Discussion of *Tian & Ye (2018)*: A Dark Side of Corporate Venture Capital

Shenje Hshieh
City University of Hong Hong

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Summary of Paper

- Explores the relationship between institutional ownership and investments
- Focuses on CVC investments made by firms around the Russell 1000/2000 threshold
- Uses Russell index reconstitution as an IV
- Finds that increases in institutional ownership leads to reduction of “bad” CVC startup investments

CVC Investment Objective

		Strategic	Financial
Link to operational capability	Tight	**Driving** advances strategy of current business	**Emergent** allows exploration of potential new businesses
	Loose	**Enabling** complements strategy of current business	**Passive** provides financial returns only

Source: Chesbrough (2002, Harvard Business Review)

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General Comments

- Clear execution of empirical design
- Explores an interesting category of corporate investments with unique observable characteristics
- Rich cross-sectional results
- Room for improvement in supporting the conjectured mechanism/channel (i.e., managerial entrenchment)

The Story

1. Firm is randomly assigned to Russell 2000
2. Institutional ownership increases
3. Monitoring and corporate governance improves **(still actively debated, e.g., Schmidt and Fahlenbrach, 2017)**
4. Managerial entrenchment is reduced
5. Negative NPV projects are eliminated **(actively or passively?)**

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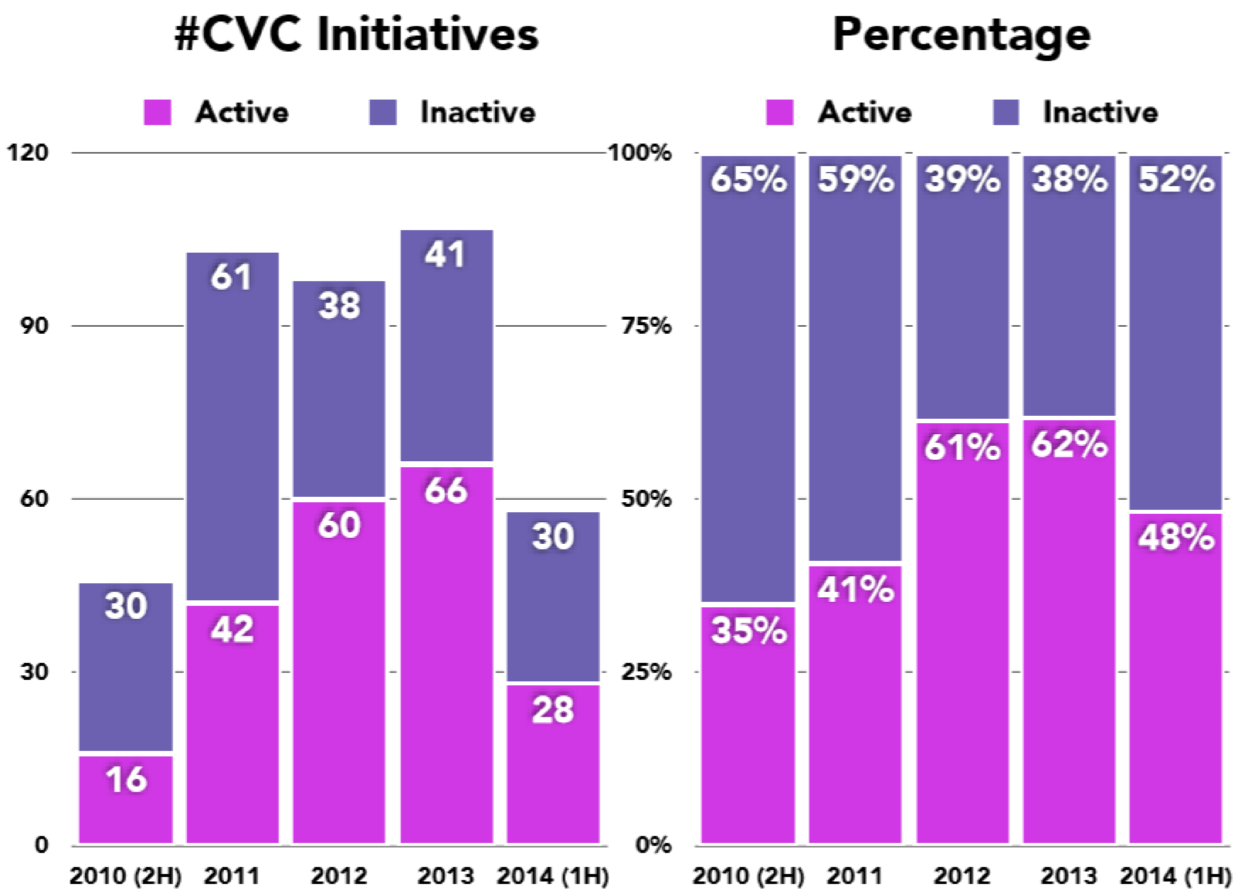
Possibly Simpler Stories

- Firms in the bottom of Russell 1000 are worse at venturing, such as investing too late (Park and Vermeulen, 2015)
- Good startups avoid CVCs (Fred Wilson has said that he would “never, ever, ever, ever” invest alongside a CVC due to mismatched objectives)
- Investments are cut or stagnate due to financial constraints (i.e., CVCs becomes “zombie VCs”)

Authors needs to do more to show managerial entrenchment is the primary mechanism.

