

European companies lag behind U.S.
corporations in starting new businesses.
A few best-practice companies
show how the continent can compete.

Europe Ventures Forth

New Ventures: A Special Report

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Photography by Holly Lindem

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Over the past five years, numerous U.S. corporations have been spectacularly successful at investing in startups. By building portfolios of early-stage investments, companies such as the Intel Corporation and Cisco Systems Inc. have developed enormous strategic advantages and made very attractive returns in the process. (See Exhibit 1.) Such corporate venturing has become a phenomenon central to the New Economy, and as established companies strive to keep in touch with the cutting edge of new technologies, fight off dot-com challengers, and find new markets for their core products, they too have joined the game.

But to date, corporate venturing has largely failed to cross the Atlantic. With a few notable exceptions — typically those companies competing in the global high-tech sector such as Siemens, Nokia, and Deutsche Telekom — the practice remains unexplored territory in Europe.

This needs to change, and fast. Corporate venturing has become an essential tool in a new business world of e-commerce, industry convergence, and global markets, and every European CEO must explore ways to develop a corporate venturing initiative.

The leading players in corporate venturing have grown quite large. In 1999, 10 of the world's 22 largest venture-capital funds investors were corporations (see Exhibit 2), and the value of venture investments made by the U.S. corporate sector came to nearly 17 percent — \$8 billion — of total U.S. venture capital. This is more than three times the \$2.4 billion invested by European corporations that year. Of the 20 companies in the world with the most venture-capital initiatives, only four were European (see Exhibit 3).

A recent Booz-Allen & Hamilton study of regional competitiveness in the technology sector confirms the conclusion suggested by these figures: European compa-

nies are falling behind. A weaker record of innovation, a lack of entrepreneurial spirit, and market fragmentation arising from restrictive European business regulations have allowed their U.S. competitors to take the lead in the New Economy. Despite producing a mass of world-class research, European companies and independent research institutions are often unable to turn their ideas into viable commercial propositions.

In order to address this relative failure and create global technology leaders for the future, European companies need to make dramatic improvements in their capacity for innovation. We believe that corporate venturing will be an important factor in the achievement of that goal, helping companies to improve their access to new technologies and their ability to commercialize in-house R&D, and, more generally, to stimulate a new entrepreneurial spirit.

The European Difference

Corporate venturing has, until recently, bypassed European boardrooms in no small part because of the stock market. Throughout the 1990s, European shareholders punished corporations that strayed outside their core competencies and rewarded those that “stuck to their knitting.” The idea that a semiconductor company or even an oil company should dabble in the risky world of venture capital seemed anathema.

But there were also barriers within the corporate organization. Companies often lacked the knowledge to value early-stage investments and to perform the painstaking but essential due diligence on them. They found it difficult to characterize investments in terms of their risks and the strategic or financial leverage they might bring. And they were uncertain how to manage

investments once they were made — how to nurture young firms, build new businesses, and retain the talent behind them.

Until very recently, venture capital in the technology sector was much more prevalent in the U.S. than in Europe, and so this critical know-how was much harder for European companies to obtain. In addition, Europe has been far less conducive to entrepreneurship, making it difficult to build startup businesses rapidly. (See “Incubators in Europe,” page 145, for more on the challenges for new ventures in Europe.)

Furthermore, conflicts of interest seemed to be everywhere: between companies’ R&D efforts and those of their startup investments; and between existing corporate pay structures and the compensation systems needed to reward in-house managers of venture capital. The latter difficulty is particularly acute in Europe, where differenti-

ated and variable compensation has long met with resistance from trade unions and politicians.

These concerns, together with senior management’s required investment of time and the stock market’s demand for focus, added up to a clear conclusion — corporate venturing was simply not worth it.

Yet at the same time, many U.S. corporations had been reaching precisely the opposite conclusion. They were far quicker to recognize that the nature of the New Economy demanded a major shift in how companies think about their markets and their future. (For a view of corporate venturing trends in the U.S., see “Adventures in Corporate Venturing,” page 119.)

