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Corporate venturing: how to unlock innovation potential

Finding the best fit between compensation systems and integration strategies

People and Organisation
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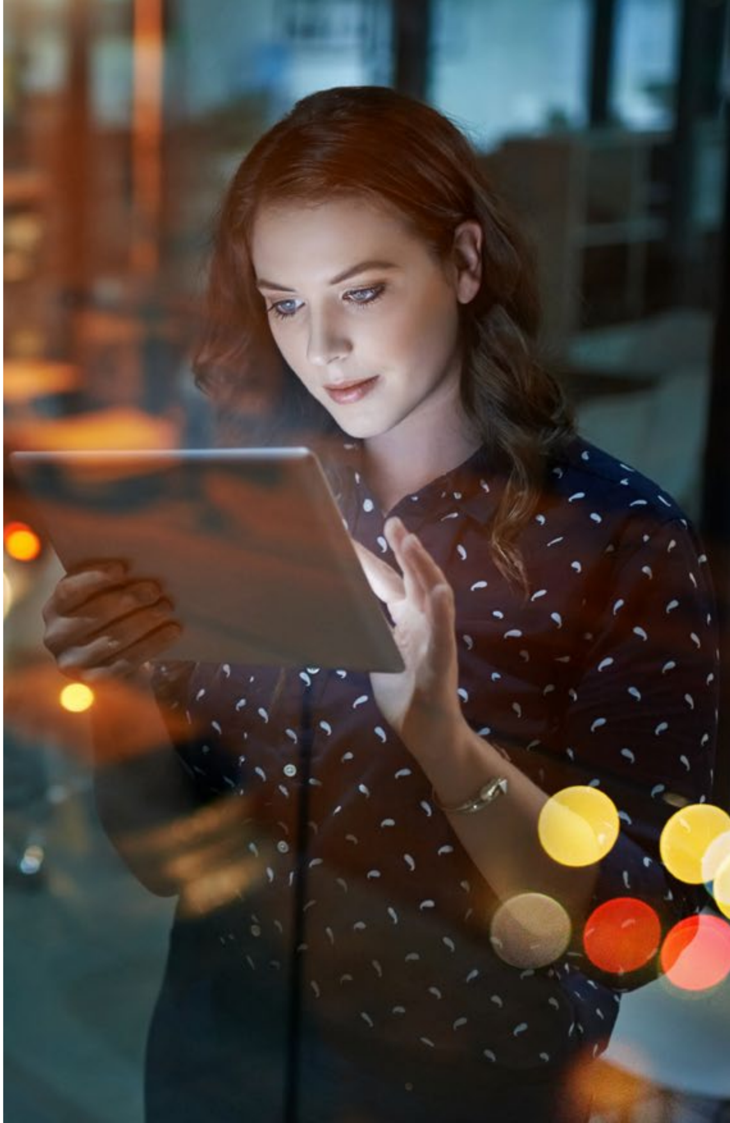

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Introduction

If you want to keep pace with the global environment and stay relevant, you have to innovate. It’s essential for companies to actively pursue innovation strategies, constantly broaden their business horizons, and take the initiative when it comes to creating and advancing into new markets.

Corporate venturing – investing funds in innovative and promising start-ups – allows you to develop new business areas with limited risk. If you want your corporate venturing to be a success, you have to get the maximum power out of the start-up’s innovation engine*. This means you have to be capable of driving the start-up’s employees to optimum performance.

But how do you achieve a culture of innovation and high performance in a corporate environment?

The first thing you have to do is attract, retain and motivate high-potential employees and unlock their innovation potential by aligning compensation strategy with business strategy. Whether the start-up is fully integrated, becomes a partner in the form of a joint venture or is acquired purely as an investment, **the components of compensation need to support the business strategy in the best way possible.**

You have to get a comprehensive understanding of the individual elements of remuneration and the way they interact as part of a total compensation package.

*Platforms such as accelerators, incubators and start-up hubs are also a resource for high-potential and high-growth start-ups, providing comprehensive support to enhance innovative thinking or put ideas into practice.

