



They're alive!

by Suzanne Stevens Posted 01:44 EST, 20, May 2005

In 1994, researchers at British Telecom developed a piece of software that has revolutionized the company's ability to deploy its 28,000 field technicians. Created in the company's BT Exact research labs and called Taskforce, the software delivers real-time data and has enabled BT to reduce the appointment time for new customer installation from all day to two hours. Over the years, as BT's service offerings grew more complex and its customers more demanding, Taskforce kept pace, growing steadily in sophistication and capability.

Which posed a problem, actually. By 2001, maintaining Taskforce was costing BT several million dollars a year — difficult to justify inside a company focused on communications services, not software. On the other hand, there were likely other companies that could use Taskforce to manage their field technicians — making it a prime candidate for BT's spinout process, instituted in 2000. Thus, after two years in BT's technology incubator, where it was nurtured with seed capital and management attention, Taskforce emerged in March 2003 as a new company, Vidus Ltd. BT maintained a stake in Vidus and became its first customer. "When we find a unique solution," says Mike Carr, BT's senior vice president for research and venturing, "the problem is how to give it market scale. Creating a standalone company is a good way to do that."

As technology spinouts go, the tale of Taskforce is a noteworthy success story. It has a happy outcome, both for BT and for New Venture Partners LLC, the Murray Hill, N.J.-based venture capital firm that has been working closely with BT on such deals since 2003: In February 2005, mobile resource management provider @Road acquired Vidus for more than \$54 million. Vidus was no fluke, either; BT has spun out eight other startups in the five years since it created a technology incubator as a strategic component of its \$650 million R&D operation (see chart). A team of four works with New Venture Partners to identify technology with commercial potential inside BT's labs.

But BT's promising spinout program is the exception these days. Indeed, in the whole challenging field of corporate venture capital, consistently crafting spinouts is proving to be one of the toughest tasks of all. Yes, there have been some stellar deals over the years — Xerox Corp. spun 3Com Corp. out of its Palo Alto Research Center in 1979. You can even point to a few successes in the flurry of activity in the late 1990s, when the IPO markets and venture investing of all kinds soared in sync; during that period, New Venture Partners originated as part of telecom equipment provider Lucent Technologies Inc., a prolific spinner of startups before corporate mismanagement and the telecom meltdown led to a drastic retrenchment. Still, companies that can make spinouts a reliable tool are rare. Building a small, nimble company inside a large, conservative corporation is twice as hard as building a startup externally, says Heidi Mason, managing partner of the Danville, Calif.-based Bell-Mason Group, which provides consulting services to corporate venture groups. "When challenges arise, unless the company puts the proper structures in place to protect the new venture, the existing culture tends to win." As a result, Mason says, the average life span of internal venture groups is a dismal three to five years.

This isn't because technology spinouts don't have some compelling logic behind them. As with BT's Vidus, a big company can create a small one that sells something it would like to buy. A spinout can also provide an alternative pathway to market for technology not being used by the corporation. In either case, the methodology is the same: Identify technology with outside sales potential, incubate it, build a management team around it, attract outside investors and execute an exit that nets a return, financial or otherwise, for the corporation. The incubation period

typically lasts between six and 18 months, and seed funding can range from \$50,000 to several million dollars.

And there's still plenty of willingness to attempt spinouts. Along with BT, Xerox, Unilever, Royal Philips Electronics NV, Agilent Technologies Inc. and Chevron Corp. are among the companies currently active in the field. The research-rich information technology, pharmaceutical and biotech industries find spinouts especially attractive, but a heavy-industry stalwart such as Caterpillar Inc. can get in the game as well; it spun out analytical software company Akoya Inc. in November 2004.

Still, corporate-backed startups face most of the same challenges that regular startups face, as well as a few that are particular to them. Intriguingly, some companies, notably Intel Corp. and Boeing Co., have maintained their technology incubators but have shifted from spinning out new companies to spinning the technology back in to support existing business

Of the seven to 15 ventures in the pipeline of Intel's New Business Initiatives technology incubator at any one time, half fail during the seed phase; 50% of the remainder don't survive business development, according to NBI general manager Angela Biever. No amount of due diligence or market probing can anticipate the hurdles between a good idea and a viable startup. "A complete buy-in of higher-level executives is critical," says Jai Das, investment manager for Agilent Ventures — itself a 1999 Hewlett-Packard Co. spinout. "A spinout is not always the first priority in the CEO's mind. What he sees is the possibility of 14 engineers walking out the door. But the more deals a CEO sees, the more he realizes the opportunity." Plus there's nothing stopping an employee who believes in an idea from turning entrepreneur and pursuing the idea on her own, Das adds. Why not negotiate a stake in the venture?