Most importantly, technological change is now so pervasive that high-quality market intelligence has become a competitive necessity. Companies must keep their ears to the ground as never before.

Exhibit 1: Major Companies Capturing Value in Emerging E-Business

Venturing Company	Startup	The Deal
Delta Air Lines	Priceline.com	Delta received warrants for a 10% stake in Priceline.com in exchange for supplying airline tickets
United Technologies	FreeMarkets	United Technologies holds a 6% stake in FreeMarkets
VW&R Inc.	Chemdex	VW&R took a 10% stake in Chemdex, which in exchange received access to VW&R customers
Chevron	Ariba	Chevron took a 1% stake in Ariba in exchange for procurement software
Nike	Fogdog	Nike took a 12% stake in Fogdog, which in exchange could purchase Nike’s entire product line at a discount for 6 months

What's more, the convergence of previously separate industries, such as voice and data communications, computing and telephony, and even mobile telephony and banking, is compelling companies to acquire industry understanding and skills that were previously far outside their normal fields of operation.

Beyond this, e-commerce has created the risk that new business models will undermine those of established players. Sudden shifts in business practices — such as the rise of auctions, which shift power to buyers — threaten the old way of doing business. However, some companies are beginning to think creatively about how to increase their market leverage, maximizing the revenue potential of their own technological platform or customer base.

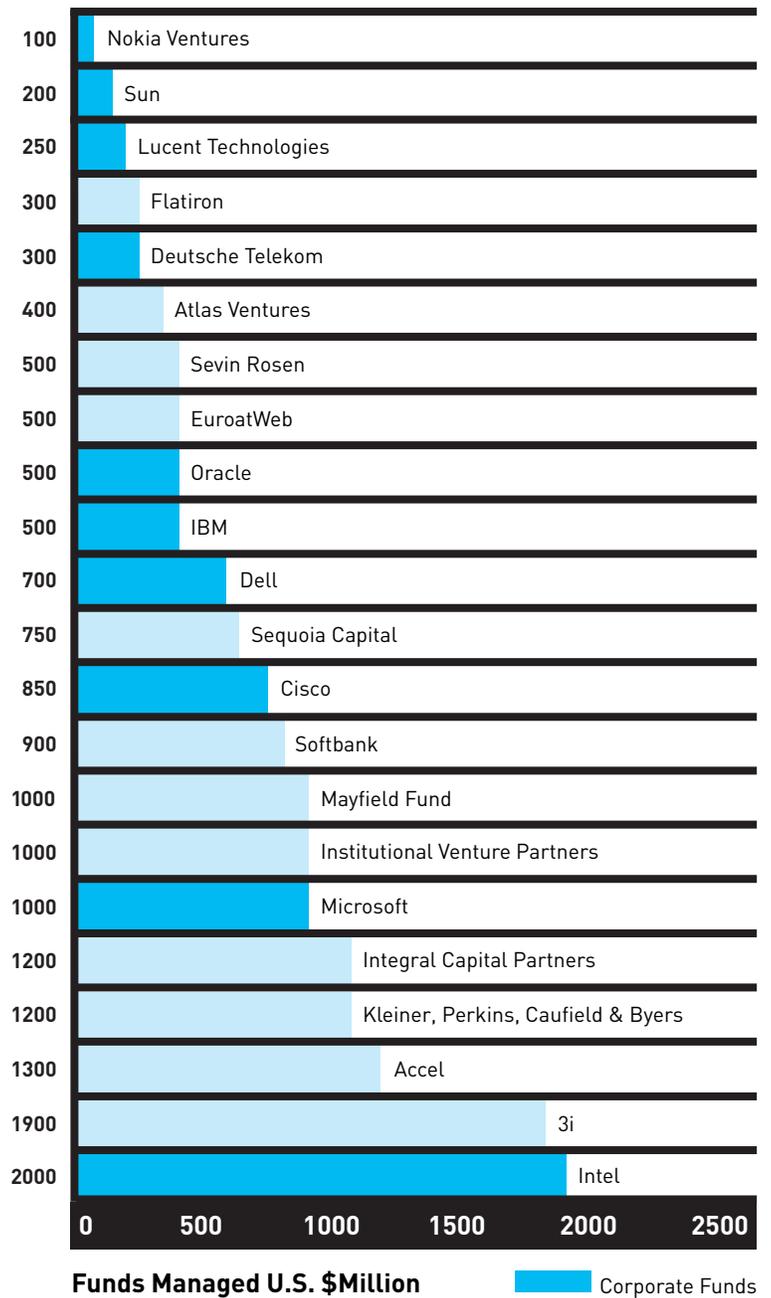
Something Ventured...