Purpose of this booklet

If you're part of a corporation, start-up or venture, this booklet is designed to familiarise you with the compensation frameworks that fit best in the light of the chosen integration strategy (full integration, joint venture or pure investment), by:

- Outlining the purpose of corporate venturing and different integration strategies
- Elaborating on why choosing an appropriate integration strategy is crucial, and describing the total compensation elements – with a special focus on variable compensation – considering the impact on culture, motivation and entrepreneurial spirit
- Thinking through compensation frameworks against the backdrop of the different integration strategies, and giving recommendations on remuneration structures that are effective, flexible and cost-efficient
- Defining the next steps that need to be taken to design and implement a compensation framework tailormade to the specific needs
- Summarising key takeaways

Purpose of corporate venturing

Corporations

- Diversification and access to new business areas
- Use the agility of a start-up environment and foster innovation
- Strategic alternative to classic R&D or organic growth
- Create synergy between complementary resources
- Extend and develop core competencies
- Generate or acquire entrepreneurial spirit

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Start-ups

- Less risk, 'safe harbour' of the corporation
- Access to capital, knowledge and network
- Legitimacy and profiling through collaboration and partnership with reputable brands
- Brand recognition
- Accelerate market entry
- Retain entrepreneurial freedom

Investment

Joint venture (business unit)

Full integration (in-company start-up)

Integration strategies

Investment

- Investment typically below 50% (corporation has no absolute control)
- Classic start-up environment remains
- Start-up pursues its own strategies (although the corporation is involved in defining these strategies)
- A concrete plan is often not available yet: product development and market entry still need to be defined

Create the business

Joint venture (business unit)

- Investment typically 50% (control is divided between corporation and start-up)
- New corporate environment combining start-up and corporation business
- The corporation is a partner to the start-up and substantially involved in its business (strategies are defined together)
- A concrete plan is established on the basis of which the corporation and the start-up define new strategic directions