British Telecom's spinouts			
BT's technology incubator has spun out nine startups in five years			
Spinout	What they do	Where they are now	Year spunout
Kymata	Manufactures passive optical components	Acquired by Alcatel Optronics in 2001 for \$117.6 million	1998
Psytechnics	Develops perceptual voice- and video-quality measurement tools	Operating independently, backed by BT, 3i, New Venture Partners, GIMV and others	2000
Asset House	Develops content-services infrastructure software	Operating independently, backed by LMS Capital	2000
Venation	Develops content-delivery enabling software	Closed in 2004	2000
Exago ¹	Develops knowledge-management software	Acquired by Corpora in 2004 for £4.9 million (\$9.3 million)	2002
Vidus ²	Develops software to schedule and manage large, complex mobile workforces	Acquired by @Road in 2004 for \$54 million	2003
Azure ²	Develops revenue assurance products for the telecom industry	Operating independently	2003
Evolved Networks ²	Develops network-planning tools for telecom industry	Operating independently	2003
Microwave Photonics ²	Enables switched distribution and Radio-over-Fiber transmission of wireless signals	Acquired by NextG Communications in 2005 for an undisclosed price	2003

¹ in partnership with ANGLE Technologies
² Spinouts completed in partnership with New Venture Partners, which acquired exclusive rights to spinout BT technologies in 2003

Source: [British Telecom](#)

Agilent's effort to mine internal R&D for commercial gems is still an impromptu operation, rooted in the venture team's familiarity with research and business unit needs. Das says the company is exploring a more formal mechanism to facilitate spinouts. For now, they are as much about serendipity as structure, with companywide forums keeping researchers, business managers and the venture team connected.

Without support from the board and corporate leadership, internal venture groups are vulnerable to every management shakeup, every financial bump in the road. Consider Boeing's Chairman's Innovation Initiative, an incubator program launched in 2000 to foster an entrepreneurial culture and generate revenue by spinning out new companies.

Boeing employees submitted business ideas to a Web site that has since become a treasure trove of innovation. CII spun out a handful of companies — including message security software maker MessageGate Inc. in 2003 — and the incubator's budget was increased to \$200 million, according to its former director, Carter Williams. But that was before Philip Condit resigned as CEO and CFO Michael Sears was fired in December 2003 over alleged ethical lapses involving stolen documents and improper hiring.

"Phil Condit and Mike Sears believed strongly in the CII and understood the subtleties of cultural change," says Williams, who left Boeing in October 2004. "When you bring in new leadership facing multiple challenges, it is difficult to explain to shareholders that this investment is a good long-term strategy."

CII survived but with a new charter to incubate technologies that are central to the core business and can be spun back into Boeing. The company's 5-year-old practice of investing in external venture funds wasn't so lucky. The program was scrapped earlier this year.

Even as corporations become more outward-looking in the management of IP, the fear of allowing those assets to spin out into a new venture can still trip up a promising opportunity. A company, after all, may invest millions conducting research and securing patents, and there's no precise science to calculate the risk-reward ratio of letting that IP go. "You have to be careful at which point you make the decision that spinning out is what you want to do," BT's Carr says. "But having a great racehorse that you never let run doesn't work."

Separation anxiety isn't exclusively an executive-level affliction. The biggest deal breaker for Agilent spinouts, according to Das, is that the development team is unwilling to let go of the job security, camaraderie and other benefits of corporate life. "They're not always entrepreneurial," Das says. In the end, though, the employee makes the decision to stay or go.

Nearly every corporate spinout is accomplished in partnership with outside investors, who ideally are invited in during the later stages of incubation. Yet there are legitimate reasons why some VCs steer clear, including a corporate parent that is too controlling or overly focused on how the new venture can meet its own needs. In addition, unlike with a traditional investment, early-stage VCs are often presented the deal before the business plan is firm and a management team is on board.

"Ask venture capitalists whether they would invest in a B team with an A idea or an A team with a B idea. Most will choose the latter," says Robert Rosenberg, an NVP partner and a former member of Lucent's internal venture team. "[Corporate spinouts] break that rule."

There is an upside for VCs, namely the ability to leverage the investment already made in a viable technology with, in some cases, the corporate parent as a large, reliable customer. A handful of VC firms are making corporate spinouts an active part of their portfolios. Blueprint Ventures has directed 64% of its investment activity into corporate spinouts. NVP has exclusive agreements with Royal Philips Electronics and BT to spin technology out of R&D labs. BT has already benefited from NVP's ability to attract experienced and entrepreneurial managers, says Carr. NVP also brings capital, which has allowed BT to be more selective about the point at which it courts outside venture funds.

"Being in an emergency situation where you've put a lot of money into something and need help to get to the next stage is a bad position to be in from a negotiating point of view," Carr says. "You're much better off using your own internal fund until [the startup] is on the front foot in terms of development and then asking for venture capital in the expansion phase."

Sustaining an internal organization to spin out new ventures will never be easy. There's no special sauce to doing it well, and quantifying a program's success will always be a challenge. But with companies such as BT able to report some successes, other organizations are likely to try their hands at spinouts as well. CD