It’s a good time for Corporate Venture Capital in the Middle East

Global accelerator Mach49 and global law firm DLA Piper explore venture creation in the region

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2021 is so far a record year for corporate venture capital investments globally. In six months global corporate venture capital funding has surpassed the total for all of 2020 at over USD79 billion according to CB Insights.

However, only a small number of the top corporates headquartered in the Middle East have a fully established corporate venture strategy, even though the time has never been better to put one in place, particularly as there are record levels of “dry powder” in corporate cash reserves. There is also a growing national effort to prioritise homegrown digital innovation – just a glimpse at the UAE’s Vision 2030 tells us that “innovation-focused businesses” are front and centre of its strategy.

Across the Middle East, the COVID-19 global pandemic requires businesses to supercharge innovation to meet new consumer demand, especially for digital and frictionless service and product offerings. In large developed businesses, agile innovation and rapid deployment of capital is difficult to achieve given the layers of bureaucracy and slow moving internal approval processes, which often shackle progress.

This is where a corporate venture capital (CVC) strategy can help businesses to expedite progress into innovation and digital adoption. But where to start? With our 30 years’ experience in Silicon Valley and Mach49’s experience of growing multinationals through designing and launching internal corporate CVC activities, we understand that it is crucial for large companies to have thorough knowledge of the venture capital ecosystem in order to develop a successful CVC strategy.

If you are considering CVC, you need to develop and tailor your strategy for each corporation and their specific goals. These programs need to support their growth strategy with methods and process, not just money and resources.

On the flip-side, a repeatable, scalable process is essential to support the start-ups through from their creation to growth to exit.

Corporate venture capital strategies may also include spinouts to monetise “stranded” corporate assets and incubators.

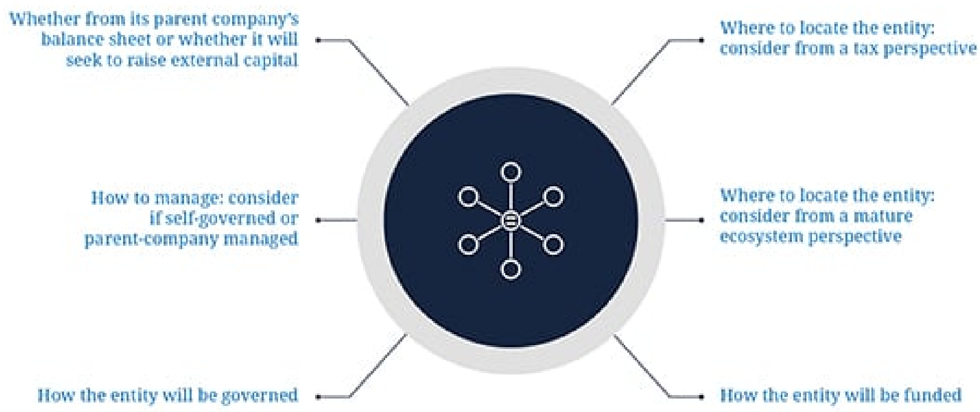
Consider these three areas when implementing your CVC strategy:

- setup and structure;
- transaction implementation; and
- portfolio management.

Below we aim to demystify these stages.

Setup and structuring

There are several ways to set up a corporate venture program within or alongside a large corporate and structure the execution of investments. When setting up a CVC holding vehicle, consider these factors:



In terms of the execution of investments, the structure generally best suited for a CVC in the Middle East is to use standalone investment vehicles, which sit beneath the CVC holding entity – the UAE is a particularly good home for this for a number of reasons. First, executing transactions "on-shore" (ie not in a free zone) in the Middle East can be more cumbersome than other more established venture ecosystems (for example, the EU or US). This is due to the protracted notarial requirements of setup and effecting changes to a company's share capital and also limitations on how the share capital can be structured.