So what can corporate venturing do for an organization? Conversations we have had with senior executives at several leading corporations over the past few months reveal a number of powerful and distinct purposes the practice can serve.

- **Access to technology.** In early 1999, Lucent's Enterprise Networks Group (now Avaya Communications Inc.) completed the acquisition of SDX Business Systems, a U.K. provider of business communications systems. SDX had recently acquired Network Alchemy, a U.K. startup that manufactured digital telephone switchboards (PBXs), and both became part of Lucent's portfolio. Lucent had been looking to extend its capabilities beyond voice communications into the burgeoning field of data, and SDX seemed a promising target.

The deal was driven by SDX's powerful call-center

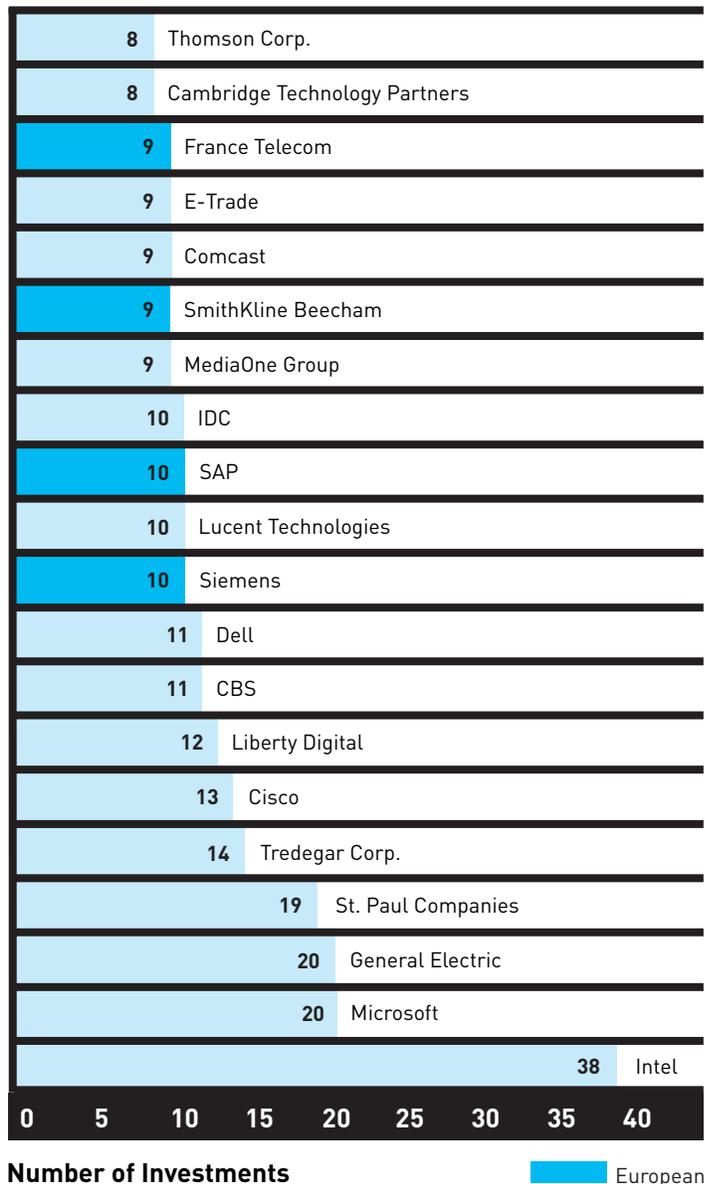
Exhibit 2:
The World's Largest New Economy Venture Investors, 1999