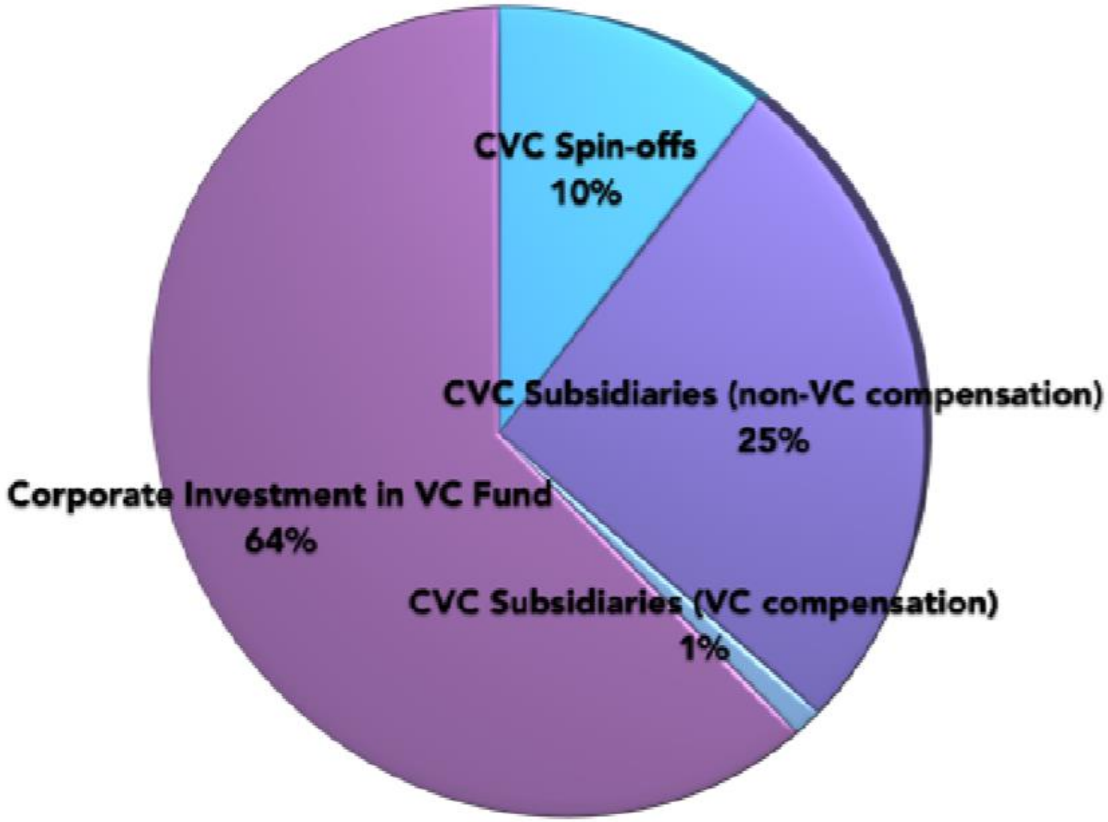
Zombie VC (Park and Vermeulen, 2015)



CVC Structure and Manager Incentives

- How is the CVC structured? Is it a subsidiary or an LP of a VC fund? This can affect how managers are paid and riskiness of startups to invest
- Do we observe stronger effects for subsidiaries as opposed to in-house CVCs?
- Do compensation schemes differ (e.g., fixed salary vs. profit sharing)? See Dushnitsky and Shapira (2010)
- To whom does the CVC reports (e.g., CEO vs. CFO)? See Simoudis (2015)
- More information on CVC is needed to make managerial entrenchment argument more credible

CVC Initiatives (2010-2014)



Suggestions 1

- At what startup stage do CVCs invest in your sample (e.g., series A, etc.)? This gives us a measure of investment ability of the manager.
- Are CVCs actively culling their portfolio of startups or simply inactive (portfolio startups are passively written off)? Use early exit as an outcome variable.
- What do we observe for firms that move from Russell 2000 to Russell 1000? Should we expect more bad CVC investments?

Suggestions 2

- Exclude year(s) where the dotcom bubble burst (drying up of available investments), which could be related to inactiveness of CVCs
- To further rule out possible poor performance story:
  - Control for financial constraints (e.g., KZ Index, Whited-Wu Index, etc.)
  - Show no discontinuity in ROA (or other performance measures) between firms in Russell 1000 and those in Russell 2000
- Are there discontinuities in cash holdings or capital intensity (i.e., plants, property, and equipment)? Free cash flow hypothesis (Jensen 1988)

Other Concerns

- External validity: What is the general relationship between institutional ownership and CVC portfolio characteristics? Show reduced form results for your sample and for universe of public firms.
- Small sample of active CVC parent firms (37 firms); may need another natural experiment.
- Not sure if observing culling of CVC projects is evidence of a "dark side"
  - E.g., Wong and Li (2017) finds that institutional ownership increases R&D spending and patenting
  - Taken together with this paper, findings are consistent with Ma (2016)
  - More work is needed on the difference between in-house and external innovation generation.

References

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