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Corporate Venture Capital

Darian M. Ibrahim

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I. INTRODUCTION

In 1999, Joseph Bankman and Ronald Gilson published *Why Start-ups?* in the *Stanford Law Review*.[1] In that essay, Bankman and Gilson argued that, in theory at least, startups should not exist. No innovative employee should leave her corporate employer to form a startup; instead, the corporation should win the "auction" to keep all promising entrepreneurs and ideas in-

* Tazewell Taylor Professor of Law, William & Mary Law School; Fellow, Center for the Study of Law and Markets, William & Mary Law School. I thank William & Mary Law School and the Center for the Study of Law and Markets for financial support, Joe Green and Alan Meese for terrific comments, and Abigail Cross and Fred Dingledy for excellent research assistance.

1. Joseph Bankman & Ronald J. Gilson, *Why Start-Ups?*, 51 STAN. L. REV. 289 (1999).

house due to the corporation's tax, information, and scope advantages.[2]

Theory is one thing, the real world is another. Engineers do leave large corporations to form startups, and startups have flourished into technological giants. The NASDAQ, comprised of these former startups, is at an all-time high.[3] Bankman and Gilson attribute this theoretical/real-world divergence to both complications with developing innovative ideas inside large corporations[4] and to the psychic rewards employee get from leaving to become their own bosses.[5] In the *Innovator's Dilemma*, former Harvard Business School Professor Clayton Christensen also identified asymmetries within large corporations as an obstacle to "intrapreneurship," or innovating in-house.[6] Coupled with traditional concerns about the nimbleness and adaptability of a large organization by its very nature, large corporations are thought to be incompatible with groundbreaking innovation. Hence, we have startups.

Startups are here to stay, and Bankman and Gilson's question has a satisfactory answer. But startups only flourish if they receive funding. An innovative idea, no matter how promising, needs capital to be developed, and entrepreneurs need help navigating the transition from startup to large company. Who funds startups? Can the corporation play a role here?

The answer to "who funds startups?," at least to this point, is clear to almost everyone with a rudimentary understanding of this area: venture capitalists.[7] Leading Silicon Valley venture capital firms include Kleiner Perkins, Sequoia Capital, Benchmark Partners, and Andreessen Horowitz,

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2. *Id.* at 293 ("When all else is equal, the employer has advantages – tax, information, and scope – that should result in it consistently winning the auction" to keep employees and their ideas in-house.).

3. Karen Langley, *Nasdaq Composite Touches 10000 as Post-Virus Rally Marches On*, WALL ST. J. (June 9, 2020 5:04 PM), https://www.wsj.com/articles/nasdaq-composite-erases-coronavirus-losses-to-seize-new-record-11591695001 [https://perma.cc/4UMR-KTXW].

4. *See* Bankman & Gilson, *supra* note 1, at 290–92 (stating that problems with developing ideas in-house include property rights disputes over the innovation and corporate compensation structures).

5. *Id.* at 306.

6. CLAYTON M. CHRISTENSEN, THE INNOVATOR'S DILEMMA: THE REVOLUTIONARY BOOK THAT WILL CHANGE THE WAY YOU DO BUSINESS 33–68, 89–110 (2005) [hereinafter THE INNOVATOR'S DILEMMA]; *see also* Darian M. Ibrahim, *Intrapreneurship*, 73 WASH. & LEE L. REV. 1741, 1747 (2016) (favorably discussing Christensen's theories and layering on a corporate law solution to reducing the asymmetries he identifies as barriers to in-house innovation).

7. *See* Will Drover, et. al., *A Review and Road Map of Entrepreneurial Equity Financing Research: Venture Capital, Corporate Venture Capital, Angel Investment, Crowdfunding, and Accelerators*, 43 J. MGMT. 1820, 1827 (2017) ("Venture capitalists—professional investors funding portfolios of potentially high-growth ventures—have had a transformative impact on the modern entrepreneurial landscape.").

and they have funded the likes of Google, Facebook, Uber, Airbnb, Coinbase and virtually every other startup success story.[8] Venture capitalists are the go-to financiers for startups due to their dedicated funds for startup investment – an extremely risky endeavor – along with their decades-long experience in this area and connections with executives, attorneys, investment banks, and virtually every other relevant player necessary to grow and develop rapid-growth startups to a successful exit.[9]