technology rather than by Network Alchemy, which was still in product testing. But the latter would provide even bigger rewards: Its technology was about to prove so simple, so cost-effective, and so powerful that it would establish a position of unchallenged leadership in its target sector.

Initially, Lucent did little to interfere with the new member of its venture portfolio. But as Alchemy's sales grew at 15 percent per month during 1999, Lucent realized how successful its investment could be. Lucent made development capital available, assembled a business devel-

Exhibit 3: Top Corporate Venture Investors, 1999



opment team, courted powerful channel partners, and put into action a European expansion plan.

Lucent's experience is typical of companies using corporate venturing to compete in an emerging technological game in which they would not otherwise be players. A portfolio of interests in strategically important areas increases the chances of being involved in and capitalizing on the next big thing. At the same time, a financial commitment to a young company with promising technology but meager financing can help ensure its survival and maximize the chances that it will deliver.

Lucent's reason for its investment was expansion into a new industry, and similar business logic applies to defensive strategy within an existing industry. A company

can use early-stage investments to take stakes in companies anticipated to become strong competitors. Indeed, the leading corporate venturing practitioners routinely invest in competing technologies in which a dominant new standard is likely to emerge, but in which the outcome is unclear. Such hedging strategies have a side benefit: When the winning technology does emerge, it is less likely to be in the hands of a competitor.

- **A new model for corporate R&D.** Besides these strategic and industry-positioning considerations, the motivation to move into corporate venturing can also be strictly operations-driven. Venturing can form a powerful part of an expanded model for corporate R&D, complementing internal efforts with external investments in innovative companies. Venturing is a natural extension of the extended enterprise model of innovation, which is increasingly being adopted by technology-driven companies and

which has reduced internal sensitivities to potential conflicts of interest.

In the late 1990s, as the Royal Dutch/Shell Group of Companies reviewed ideas for boosting revenues in what was a thoroughly mature industry, it identified innovation as a key lever. It was clear that the innovation required would take Shell beyond the scope of its traditional core competencies. Yet the research that the company routinely conducted with universities seemed less and less likely to generate the necessary breakthroughs to stay on the leading edge of innovation. Shell determined that it needed to accelerate grass-roots innovation within the company itself.