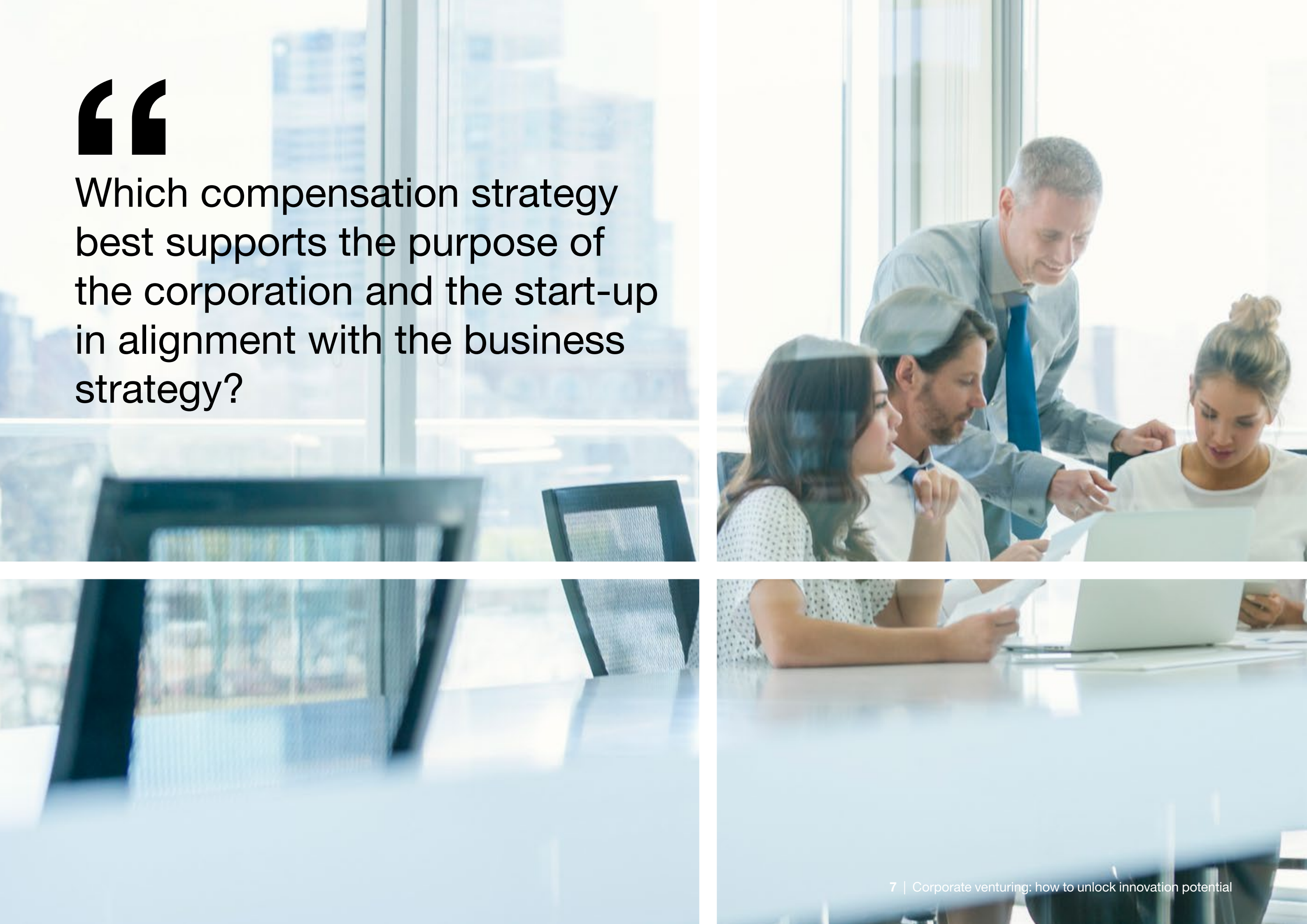
Execute the business

Full integration (in-company start-up)

- Investment typically above 50% (corporation has majority control)
- Start-up is integrated in the corporation's business environment
- Start-up's business is (or will be) part of the corporation (strategies are defined by the corporation)
- The corporation has a concrete plan which the start-up is embedded into

Run/develop the business

Autonomous approach — **Integrated approach**



> “Which compensation strategy best supports the purpose of the corporation and the start-up in alignment with the business strategy?

Compensation elements

Total compensation consists of various components. Variable compensation elements are particularly important for corporate venturing.

Fixed compensation elements

Base salary

- Fixed
- Often based on size of role and associated responsibilities

Pension and social security, fringe benefits

- Sustainable and legally compliant solution needed
- Pressure on funding of liabilities
- Benefits often used to improve employment proposition and morale

Variable compensation elements

Bonus

- Retrospective
- Variable
- Short-term (often up to 12 months)

Long-term incentives

- Prospective
- Variable
- Participation in long-term value creation (often 3-5 years)
- Aligning interests of employees with share-holders

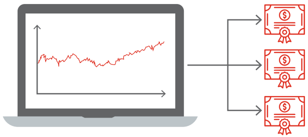
Variable compensation

Real equity participation

'Real' equity participation means that employees can ultimately receive real shares in the company. This encourages high employee commitment, and may create an opportunity for tax-free capital gains in Switzerland*.

Instruments:

- Employee share purchase plans
- Restricted share units
- Performance share units
- Stock options



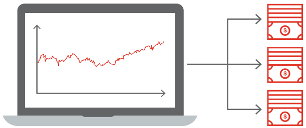
Opportunity to become a shareholder

Phantom participation

A long-term incentive (LTI) can be introduced without giving away ownership rights. 'Phantom' share plans are cash settled plans that economically mirror the development of the value of real shares but result in a cash payout for the employee. This means no shares are allocated, which generally results in less complexity and maintains the current ownership structure.

Instruments:

- Phantom shares
- Phantom options
- Deferred cash models linked to share price



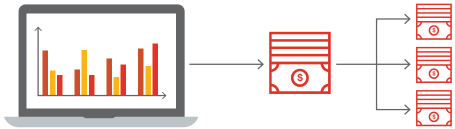
Receive a part of the real economic value increase

Value creation/profit sharing

Through profit sharing plans employees can participate directly in your profitability. The funding is based on financial and/or non-financial KPIs, depending on the defined indicators for value creation (e.g. execution of defined business initiatives).

Instruments:

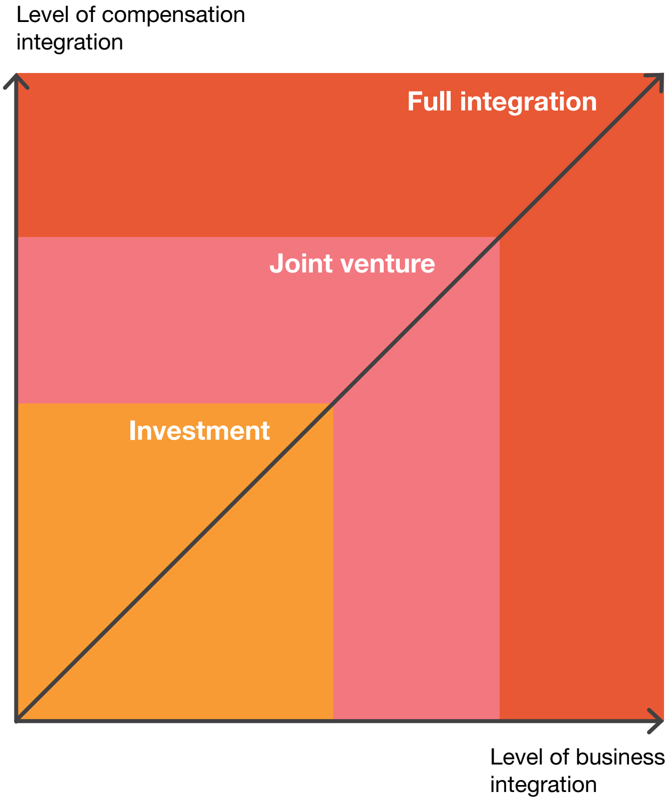
- Pay-out may depend on earnings, performance and/or profit, and may include a discretionary quota
- Performance bonus (e.g. based on team or individual performance)
- Deferred cash models linked to KPIs