Why are venture capitalists the winners in the startup funding game? First, they have dedicated themselves to this space. They are not alone, as angel investors, venture lenders, and now crowdfunding investors also invest in early-stage startups. Yet these ancillary players in entrepreneurial finance all depend on VCs to fund and advise startups as they grow and either exit via IPO or sale to a larger company. Angel investors fund startups with their own limited cash in their earlier stages;[10] crowdfunders come in even earlier to replace friends and family investment at the very early stages of a startup's life cycle,[11] and venture lenders provide short-term loans for startups until their next venture capital investment.[12] None of these financiers, independently or together, challenge venture capitalists as the dominant technology financiers.[13]

But there is one player whose entry into this space can significantly alter that dynamic: the large corporation. Unlike the ancillary players who depend on venture capital, large corporations have sufficient capital to fund startups

8. *From Alibaba to Zynga: 45 of the Best VC Bets of All Time and What We Can Learn from Them*, CBINSIGHTS (June 9, 2021), https://www.cbinsights.com/research/best-venture-capital-investments/ [https://perma.cc/Y8PD-NRCJ].

9. Successful exits are either initial public offerings (IPOs) or acquisition by a larger company. Mark A. Lemley & Andrew McCreary, *Exit Strategy*, 101 B.U. L. REV. 1, 7 (2020) (discussing the paucity of the "two only successful exit options" for VC-backed startups).

10. *See infra* Part II. A. Angel Investment

11. *See infra* Part II. B. Crowdfunding

12. *See infra* Part II. C. Venture Debt

13. Another recent trend is mutual funds investing in startups. However, mutual funds tend to invest in unicorns. *See* Jeff Schwartz, *Should Mutual Funds Invest in Startups? A Case Study of Fidelity Magellan Fund's Investments in Unicorns (and other Startups) and the Regulatory Implications*, 95 N.C. L. REV. 1341 (2017) (highlighting that mutual funds are investing in famous unicorns). Sovereign wealth funds and hedge funds sometimes invest in later-stage startups with higher valuations as well. *See* Elizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. 353, 373 (2020) ("Whereas in the past, startups were typically funded by family and friends, angel investors, and venture capitalists, in recent years these investors have been joined by family offices, hedge funds, mutual funds, pension funds, and sovereign wealth funds."); *id*. ("[T]he greater diversity of investors in late-stage rounds of financing has expanded the universe from the Silicon Valley community of VCs that are repeat players in a reputational market to a global mix of institutional investors that resembles public markets in some respects.").

to a successful exit without help. They may also be able to offer superior value-added services to startups over venture capitalists. For example, if the startup's technology aligns with the parent company's, as "strategic" corporate venture capital investments do,[14] that is a big plus to the entrepreneur. Corporations may also get a "first look" at the most promising startups, if the would-be entrepreneurs are currently corporate employees. For reasons explored in the Article, leading technology corporations can *leverage their corporate clout* to become significant players in Silicon Valley going forward. If not as innovators – or innovators alone – then in funding others' innovation.

Until now, large corporations were not a serious challenge to venture capitalists dominance in the startup-financing game for several reasons. One challenge is how to fund dynamic, fast-moving innovations when corporations by definition become more bureaucratic and slow as they age and scale to large public companies. The solution: establish corporate venture capital units that operate independently from their parent corporation, and more like a venture capitalist, with only financial support from the parent.[15]

A second challenge is, even if large corporations can fund startups,[16] why would they? Established corporations display a rational preference for incremental improvements on existing products.[17] Making the next iPhone, with an established user base and brand loyalty, is easier than obtaining buy-in on a brand new product. And if a challenger to the iPhone or related product emerges, Apple can try to buy them. However, from a financial perspective, a corporation who acts as venture capitalist can capture tremendous financial upside for their parent corporation if it funds the next technology stalwart. It is a cheaper (due to the early stage investments) and more diversified (given a broad range of these investments) than buying one competitor when it is a serious challenge. Also, from an informational perspective, a corporate venture capitalist can gain advantages for its parent

14. *See infra* note 84 and accompanying text.

15. *See* Drover, *supra* note 7 at 1833 ("The impact of CVC investing—where existing corporations seek minority equity stakes in young ventures—has triggered a growing body of research.").