Its response was GameChanger, which aims to reju-

Exhibit 4: Three Models of Corporate Venturing

	Model	Description	Examples	Benefits
External	<p>1. Outsourced Model</p> <pre> graph TD MC[Major Corporation] --> VC[VC] VC --> S[Startups] MC --> S </pre>	<p>Corporation commits funds to and sets investment guidelines for a third-party venture-capital firm</p> <p>Relationship may be one of joint venture or strategic alliance</p> <p>Venture-capital firm manages all deal-making</p> <p>Corporation retains right to follow up on investments directly</p>	<p>Adobe</p> <p>P&G</p>	<p>The lowest involvement option</p> <p>Allows a learning approach</p> <p>The simplest approach for organizations</p> <ul style="list-style-type: none"> •with no venturing experience •with extremely lean management structures
Internal	<p>2. Incubation Approach</p> <pre> graph TD MC[Major Corporation] subgraph MC_Box [Major Corporation] OU[Operating Unit] CVU[CV Unit] IU[Incubator Unit] OU --> CVU CVU --> IU end S[Startups] SO[Spin-offs] IU --> S IU --> SO </pre>	<p>Corporation gathers ideas from within or outside its organization</p> <p>Incubates promising ideas internally using its infrastructure</p> <p>Promising projects may be spun off</p>	<p>Shell</p> <p>BP Amoco</p>	<p>Investments are smaller and in earlier stages</p> <p>The best model for corporations</p> <ul style="list-style-type: none"> •with considerable R&D-related resources •with less cash •in which the main motivation is to improve idea capture from within the current organization •for which softer factors, such as imbuing entrepreneurial spirit, are important
Internal	<p>3. Corporate Direct Investment</p> <pre> graph TD MC[Major Corporation] subgraph MC_Box [Major Corporation] CVU[CV Unit] end S[Startups] CVU --> S </pre>	<p>Corporation develops its own investment capability internally</p> <p>Makes external investments in young companies</p>	<p>Cisco</p> <p>Deutsche Telecom</p> <p>Intel</p>	<p>The best general-purpose model for a fully committed approach where strategic concerns and technology capture are paramount ...</p> <p>... and where direct access to the widest possible set of companies is important</p> <p>May need to be linked to a full M&A function to realize full potential</p>

venate Shell’s technology portfolio by taking ideas from wherever they might arise in the organization and providing seed finance for the best ones. In the GameChanger process, groups of small teams critique new business ideas and apply venture-capital criteria to decide which ideas should be recommended for funding.

Several senior managers and representatives of Shell’s venture-capital group make up the GameChanger team that reviews outline proposals and decides on the spot whether to fund them to proof-of-concept stage. According to a recent report in *Business Week*, four of Shell’s five top business initiatives in 1999 emerged from the GameChanger teams. A second Shell initiative, Tech Ventures, makes larger investments to commercialize the most promising innovations.

Increasingly, companies are extending this kind of approach to ideas originating outside their organizations. When managed right, a portfolio of investments in companies working in technologically relevant areas can be an efficient alternative to in-house development and testing, maximizing entrepreneurship while reducing management overhead and P&L expenditure.

Conversely, venture investments can complement corporate R&D, offering the chance to get more leverage out of existing assets. Fixed assets like plants, buildings, and test facilities can be used by the startup companies, and managing incentive and compensation issues shrewdly can help to retain the best talent at a time when loss of key staff is one of the most pressing corporate problems. For the larger R&D spenders, venturing offers a better

Corporate venturing remains unexplored territory in Europe. This needs to change — and fast.

way to exploit the fruits of research. Technologies that don't fit into the year's launch schedule can be spun off into new companies.

- **A tool to drive demand for core products.** Perhaps the most powerful application for corporate venturing is as a tool to stimulate demand for core products. Intel is a prime exponent of venturing as a way to promote the use of its platform technology. It has made about 450 investments with a cumulative value of \$3.5 billion since it began investing in startups in the early 1990s. The single unifying theme of all these investments is selling more of Intel's core products while taking a backseat in management of the companies that are making use of them. In doing so, Intel has built a network of companies with common interests.

In 1999, the company set up two funds, Intel Communications and Intel 64, dedicated solely to developing markets for its next generation of products, and provided them with more than \$450 million to invest. The funds have made more than 275 investments in new ventures that are developing software or hardware optimized for the Intel 64 next-generation Merced processor and for Intel's new chips for the networking industry.

This is a ruthlessly focused application of corporate venturing — and it seems to work. Intel has brought 15 of the companies in which it has invested to IPO stage, a better rate of success than any other venture investor's. And investments in emerging economies such as China have materially helped the company develop new markets for its products.

- **Not only for profit.** With results like Intel's capturing headlines, some companies are finding corporate venturing attractive for its potential financial benefits. But when this is the prime motivation, problems are more

likely to arise. After all, if you expect to earn more through what is essentially speculation than by investing in your core business, then something must be wrong.

