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How, when and why to use the Corporate Venture Capital (CVC) model

July 16, 2024

Standfirst: Geoffrey Chan and Angela Liu of Skadden, Arps, Slate, Meagher & Flom in Hong Kong examine key structuring considerations for international companies planning to establish a corporate venture capital arm in China or elsewhere in Asia

- The first question for a company to ask is whether and how it should establish or use a CVC model for its strategic initiatives in Asia
- Commercial considerations include the nature of the investment team; alignment of compensation and incentives; autonomy and control; and tax, accounting and regulatory issues
- There are many other factors to take into account including the structure's complexity, maintenance costs, ease of deal execution, governance process and control rights over investee companies
- The various potential legal forms of the CVC each have their own merits and drawbacks

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In June 2024, Porsche Ventures, the corporate venture capital (CVC) arm of Porsche, announced the launch of a China-focused venture capital fund in collaboration with China International Capital Corporation. According to the press release issued by Porsche, this fund "will be the exclusive channel through which Porsche invests in early-stage startups in China over the coming years." This announcement is welcome news, as it marks one of the few closings of China-focused investment funds in 2024.

This Porsche fund is not alone. Industry heavyweight Apple opted for an external investment fund manager model instead of an internally managed CVC arm. In March 2024, the Restore Fund announced that it raised an additional US$50 million from TSMC of Taiwan and US$30 million from Murata of Japan to bolster the US 200 million that had been committed by Apple in 2023. This new fund is reportedly co-managed by HSBC Asset Management and Pollination, rather than by Apple.

Anecdotally, several other global multinational corporations (MNCs) are also privately believed to be discussing the establishment of either wholly captive or externally managed CVCs to support their 2024 and future strategic initiatives in local markets in China, Japan and elsewhere in Asia.

For MNCs and operating companies that benefit from making investments in high-growth companies, a swift decision-making process is often required in order to ensure success. However, MNCs face significant regulatory scrutiny and corporate citizenship expectations from their stakeholders, leading to more complicated (and usually time consuming) internal decision-making processes. In contrast, traditional private equity (PE) and venture capital (VC) firms excel at quickly assessing risks and deal dynamics based on a calculated balance of factors. High-growth companies often need to maintain a fast decision-making process and a lower regulatory cost structure in order to stay nimble and grow in the market. As a result, they often weigh the advantages and disadvantages of accepting investment from an MNC versus an investment from a PE/VC fund. While no single model fits all situations, CVCs help MNCs bridge this gap by, among other benefits, setting clear boundaries to alleviate the potential business-related concerns of such underlying high-growth investee companies. It is crucial for both MNC investors and investee companies to be cognizant of their respective differences and commit to deeper communication and mutual understanding in order to achieve greater business benefits from their relationship.

In general, how should corporations consider whether to establish or use a CVC model for their strategic initiatives in Asia?

CVC Background

Corporate venture capital refers to equity investments made by established corporations through dedicated,

often specifically established vehicles, in external private companies, including startups and other companies with high growth potential. In today's PE/VC ecosystem, CVCs play an increasingly important role, offering an alternative funding source for entrepreneurs.

Unlike traditional PE/VC firms, which focus solely on maximizing financial returns, CVCs typically have hybrid objectives, aiming for both financial returns and strategic goals that often align with the MNCs' core business lines. These strategic goals can include gaining access to new technologies, obtaining informational advantages in targeted industries, identifying potential disruption, and capturing emerging business models. Fast-changing market conditions further contribute to the popularity of CVCs as corporations seek to stay ahead of innovation waves and seize new opportunities.

Given that CVCs are most effective if designed to meet each corporation's distinct strategic objectives, needs and corporate infrastructure, careful structural planning is critical for their long-term success and compatibility with the MNCs' operations.

Key Commercial Considerations

Deciding whether to establish a CVC (or what legal form to adopt for such CVC) involves many considerations. Here are a few such considerations when deciding the CVC's role in Asia:

1. Investment Team. Corporations can engage an external manager, hire external talent and bring them in-house, or assign existing employees to the CVC program. External managers or external hires bring fresh perspectives, specialized skills, external PE/VC networks, and greater independence, while existing employees have the advantage of better understanding the MNC's corporate strategy and internal networks. Additional consideration should be given to whether the CVC program should use staff that is already based in Asia/the target jurisdiction, or if the program's investment team may be or should be based elsewhere (such as at the MNC's headquarters).

2. Compensation/Incentive Alignment. The CVC program should consider whether to adopt compensation practices that are comparable to traditional PE/VC firms, depending on whether the potential success of the CVC program hinges on the ability to attract and retain key talent (especially externally hired talent). However, corporations should balance this with existing organizational culture and remuneration structures, especially if the CVC program is closely integrated with the MNC.

