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## **The Lowdown on Strategic Investments**

A fast-growing company recently called me up for some advisory work. One of its main competitors -- a multibillion-dollar company -- was making overtures for an acquisition. The sides started to talk and found they had both synergies and major disagreements about valuation and strategy. So the discussions moved to another approach: a strategic investment.

Such investments are the lifeblood of the venture capital industry and an increasingly popular tool for large companies. Some even have their own venture capital entities, known as corporate venture capital, or CVC, arms. Perhaps the most famous is Intel Capital, which has invested \$7.5 billion in about 1,000 companies since 1991, according to the company. Notable transactions include investments in Clearwire, Broadcom (BRCM), MySQL, Red Hat (RHT), and Research-in-Motion (RIMM).

CVCs usually have their own Web sites or micro-sites within the parent company main site -- and they are valuable resources. Here are some links:

- T-Mobile Venture Fund
- Chevron Technology Ventures
- Nokia Growth Partners
- Motorola Ventures
- Intel Capital

### **Financial Gain Not The Only Reason**

If a company does not have a formal CVC arm, it can be difficult to find the right person to approach about making a strategic investment in your company. Keep in mind that some companies, such as IBM (IBM) and Cardinal Health (CAH), avoid strategic investments altogether. To see which companies do make investments, take a look at the National Venture Capital Assn.'s member list.

There are myriad reasons for strategic investments. But interestingly enough, financial gain is usually not the top priority. Instead, a company will often make a strategic investment to get a "window" on new technologies or to promote its current business.

Take Nokia Growth Partners. This CVC focuses on opportunities in "mobility, communications, and the Internet." Some of its investments include Kyte [a video system for social networks and mobile phones], Morpho [mobile graphics], and ViVOtech [electronic payments]. Or look at the pharmaceutical industry. Major companies like Merck (MRK) and Pfizer (PFE) make strategic investments in biotechnology operators to fill their drug pipelines.

#### Strategic Investors Allay Customer Fears

While strategic investments come in many forms, there are some generalities. For example, a strategic investment is often a minority stake and part of a syndicate of other investors [usually venture capitalists]. Another key point to keep in mind: Strategic investments are typically focused on ventures that are beyond the startup stage.

#### O.K., So Why Take A Strategic Investment?

One key reason is credibility. It can be extremely difficult for a small company to sell to major customers. But, if there is a major strategic investor involved, then the fears should subside. If anything, the strategic investor can leverage its own customer base and make introductions.

Thus, it's important to craft a go-to-market [BusinessWeek.com, 5/31/06] strategy which includes extensive deliverables. The strategy will have to cover the following: How many customers will be contacted? What is the expected conversion rate? Will there be revenue splits or commissions? There also should be constant communication with the strategic investor. After all, big companies can get bogged down in bureaucracy.

#### Provides Substantial Infrastructure

Next, a strategic investment can validate a new technology. One example is INSIDE Contactless, which is attempting to build microprocessors for the emerging industry of near-field communication. As a result, the company snagged strategic investments from Samsung Ventures America, Nokia Growth Partners, and Motorola Ventures.

A strategic investment may also provide access to substantial infrastructure. For instance, Intel Capital encourages networking among its portfolio companies and holds events and workshops across the world. Another benefit is getting access to technology and product road maps.

Of course, despite all the benefits, strategic investments can have complications -- and could possibly wreck your company's prospects. One area to be careful about is control. In some cases, a strategic investor will try to negotiate an exclusive distribution arrangement. Obviously, this can limit the growth potential and make it difficult to sell the company.

#### Guard Your Intellectual Property

This is not to imply that exclusives are always a bad thing. With pharma deals, these clauses are expected. After all, if you strike a global distribution deal with Pfizer (PFE), you should have enough market coverage for your product.

Another tricky problem is the mechanics of sharing confidential information [BusinessWeek.com, 4/2/07]. What if the prospective strategic investor takes your valuable intellectual property and then walks away? Well, this is why you need to retain a top-notch law firm that can structure solid confidentiality agreements. It also helps if you have taken steps to protect your intellectual property, such as with patents. Before negotiating, you should have a comprehensive intellectual property system in place.

Finally, a strategic investor might ask for a so-called "right of first refusal" [ROFR] for an acquisition. Simply put, the fear is that a competitor will make an offer for the company. If you agree to this, it means it will be difficult to sell the company to anyone other than the strategic investor. In other words, this could ultimately reduce the valuation on a potential sale. So, if you want to get the best return for your company's shareholders, it's imperative you get rid of the ROFR clause.

Bottom line, a strategic investment can be enormously beneficial, especially if you need to conquer a new market. It requires lots of communication and planning and time, but it can definitely be worth it for the long-term value of your company.

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