Remuneration in cash

*Further information on the valuation of shares in non-quoted companies is provided in the booklet "Equity compensation in high-potential companies".

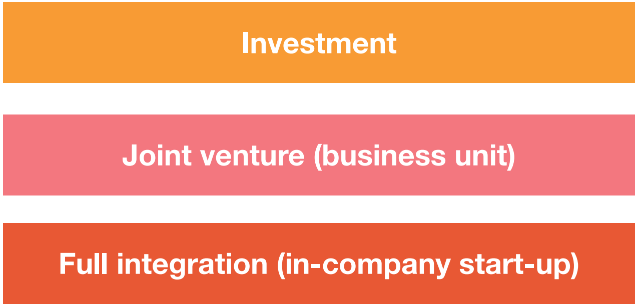
Extent of integration



Key considerations

- To what extent will the business be integrated, i.e. what is the integration strategy?
- To what extent will the employees and their compensation framework be integrated in the corporate environment?

Integration strategies



Compensation framework: Investment

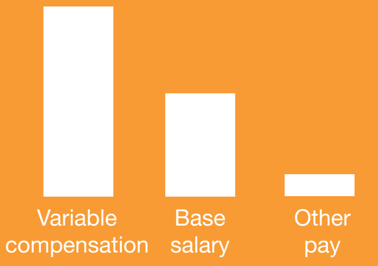
Considerations

- The start-up's compensation structure varies depending on its growth stage, but is more or less independent of the corporation's remuneration philosophy. In other words, there is freedom when it comes to designing the compensation system
- Focusing on growth strategy: fostering entrepreneurial behaviour by letting employees participate in long-term value creation
- Long-term incentives are important components of the total compensation package (particularly during early growth stage)
- Base salary and other monetary benefits are usually lower in comparison to established companies (less security, but participation in value added)

Recommendations

- More compensation 'at risk', more leverage (more upside potential)
- More variable compensation at the expense of base salary and other pay components
- Special focus on long-term variable compensation to align the employees' interests with those of the company and its shareholders
- Bonus component to complement long-term with short-term incentives

High risk, low reward certainty



Autonomous approach

Integrated approach

Compensation framework: Joint venture

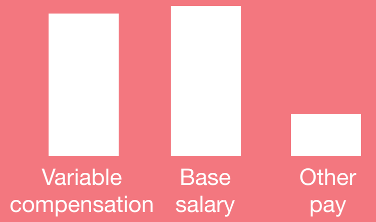
Considerations

- Blend of the start-up's and the corporation's compensation (the corporation often wants its compensation philosophy to be reflected in the start-up's remuneration system, or at least for there to be no contradiction)
- Focusing on incorporation and strategic objectives of joint venture, i.e. defining concrete milestones
- Linking variable compensation to the achievement of these milestones, i.e. business performance (not individual performance)
- Base salary and other monetary benefits are often significantly more advanced than in 'real' start-ups (compensation in line with market depending on industry and sector)
- Often executives are required to invest to increase the 'skin in the game'
- Compensate higher risk in a lower-risk environment with a higher amount of variable compensation

Recommendations

- Less compensation 'at risk', less leverage (less upside potential)
- Balanced ratio of variable compensation to base salary and other compensation
- Special focus on variable compensation to achieve business targets (milestones)
- Participation programme to complement short-term with long-term incentives (particularly during growth stage), letting employees participate in the value development of the joint venture

Medium risk, medium reward certainty



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Compensation framework: Full integration