Nevertheless, if corporate venturing in New Economy startups, in particular e-business startups, is done well and explained credibly to shareholders, the investments will be perceived as part of a clear and comprehensive strategy to reinvigorate the business.

The Key Decisions

In our view, the time has come for European chief executives at least to consider launching a corporate venturing initiative. That means making three top management decisions.

The first and most fundamental decision is whether and when to act. Corporate venturing is not for everybody, and, like marriage, it should not be entered into lightly or unadvisedly. Our experience indicates that there are seven signs the time has come to make a commitment: The first four are related to strategy; the last three are related to innovation.

1. Your corporation is technology-driven and is in an industry subject to change across many fronts, much of which might be driven by small, innovative companies. The software industry is an obvious example, but there are others in which the capital intensity of R&D is a weaker barrier to new entry than it has been in the past.

2. Your corporation is a large one that is not necessarily technology-driven but that has recognized the potential of online technology to transform and/or threaten parts of your business. This is happening, for example, in the oil industry, with the emergence of online auctions for oil trading.

3. You have realized that your company's future strat-

Cisco and Intel have built top-flight in-house investment teams, taking on the established venture capitalists at their own game.

egy requires that it move beyond its traditional core competencies. Media companies seeking to create a strong online presence and telecommunications firms creating mobile portals are good examples.

4. New upstart competitors are beginning to make a tangible impact on your company's market share.

5. The future success of your business will depend in large part on the application of skills that are currently not central to the organization, and it is proving difficult to recruit staff with such skills. A mobile telecommunications company lacking staff with Internet skills is an example.

6. Retention of key staff in technical departments has become a challenge.

7. You are being approached with numerous investment proposals from outside the organization. You feel that some have merit, but you lack a formal system for dealing with them.

Having decided to make the marriage-like commitment to venturing, you must next decide on your principal goals for a corporate venturing initiative as discussed above. Is the intention to get access to new technology and new markets, strategic defense, or a new model for research and development?

The third management decision concerns the appropriate structure for your corporate venturing unit and how it should be run. Should the unit be built internally, or can it be outsourced? If it is an in-house unit, should it invest directly or act like a business incubator? To whom should it report? And how should its managers be rewarded?

Choosing a Venturing Model

Adobe Systems Inc. and Proctor & Gamble Company have invited venture-capital firms to run their corporate venturing efforts for them, opting for minimum disrup-

tion to their core operations. Shell, in contrast, has acted like a business incubator, treating corporate venturing as a tool to galvanize the organization and enhance its ability to innovate. Cisco and Intel, meanwhile, have built top-flight in-house investment teams, taking on the established venture capitalists at their own game.

Clearly, there are many ways to make corporate venturing work. The right organizational model will depend on your objectives, your resources, and your level of ambition. Broadly speaking, the wide range of models currently being used fall into three categories (see Exhibit 4):

The *Outsourced model*, in which the company works in partnership with a venture-capital firm, is an attractive entry proposition. The option with the lowest involvement, it allows a learning approach and appeal to companies that are starting from scratch or that have such lean management structures that there are simply no experienced managers to lead the initiative.

The *business incubation model* is likely to appeal to companies with considerable R&D resources that can be leveraged through the effort, or companies whose primary motivation is to improve innovation and the capture of new ideas within the organization. It is also valuable when softer management issues, such as imbuing entrepreneurial spirit or improving staff retention, are paramount.

Corporate direct investment is the best general model for a full commitment when access to new technologies and strategic defense are the principal goals. This option offers the possibility of directly investing in a wide variety of companies.

It is important to bear in mind that the models are not mutually exclusive: Indeed, a company may employ elements of different models or move from one to another. For example, the Dutch telecommunications group

KPN Royal Dutch Telecom recently set up KPN Valley, its own incubator and venture unit, having previously outsourced its corporate venturing activities to the U.K.-based venture-capital group Advent.

