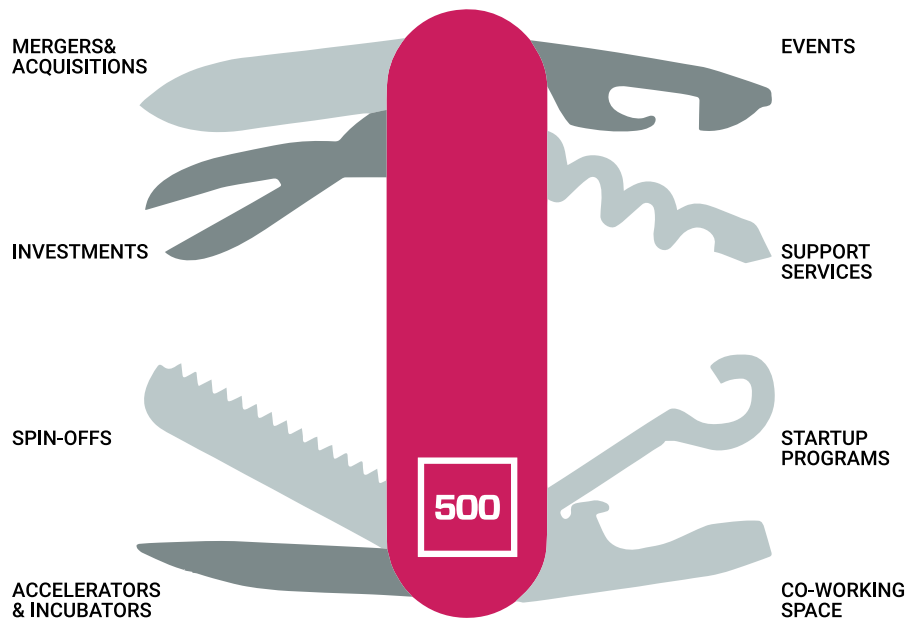
05

HOW TO WIN TOMORROW: BRING INNOVATION INTO YOUR PARENT COMPANY



Corporate innovation requires a complete set of tools so you can be prepared for a number of scenarios.

Is corporate venturing enough to cover all innovation efforts of the parent company? Most definitely not. Ultimately, there are numerous ways in which corporates can engage with startups, that we named the “Swiss Army Knife of Corporate Startup Engagement”:



Each of these startup engagement mechanisms has its own significance, benefits, timeframes, costs, involvement, and resources required, as well as fulfilling different corporate objectives.

At the end of the day, there is no silver bullet

A single collaboration approach does not equip corporates to succeed. Corporates need to develop a portfolio of startup collaborations, and likely in a spectrum of stages (from seed to early to late-stage) via a variety of engagement mechanisms. Corporate venture capital investment is just one of these innovation efforts.

All of these activities should be aligned. However, these initiatives are often led by different units (CVC, business units, corporate development, R&D, M&A, etc.). It is vital that all stakeholders involved in innovation activities align; sharing information, outcomes, learnings, and perspectives to drive smoother collaboration. This could be implemented by:

- Introducing a Chief Innovation Officer position to which all of the innovation efforts report to
- Adopting a software platform to integrate, coordinate, monitor, and steer all complementary activities
- Implementing regular reporting and tracking
- Instituting a fast-track process to support interactions



CASE STUDY

AirAsia, RedBeat Ventures

In 2019, RedBeat Ventures, the venture arm of AirAsia, announced the launch of a new global venture capital fund, alongside a strategic partnership with 500 Startups.

"RedBeat Capital is designed to support and invest in post-seed scalable startups seeking to enter or expand their presence in Southeast Asia. With a particular focus on Travel and lifestyle, Logistics, and Financial technology there's no better place to start than in San Francisco. Christine [500 Startups CEO] and her team will help us to identify startups where we see the value of integrating our rich data, unrivaled network capabilities, and strong regional expertise."

Tony Fernandes
AirAsia Group CEO



The 500 Startups formula for capacity-building in new CVC units



CONCLUSION:

Finding your way through the startup ecosystem

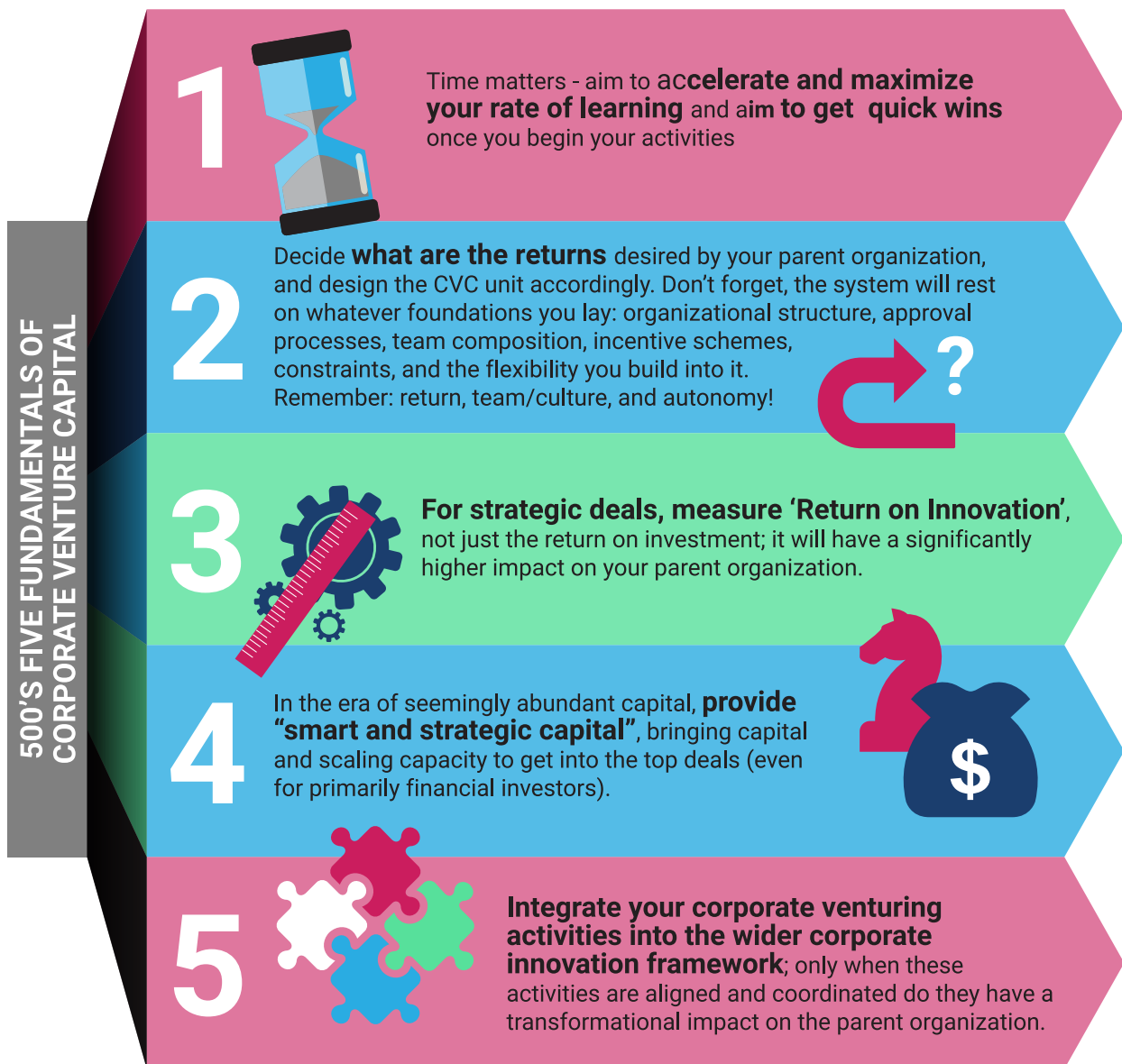
Throughout this journey, we have emphasized the need for strategic intent for those exploring the startup ecosystem and establishing CVC units. Key points to remember are to know your motivations, boldly explore new technologies, and to look outside the industry. Above all, strategies to get started include picking the right structure and making the right decisions around talent and team building. Too often those that want strategic relevance for the company assume that it will come automatically and emerge over time. However, in reality, it requires a high level of focus and strategic intent upfront.

TAKEAWAY

We hope our 500CVC report guides your innovation journey. Go to our website at <https://innovation.500.co/> to take the first steps on your innovation journey. Learn your corporate venture capital persona, best practices, and beyond. Please get in touch to learn more by reaching out to innovation@500startups.com or contact any of the authors.



There's no silver bullet, but our research points to these five fundamentals of corporate venture capital:



All of these initiatives in unison should not only help discover value for the parent company today but well into the future. For us, creating a better corporate venture capital industry is central to our mission of building thriving global ecosystems. We can all get there.

06

OUR METHODOLOGY

Our research for this report is based on data from a uniform survey that we conducted with over 100 corporate venture capital professionals from May - July 2019. Survey respondents were selected from their classification in the Pitchbook database as CVC units. Respondents were contacted via email to be anonymously included in the report. Only unique CVC units were contacted to avoid redundancies and replications. Respondents came from across the world, with 35 countries, and 5 continents represented.



Our Survey

101 Respondents CVC Units*

41 Sectors Represented

35 Countries Represented

5 Continents Represented

*CVC Unit" were determined from Pitchbook

ABOUT 500 STARTUPS

500 Startups is a venture capital firm on a mission to discover and back the world's most talented entrepreneurs, help them create successful companies at scale, and build thriving global ecosystems. 500 Startups is a global family of venture capital funds with 20 funds to date, managing \$500M+ in committed capital. At the time of writing, 500 Startups has invested in over 2,300 startups in 75+ countries since its inception in 2010. 500 Startups is considered to be the most active global VC fund in the world in terms of investment, and #2 in terms of exits according to Pitchbook.

500's portfolio includes 15 companies that are valued at over \$1 billion, and 75+ additional companies valued at over \$100 million. Notable investments in the 500 portfolio include Credit Karma, Twilio, Grab, Bukalapak, The RealReal, Talkdesk, Knotel, Udemy, Ipsy, and Vungle.

To date, 500 Startups has hosted more than 50 accelerator programs across the globe, helping startups design, test, and refine efficient and scalable growth strategies. 500 Startups further contributes to the development of innovation ecosystems by supporting startups and investors through educational programs, events, conferences, and partnerships with corporations and governments worldwide.



ABOUT THE AUTHORS



Bedy Yang is a Managing Partner of 500 Startups. Contact her at bedy.yang@500startups.com



Vijay Rajendran is Director of Corporate Innovation and Partnerships at 500 Startups. Contact him at vijay.rajendran@500startups.com



Alba Zurriaga Carda is a Manager of Innovation and Partnerships at 500 Startups. Contact her at alba.zurriaga@500startups.com



Michael Julve is an Associate at 500 Startups. Contact him at michael.julve@500startups.com

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Which CVC type are you?

Find out at <http://innovation.500.co/cvc-report>