16. Balance sheets of leading technology corporations reveals boodles of free cash. Tesla just invested $1.5 billion in bitcoin, and that was only 7.5% of its free cash on hand. Tesla, Inc., Annual Report (Form 10-K), at 31, 33 (Dec. 31, 2020).

17. Christensen called these "sustaining innovations." CHRISTENSEN, *supra* note 6, at xxii, xxvi.

corporation by surveying the landscape of what startups are doing.[18] And finally, as Christensen explores, a large corporation that has no ownership in disruptive technologies is likely to someday fall the victim to one.[19] Thus, corporations have increasing incentives to act as venture capitalists on the side.

The remainder of this Article makes the case for corporate venture capital as a potentially game-changing entrant into entrepreneurial finance. Part II begins by retracing the ancillary players in entrepreneurial finance and their roles in the startup ecosystem. After finding each of them incapable of denting the venture capitalist's current dominance, Part III introduces the large corporation as venture capitalist. Part III discusses the growing scale of corporate venture capital and why it may be desirable for startups, innovation, and society as a whole. Part IV looks at legal differences that may become important for corporate venture capitalists to consider, including securities, antitrust, and corporate law concerns.

Importantly, the Article concludes not by per se endorsing corporate venture capital over venture capital, but recognizing that corporate venture capital has a greater role to play in entrepreneurial finance going forward. It is likely that corporate venture capital and traditional venture capital work side-by-side.[20] This new state of the world with corporate venture capitalist has important implications for future law-and-entrepreneurship and law-and-

18. This is unlike venture capital firms. *See* Jennifer S. Fan, *Catching Disruption: Regulating Corporate Venture Capital*, COLUM. BUS. L. REV. 341, 343 (2018) ("[Venture capital firms] purely focus on financial returns, most corporations seek strategic benefits from their venture investments, in addition to financial returns."); *see also* Gary Dushnitsky & Dovev Lavie, *How Alliance Formation Shapes Corporate Venture Capital Investment in the Software Industry: A Resource-Based Perspective*, 4 STRATEGIC ENTREPRENEURSHIP J. 22, 38–40 (2010) (study finding that strategic alliances and corporate venture capital may complement each other).

19. Examples abound: Blockbuster to Netflix, taxis to Uber, hotels to Airbnb, travel agencies to Expedia, and brick-and-mortar retail businesses to Amazon. As Michael Blanding points out, the "second wave of Internet disruption" is now focused on "decoupling" activities that consumers value from the ones they do not. *See* Michael Blanding, *Disruptors Sell What Customers Want and Let Competitors Sell What They Don't*, HARV. BUS. SCH. WORKING KNOWLEDGE (Feb. 2, 2015), https://hbswk.hbs.edu/item/disruptors-sell-what-customers-want-and-let-competitors-sell-what-they-dont [https://perma.cc/X86H-RUN2]. Blanding provides an example of decoupling: "Watching TV and watching commercials, for example, have traditionally gone together—the former creating value for the consumer, the latter capturing it for the company. When TiVo came along, it allowed viewers to record the shows they wanted without all of those annoying ads." *Id.* Innovators seek to deliver what consumers find most valuable, while leaving what is not to the established players. *Id.*

20. Indeed, this is already the case thus far. *See infra* note 68 and accompanying text (discussing how corporate venture capitalists invest in start-ups alongside traditional venture capitalists).

economics scholarship.[21] As a descriptive piece of scholarship, this paper answers some questions but leaves others that need empirical investigation dangling.[22] Normatively, it makes the cautious case for corporate venture capital, finding strong tailwinds and few legal concerns.

II. THE FRINGE PLAYERS: ANGELS, CROWDFUNDERS, AND VENTURE LENDERS

Before reaching the emerging heavyweight bout—venture capitalists versus corporate venture capitalists—it is necessary to explore why venture capitalists have dominated the startup investing space to date. There are other dedicated startup financiers and financing methods, yet all depend on—and none can challenge—the venture capitalist's dominance. The main ones that will be discussed are angel investors, crowdfunders, and venture lenders. Other less prevalent alternatives, such as state-sponsored venture capital funds, likewise have deficiencies that make them a less attractive option for entrepreneurs than venture capital.[23]

To understand why venture capitalists dominate in this space, it is necessary to understand what startups are looking for in a financier. There are many intangibles: a good working relationship, non-oppressive investment terms,[24] the best valuation, and so forth. But as a general matter,

21. This Article is certainly not the first examination of corporate venture capitalist, even by me. *See, e.g.*, Fan, *supra* note 18 (discussing the rise of corporate venture capital); Ibrahim, *supra* note 6 (exploring the idea of a large corporation's venture arm investing in start-ups). But as Fan correctly points out, for the most part, "legal scholars have overlooked CVCs." *See* Fan, *supra* note 18, at 344.