Managing Venturing

Companies face two other critical management issues if they plan to move beyond the outsourced model to develop a true in-house venturing capability. The first is identifying where the unit should be placed within the organization. Our research strongly suggests that in order to be successful, a corporate venturing unit must have top-level sponsorship. “Each and every project is matched with a champion inside the company,” says Wim Schinkel, head of Shell’s GameChanger unit. Paul Shreve, head of business development for Cisco in Europe, concurs: “Each investment must have a sponsor inside the organization, a home.”

Investment managers should also be allowed to operate independently with an appropriate reporting line. Reporting to the CFO risks having a unit become too financially oriented, when returns should be viewed as partly strategic. Yet reporting to the chief technology officer can mean that other parts of the organization take a skeptical view of the unit’s investments, doubting their relevance to the core business.

Our interviews with successful corporate venturing executives indicate that successful corporate venturing units steer clear of the commonly used functional heads and have their investment managers report directly to the CEO or to a key business-unit head. Shell’s GameChanger unit, for example, is under the sponsorship of the head of the company’s Research and Technology Center; Cisco’s Capital Group reports to the head of mergers

and acquisitions; and Intel Capital is the responsibility of the vice president for business development.

Successful corporate venturing units also tend to distinguish clearly between the sourcing of ideas and actual deal-making. They make use of a broad network to scout for potential projects from the widest possible range of sources, while a small core operation evaluates the ideas and seeks to implement the best of them. This combination helps to address the challenge that many nascent schemes face: All proposals must be appraised against a common standard, and yet ideas should originate from across the whole organization.

The primary role of the dedicated central unit is guardian of the overarching investment strategy. For Cisco, whose corporate mission Mr. Shreve characterizes as “being the world’s ultimate Internet plumbers,” this means investing “only to make the bits go faster or where we can add more value to the bits as they fly.” Such a strategy then sets the criteria for investment appraisal and decision-making. The core unit is also responsible for monitoring current investments and acting as a liaison with the wider organization on potential investments.

In its simplest form, the network should encourage any member of the organization to originate an investment proposal. Shell, for example, uses its corporate intranet to manage the collection of ideas: Any employee can submit a proposal online or browse the 150 or so other ideas carried on the database of corporate venturing opportunities. At Cisco, Mr. Shreve estimates that about half of the proposals his group receives originate from within the company’s business units.

The second critical management issue is compensation of the managers who run the corporate venturing function. Our research indicates that this is one of the

Exhibit 5: Practical Implementation Checklist

Phase 1: Choose the Right Structure	Internal or external; incubation or direct investment approach Institute direct reporting to the CEO or a key business-unit head Define the compensation structure for the managers involved
Phase 2: Design the Structure	Define target markets and technologies in which to invest Choose the financial structure: investments on or off the balance sheet? Independent fund? Define the investment policy and criteria: startups or established businesses, majority or minority stakes, investment levels, target sectors, technologies? Articulate the decision-making process: scouting of targets, alignment with established investment procedures, involvement of line management, approval process Define funding parameters: size of fund, size of investments, involvement of external partners, etc.
Phase 3: Mobilize and Implement	Staff the organization: Assign seasoned managers full-time, set their responsibilities Communicate the launch: Ensure excitement, buy-in, and, at the very least, understanding throughout the wider organization Establish external partnerships: for scouting possible targets, support with transactions, due diligence, management and administration of the fund, participation in funding
Phase 4: Monitor and Follow-up	Establish and monitor performance criteria: financial returns, new revenues, or performance of companies in the investment portfolio against their own business plans Think about exit, whether to buy up or sell off. Engagement, follow-up, and exit and integration strategies — formal investment, incubation, acquisition, and integration

European companies have been understandably reluctant to accept that conclusion and have implemented schemes they hope will meet the expectations of corporate venturing managers and their peers. Examples include bonuses linked to the performance of companies in the investment portfolio or equity in the startup companies (or in a side fund that tracks them). It is clear to us that the companies that practice corporate venturing most effectively have bitten the bullet and rearranged their pay structures to allow their investment managers to be compensated in line with typical venture-capital practice.

most vexing practical problems CEOs currently face. Indeed, the problem is so acute it has led more than one company in Europe to stick with the outsourced model even when an internally managed fund would probably be more effective.