However, using a structure incorporating separate venture holding companies in one of the many UAE "free zones" is an effective way to avoid burdensome transaction execution processes. Particularly recommended are the financial free zones (ie Abu Dhabi Global Market or Dubai International Financial Centre) which have legal systems closely resembling English law and allow for the execution of transactions at a relatively dynamic pace compared to other on-shore jurisdictions and even other free zones.

Common features of CVC deals allowing the corporate to exit or take total control of its investment (eg put and call options) are also generally thought to be unenforceable with respect to the shares in on-shore companies but can be enforced in the financial free zones making executing investments using a financial free zone holding company beneficial.

Implementation

It is acknowledged that 80%-90% of all startups financed by professional investors (both financial and corporate investors) fail. As a result, the corporate parent needs to be educated about this reality and adopt a mindset that tolerates a high failure rate and focuses on broader objectives for the CVC than the purely financial upside of investments, for example, greater access to and understanding of the relevant ecosystem to support internal R&D.

Equally important is to establish in-house investment legal ways of working with respect to how the CVC contracts to leverage economies of scale when making multiple smaller investments. In the US and UK, the National Venture Capital Association and British Venture Capital Association respectively have freely accessible startup investment documents available online. However, given the very different legal systems in the Middle East, it is important for CVCs in the region to use their own unique set of standard documents (including a term sheet, subscription and shareholders' agreement and articles of association) which can be quickly rolled out at the start of each transaction for investments in local companies (something DLA Piper has experience in globally).

Portfolio management

Consider how to manage portfolio companies post-investment. While placing directors on the board of a portfolio company is an effective way to exercise oversight, caution is required particularly given the uncertain financial climate and startup failure rate referenced above. Many countries in the region operate strict directors' duties regimes and have less developed insolvency regimes, which can in turn result in directors suffering personal or criminal liability on a business failure. For these reasons, the CVC may prefer to place observers on the boards of its portfolio companies as opposed to directors at least in the early stages of an investment.

Key takeaways:

- Now's a good time to consider implementing a CVC strategy in the Middle East.
- Adopting a repeatable and scalable process to build a pipeline and portfolio of new ventures that disrupt existing markets and create new opportunities is a sustainable way to use CVC as a growth strategy.
- Consider the structure and strategy of the CVC
- Internal architecture needs to be put in place to allow the CVC to be able to act dynamically both in decision making and transaction execution
- Consider using observers on boards for local companies as opposed to directors to minimise the risk of exposing directors to liability on business failure.

Want to learn more or need help

DLA Piper's CVC training suite

Our CVC practice offers a suite of training programs tailored for in-house legal and business team members who are tasked with implementing corporate venture strategies. These courses will help you to assist corporate investors in understanding issues ranging from the venture capital process, corporate venture capital structures, and term sheets as well as best practices for corporate investors acting as directors and board observers. The training program for board members and board observers has been attended by more than 20 CVC groups.

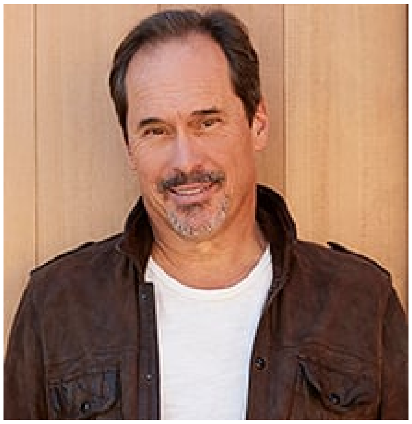
About Mach49

Mach49 partners with global businesses to disrupt markets and create new growth opportunities. It have developed a teachable, repeatable, scalable methodology and process that develops successful ventures while building client capability, not dependency.

Mach49 enables large companies to build their growth engines in two ways:

- Venture Building - Incubate, launch and accelerate new ventures at start-up speed. Build a startup factory that continuously delivers a pipeline and portfolio of new ventures.
- Venture Investing **-** Expertly invest in external startups, maximize strategic partnerships, and optimize your M&A strategy to advance innovation and grow your business in new and adjacent markets.

Co-author



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