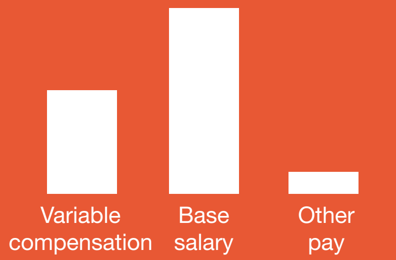
Considerations

- The start-up's compensation structure derives from the existing corporation's compensation strategy (corporation's compensation philosophy is foundation for start-up's compensation system)
- Compensation system supports needs of an established company without jeopardising its further development
- Promotions and salary increases are main incentives (rather than high upside potential by way of variable compensation components)
- Focusing on competitive base salaries in combination with attractive variable remuneration to foster team spirit (incentives should encourage agility and be linked to team and company performance, i.e. no individual bonus targets; some business areas can contribute better, other business areas poorer performance results)
- Other pay and benefits (e.g. beneficial pension plan) are aligned with the start-up's strategy and culture

Recommendations

- Little compensation 'at risk', low leverage (limited upside potential)
- Increasing base salary at the expense of variable compensation (more certainty)
- Special focus on strengthening team spirit and fostering common values
- Variable compensation to include profit-sharing elements in compensation package

Low risk, high reward certainty



Autonomous approach

Integrated approach

Case studies

Creating a business through investment	Executing a business through partial integration	Developing a business through full integration
Generating new ideas outside core business • Corporation's remuneration scheme focuses on linking pay and group performance through a group share plan • To accelerate growth and participate in new business, a separate unit was created which was also looking for external investors to fund innovation (strategic partner) • To attract, motivate and retain the right talent, a separate remuneration framework was implemented for this unit (start-up/private equity model) • Employees of this unit do not participate in the group compensation system, nor the group share plan	**Innovation and growth through participation** • Corporation offers traditional remuneration elements to employees of the core business • To stay relevant, the company invests into different ventures (portfolio companies) • Employees of the ventures become core business employees • To avoid demotivation and distraction after integration, the variable compensation of these former venture employees was still linked to the development of the former portfolio company • As a result, employees received a venture-linked LTI embedded in the core business remuneration system	**Strengthening innovation in the existing business** • Corporation's compensation elements reward individual, team and company performance • The relevance of keeping pace with the digitalisation needs to be reflected in the business activities • To extend core competencies, the company fully integrated the start-up • To enhance and accelerate the full integration of the new business, the existing compensation strategy of the corporation was fully adopted • Employees of the start-up became employees of the corporation and were entitled to the compensation elements of the company
• Offering an attractive solution for non-core business employees • Financing core business through participation in innovative new business • Knowledge transfer (e.g. technology) through strategic partner	• Focus on growth and innovation of venture to the benefit of the group • No dilutive effect on activities • Increased retention after integration • Flexible approach within group compensation framework	• Foster one corporate culture by not differentiating between corporation's employees and start-up's employees • Fast access to capital, knowledge and network • Legitimacy and profiling of the business area through the reputable brand

Autonomous approach ←→ **Integrated approach**

Next steps

What steps do you need to take to design and implement a compensation framework tailormade to support your business strategy?

01	Understand the business and integration strategy, and analyse needs
02	Analyse existing remuneration schemes, both at the corporation and the start-up
03	Formulate an explicit compensation strategy on the basis of the business and integration strategy
04	Determine the relevant compensation components, such as STI, LTI and benefits
05	Design the respective policies, term sheets and plan rules and discuss with key stakeholders
06	Clarify the implications from a tax, legal and accounting perspective (e.g. employer reporting obligations, valuation of the shares*, tax ruling)
07	Communicate the new schemes to the respective employees
08	Administrate the plans and guarantee compliance with accounting and tax requirements (e.g. salary certificates)

*Further information on the valuation of shares in non-quoted companies is provided in the booklet
"Equity compensation in high-potential companies"

Key takeaways

A well-designed compensation structure aligned with your strategy helps you

…to attract, retain and motivate talents with high innovation potential…

…who create an innovation culture within your corporate environment that is crucial for staying relevant…

…which leads to the successful achievement of your business strategy.

Glossary

Term for the purpose of this booklet	Definition
Accelerator	An organisation that supports newly founded companies or organisations in their early stages to grow quickly and become successful
Corporation	A company or a group of companies that are managed as a single organisation
Incubator	A platform that supports new business ideas, innovation and founders by providing coaching, co-working spaces and know-how
KPI	Key performance indicator, used to measure the performance and the success of a company or an employee
LTI	Long-term incentive plan, used to reward long-term performance
Start-up	A newly established business in its early stages
STI	Short-term incentive plan, used to reward short-term performance
Venture	A new business activity, often involves risk or uncertainty

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