22. These questions include whether corporate venture capitalists use non-compete agreements whereby the startup agrees not to sell itself later to a rival of the corporate venture capitalist, or a right of first refusal that grants the corporate venture capitalist the right to match the price that any other firm might offer to purchase the startup in the future. Also, an empirical comparison of corporate venture capitalist investment contracts versus venture capitalist investment contracts (examining corporate venture capital's use staged financing and the like) would be a fruitful study.

23. *See* Darian M. Ibrahim, *Financing the Next Silicon Valley*, 87 WASH. U. L. REV. 717, 736–38 (2010) (discussing state-led efforts to fund local entrepreneurs and the typical problems encountered). Accelerators are another growing option, with Y Combinator becoming an important feeder of startups to leading venture capitalists. *See* Mirit Eyal-Cohen, *Innovation Agents*, 76 WASH. & LEE L. REV. 163, 176 (2019) (discussing Y Combinator); RANDALL STROSS, THE LAUNCH PAD 4 (2012) (discussing the role of Y Combinator in start-up investing); *see also supra* note 13 (noting that some mutual funds are now investing in startups).

24. For a discussion of the preferred stock venture capitalists often receive, as opposed to the entrepreneur's common stock, *compare* William W. Bratton & Michael L. Wachter, *A*

startup financiers provide two main things: money and value-added services. Startups need cash to grow, develop, and hire. Most venture capitalists fund start-ups that have survived their earliest stages and are either expanding, planning an IPO, or preparing for a private sale.[25] A typical venture capital round averages over $10 million.[26] Investing in startups is exceedingly risky, however, with most startups failing.[27] Venture capitalists have figured out how to navigate this space and the uncertainty, information asymmetry, and agency costs that accompany these investments.[28]

The second venture capitalist contribution to a startup's growth is equally or more important.[29] These are the "value-added services" such as advice, mentoring, and connections that help entrepreneurs scale their

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Theory of Preferred Stock, 161 U. PA. L. REV. 1815, 1874–1900 (2013) (discussing preferred stock), *with* Leo E. Strine, Jr., *Poor Pitiful or Potentially Powerful Preferred?*, 161 U. PA. L. REV. 2025, 2025–38 (2013) (discussing common stock).

25. *See* Darian M. Ibrahim, *The (Not So) Puzzling Behavior of Angel Investors*, 61 VAND. L. REV. 1405, 1416 (2008) (citation omitted) (discussing how venture capital is not instantly available to some start-ups).

26. In the first half of 2021, the median Series A round raised $10 million, and the median Series B round raised $30 million. *See* Gené Teare, *Bigger Checks, Days To Close: How 2021's Red-Hot Venture Funding Landscape Is Shaking Up Early-Stage Investing*, CRUNCHBASE NEWS (July 26, 2021), https://news.crunchbase.com/news/bigger-checks-days-to-close-how-2021s-red-hot-venture-funding-landscape-is-shaking-up-early-stage-investing/ [https://perma.cc/24LW-WH8Q] (illustrating venture capital fundraising statistics).

27. One analysis of government statistics concluded that twenty percent of firms fail within the first year and that sixty percent of firms close within six years of their founding. *See* Robert Paul Singh, *Overconfidence: A Common Psychological Attribute of Entrepreneurs Which Leads to Firm Failure*, 23 NEW ENG. J. ENTREPRENEURSHIP. 25, 26 (2020) (highlighting the risky nature of start-up investing).

28. *See* Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1076 (2003) (listing uncertainty, information asymmetry, and agency costs as potential problems with venture capital contracting).