The problem stems from a fundamental conflict. To ensure that you have the best people making your investment decisions, you must offer compensation in line with the market for investment managers, that is, venture capitalists. At the same time, the compensation of your corporate venturing managers should ideally be in line with that of their peers in other parts of the organization. But incentive packages combining salary, bonus, and equity are a long way from the potentially more lucrative structures used by the venture-capital industry, where managers typically take some form of equity in the companies in which they invest or at least in the fund they manage.

This is a circle that cannot be squared. Many

The Route to Success

Having made the key decisions about whether a corporate venturing initiative is necessary for your company and what its objectives should be, you now face the process of implementation. Our discussions with leading practitioners and our own experience indicate that the route to implementing a successful corporate venturing initiative follows four distinct steps. (See Exhibit 5.) (Additional Booz-Allen research on corporate venturing best practices among U.S. companies appears on page 119.)

First and foremost is the selection of the right structure for such an initiative, including the appropriate reporting lines, internal scouting network, and compensation structure. Next comes definition of the detailed policies, the procedures for pursuing them, and the parameters of the funding mechanism, each of which will be based on your principal goals. The third step is to

mobilize and implement the policies, which means tackling staffing issues, managing internal and external communications, and making intended partnerships operational. The fourth and final step is to monitor actual performance and readjust where necessary.

Our conversations with many corporate venturing practitioners indicate that the process of setting up an initiative is generally well understood. At the same time, there are some valuable lessons to be learned from their experience.

The first is the need to have a clear and focused vision of what you want to achieve and to ensure that this vision is understood and shared within the top management team. It is essential to align your corporate venturing initiative with your corporate strategy in terms of markets, products, and technology. The scope and intended time scale of the initiative and the performance criteria by which it will be judged must also be well articulated.

The second lesson is the need to create an empowered unit, fully endorsed by and reporting to the CEO and/or a key business-unit head, rather than to a functional head. Once the unit's objectives and criteria are articulated, it should be allowed operating autonomy, and its managers should be rewarded in line with professional investment managers. The key risk here is of creating an isolated initiative that lacks visibility and support within the organization and that will inevitably fall short of expectations.

Third, the unit should invest strategically. There must be full strategic alignment between the investor and its targets, ensuring that know-how and capability are transferred effectively so as to create value for all concerned parties.

Fourth, the unit's work should engage the wider organization, striving for the widest possible network of

“opportunity originators.” This demands the active involvement of line management, possibly by creating appropriate incentives, as well as the creation of strong internal champions who will act as mentors for the start-up companies.

The fifth lesson is that you should think in terms of external networks, involving external partners in management and funding mechanisms and establishing a strong community of shared interests between the investments in the portfolio.

Finally, it is essential to create a sense of excitement about your corporate venturing initiative. Clear communication of its goals and guidelines will create the right image for the project and have an enormously positive effect on how it is perceived both within the organization and by shareholders.

Our experience indicates that taking these suggestions to heart will greatly enhance the success of your corporate venturing initiative and your investments, and thereby improve both the strategic positioning of your company and its shareholder value. +

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Resources

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Richard T. Pascale and Anne H. Miller, “The Action Lab: Creating a Greenhouse for Organizational Change,” *s+b*, Fourth Quarter 1999; www.strategy-business.com/strategy/99408

Marcia Stepanek, “Using the Net for Brainstorming: Smart Companies are Exploiting Cyberspace to Spark Innovation,” *Business Week*, December 13, 1999; www.businessweek.com

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