3. Autonomy and Level of Control. CVCs are often meant to act quickly in response to the fast-paced nature of high-growth companies. They may therefore need to maintain a certain level of autonomy and investment discretion away from their associated MNCs. It is important to balance the autonomy and independence of the CVC with the need to align with the MNC's corporate goals, and both the CVC program and its day-to-day operations should be established in a way that balances this tradeoff.

4. Tax. An MNC is often entitled to the benefits of certain tax treaties, but such benefits might only apply to its related CVC if the CVC is established in a way that complies with such treaties' requirements. Many types of CVC structures, due to business considerations, are not structured in a way that provides the CVC with the tax and financial information that are necessary for compliance.

5. Accounting and Consolidation. Corporations should decide between on-balance-sheet investing (*e.g.*, investing directly using the corporation's cash reserves) and off-balance-sheet investing (*e.g.*, investing indirectly through a separate fund entity funded by the corporation but managed and controlled by an independent investment team). For some types of MNC objectives, the CVC must remain separate and be structured to avoid accounting consolidation.

6. Regulatory. Strategic investments by corporations can raise antitrust and other regulatory concerns, especially if the investee company and the corporation are competitors or potential competitors. There might also be other regulatory considerations due to the status of the MNC, or regulatory constraints in certain sensitive jurisdictions or sectors. For example, a U.S. corporation investing in China or in sensitive technology sectors (for example, artificial intelligence, semiconductors, or quantum computing) needs to carefully manage exposure and maintain flexibility to modify the CVC's holding structure as regulatory constraints evolve.

7. Other Considerations. Corporations need to take into account other factors such as the structure's complexity, maintenance costs, ease of deal execution, governance process and control rights over investee companies. For example, MNCs may seek greater influence and involvement in investee companies' operations to align with their strategic goals. As such, CVCs are often more interested in having a board seat at the investee company level as well as priority rights to later acquire the investee companies, such as call rights, rights of first offers and/or rights of first refusal. Negotiating these governance and priority acquisition rights can be challenging as founders of investee companies are sensitive to losing control. Directors designated by CVCs to investee companies must also be cautious not to breach their fiduciary duties when objectives of MNCs and investee companies diverge.

Legal Structuring Options

A CVC can take various legal forms, such as an internal unit, a single-investor "captive" fund, or a multi-investor fund vehicle. The table below outlines the considerations of three often-used structures for CVC programs, each with its own merits and potential drawbacks. There are also many other variations to these three structures and MNCs often implement tweaks and/or adopt tailored nuances combining aspects of the below to meet their objectives.

	Internal Unit	Captive Fund	Multi-Investor Fund
Structure / Legal Entity	New or existing entity within the MNC's group.	New entity either controlled or materially influenced by the MNC, with the MNC as the sole investor (limited partner).	Fund vehicle with multiple investors (limited partners) including the MNC or its designated entity.
Funding Source	The MNC only.	The MNC only*.	Multiple investors (the MNC and other investors).
Investment Team	Managed by internal MNC employees, sometimes with new external hires to provide specific skillsets.	Can be managed by an internal team or an external PE/VC firm or be co-managed* by both.	Usually managed by an external PE/VC firm.
Level of Control by MNC	High control.	Moderate control; usually negotiated between the MNC and the fund manager.	Lowest control.
Consolidation	Likely yes.	Flexible, depends on the actual legal structure.	Likely no, as the fund is usually managed/controlled externally.
Strategic Alignment with MNC Objectives	Highest alignment.	Moderate alignment; usually functions more like a standalone PE/VC fund.	Moderate alignment. The fund must also cater to the objectives of the other investors.
Resources Required from the MNC	Substantial, but external hires can help.	Less if managed externally; usually negotiated between the MNC and the fund manager.	Least, as the fund is usually managed/controlled externally.

*The co-managed fund structure can often take the form of a "Joint Venture" fund model (JV Fund). Under a JV Fund structure, the fund is no longer captive but commingles funding from the MNC and other sources of funding (*e.g.*, one or more blind-pooled funds that are managed by the external PE/VC manager). The full list of considerations for JV Funds are beyond the scope of this article, but the material considerations described in this article would also apply to JV Funds.

Final Thoughts

Undertaking investments through a CVC structure can be beneficial for both MNCs and investee companies. However, CVCs face unique challenges in the PE/VC sphere. For a CVC program to succeed, there should be a clearly defined objective and performance metrics and procedures put in place that are closely tailored to the MNC's objectives, especially where financial returns are not the sole objective. Such objectives and metrics should also be designed to accommodate the MNC's needs over multiple years rather than from year to year.

As MNCs continue to pursue strategic objectives with investee companies in competitive markets, more CVCs are expected to be formed in the coming years. A carefully designed CVC structure is vital to ensure a successful, long-lasting program that can enhance the long-term competitiveness of a corporation.

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