29. eBay, for instance, was a profitable start-up that did not require outside funding. Yet it sought venture capital, which was provided by Benchmark Partners, in recognition that a venture capitalist's connections and expertise would be essential in securing a seasoned CEO and other executives. *See* Ibrahim, *supra* note 25, at 1411 n. 13 (citing RANDALL E. STROSS, EBOYS: THE TRUE STORY OF THE SIX TALL MEN WHO BACKED EBAY AND OTHER BILLION-DOLLAR START-UPS 22 (2000) (discussing how eBay founders sought mentoring and advice, not money, from venture capitalists)). Andreessen Horowitz took value-added services from VCs to another level by having in-house recruiters and back-office functions for their portfolio companies to share. *See* Louis Coppey, From Value-Added VCs to Equity Crowdfunding Syndicates: The New Platforms of the Venture Capital Industry 10–13 (June 8, 2016) (Master Thesis, Massachusetts Institute of Technology), https://dspace.mit.edu/bitstream/handle/1721.1/104539/958429584-MIT.pdf?sequence=1 [https://perma.cc/GLZ2-85QZ] (noting that Andreessen Horowitz sought to provide their portfolio companies with in-house services).

businesses and achieve successful exits.[30] Venture capitalists play the roles of mentors, advisors, matchmakers, parents, and friends for their portfolio company entrepreneurs.[31] Venture capitalists "mentor and monitor the companies in which they invest. They offer assistance and support in developing the business of their portfolio companies."[32] They help companies with operational guidance and connecting with potential customers and other investors.[33] They also "help almost half of their companies to reduce their burn rate."[34] They "use their networking skills to recruit professional managerial talent,"[35] and they "can provide seasoned expertise for decision-making, such as determining the most profitable exit strategy."[36]

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30. A recent New Yorker article argues conversely that "Startups increasingly want investors who won't interfere or ask questions." Charles Duhigg, *How Venture Capitalists Are Deforming Capitalism*, THE NEW YORKER (Nov. 23, 2020), https://www.newyorker.com/magazine/2020/11/30/how-venture-capitalists-are-deforming-capitalism [https://perma.cc/CVG5-ACSH] (observing that, on the other hand, some start-ups do not want investors interfering with their business)

31. *See* Natee Amornsiripanitch, Paul A. Gompers, & Yuhai Xuan, *More Than Money: Venture Capitalists on Boards*, 35 J. L. ECON. & ORG. 513, 538–40 (2019) (describing how venture capitalists can serve as strategic advisors); Mark C. Suchman & Mia L. Cahill, *The Hired Gun as Facilitator: Lawyers and the Suppression of Business Disputes in Silicon Valley*, 21 L. & SOC. INQUIRY 679, 698 (1996) (venture capitalists also introduce startups to lawyers, who "[a]s a result of their status as repeat players and reputational brokers in the venture capital financing process . . . play a substantial role in determining which clients gain access to which investors, and vice versa.").

32. Mira Ganor, *Improving the Legal Environment for Start-up Financing by Rationalizing Rule 144*, 33 WM. MITCHELL L. REV. 1447, 1448 (2007); *see* Elizabeth Pollman, *Team Production Theory and Private Company Boards*, 38 SEATTLE U.L. REV. 619, 628 (2015) ("VC investors have strong motivation to monitor their investments and help them grow."); *see also* Amornsiripanitch, *supra* note 31, at 539

> Venture capitalists are actively engaged in the companies in which they invest and much of this activity is mediated when they join the portfolio company's board of directors. These activities appear to be appreciated by entrepreneurs, who are more likely to give board seats to successful and well-connected venture capitalists..

33. Ganor, *supra* note 32, at 1456.

34. Paul Gompers et al., *Venture Capitalists and COVID-19* 16 (Nat'l Bureau Econ. Rsch., Working Paper No. 27824, 2020), available at http://www.nber.org/papers/w27824 [https://perma.cc/4E85-WZKU].

35. Ibrahim, (*Not So) Puzzling*, *supra* note 25, at 1411 (citing Michael Klausner & Kate Litvak, *What Economists Have Taught Us About Venture Capital Contracting*, in Bridging the Entrepreneurial Financing Gap 54, 58–59 (Michael J. Whincop ed., 2001)).

36. *Id.* (referencing Joshua Lerner, *Venture Capitalists and the Decision to Go Public*, 35 J. FIN. ECON. 293, 314 (1994) (observing that experienced venture capitalists appear better able to time IPOs than their less experienced counterparts)).

While the entrepreneurial finance space is symbiotic and collaborative, the top venture capitalists make a lot of money. Their dominant space in the ecosystem is certainly envious. The remainder of this Part examines angel investors, crowdfunders, and venture lenders and shows why all three fail as plausible alternatives to venture capitalists as dominant startup financiers.

A. Angel Investment

Angel investors are wealthy individuals, usually ex-entrepreneurs, who invest their personal funds in startups.[37] Angels run the gambit from the entrepreneur's rich uncle to professional groups such as Silicon Valley's Band of Angels.[38] Like venture capitalists, angels provide important value-added services. Angels are often the first outside advisors for entrepreneurs. Therefore, angels do a considerable amount of mentoring. Angels connect the entrepreneur to venture capitalists, as the venture capitalist follow-on investment is necessary to both angels and entrepreneurs obtaining liquidity from a successful exit later.[39] However, angels do not provide all the value-adds that venture capitalists do. They do not have the same connections to executives for a scaling startup or to investment banks who can take the startup public.[40]

The more problematic issue for angels is that they are investing personal funds. Even in larger angel investments, the amounts involved cannot rival the venture capitalists hundreds of millions of investor dollars in limited

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37. *See* Drover, *supra* note 7, at 1837 (defining angel investors as "individuals investing their own capital independently or through angel groups" in "young, high-growth-potential ventures"); Ibrahim, *Financing the Next Silicon Valley*, *supra* note 23, at 739 (defining angel investors).

38. *See* Ibrahim, *Financing the Next Silicon Valley*, *supra* note 23, at 742–45 (discussing the professionalization of angel investing through angel investment groups).

39. *See* Ibrahim, *(Not So) Puzzling*, *supra* note 25, at 1428–29

> While the presence of angels can generally attract (or at least not inhibit) venture capital, a venture capitalist might reject a funding proposal because of an overreaching angel. A start-up marred by a complicated angel round is unattractive to venture capitalists because it requires them to 'unwind' the non-standard angel preferences in order to strike the venture capitalists' standard deal.

40. *See* David Teten, Adham Abdelfattah, Koen Bremer, and Gyorgy Buslig, *The Lower-Risk Startup: How Venture Capitalists Increase the Odds of Startup Success*, J. PRIV. EQUITY, Spr. 2013, at 9 (describing the resources that venture capitalists have to increase portfolio company value); Ibrahim, *(Not So) Puzzling*, *supra* note 25, at 1411, 1419 (2008)(observing that venture capitalists play a more formal role than angel investors in that they have relationships with professional managers). Angels also invest relatively small amounts in more companies than VCs and take a less active role in them (e.g., not taking a board seat). So, they have less incentive to provide as many value-added services as VCs do.

partnership funds the venture capitalist has raised. This war chest disparity is reflected in average investment size. Angel investing is early in a startup's life cycle, and for generally less than $1 million.[41] Not all startups need venture capitalist-level cash, but plenty do.[42]

B. Crowdfunding

Crowdfunding, or raising small amounts of money over the Internet, has been legal since 2015.[43] Crowdfunding has a role to play in the startup ecosphere, just as angel investment does. Crowdfunding, in theory, can democratize startup investment, affording ordinary investors the opportunity to invest in promising young companies before they go public.[44] While some entrepreneurs can turn to a rich uncle for funding, historically disadvantaged entrepreneurs cannot.[45] Crowdfunding provides these entrepreneurs with the opportunity to attract more investors.[46] And for crowdfunding investors,

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41. Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389, 3397 (2013).

42. Lucas S. Osborn, Joshua M. Pearce, and Amberlee Haselhuhn, *A Case for Weakening Patent Rights*, 89 ST. JOHN'S L. REV. 1185, 1199 (2015) ("Many entrepreneurs and small businesses have begun utilizing cloud computing as a means to reduce their start-up costs.").

43. Jumpstart Our Business Startups Act, Pub. L. No. 112–106, §§ 301–05, 126 Stat. 306, 315–23 (2012) (codified in scattered sections of 15 U.S.C.); 17 C.F.R. § 227.100 (2015). *See* Andrew A. Schwartz, *Crowdfunding Issuers in the United States*, 61 WASH. U. J.L. & POL'Y 155, 155 (2020) ("Startup companies can now legally sell shares of stocks, bonds, or other securities to the broad public using equity crowdfunding . . .").

44. Kevin G. Bender, *Giving the Average Investor the Keys to the Kingdom: How the Federal Securities Laws Facilitate Wealth Inequality*, 15 J. BUS. & SEC. L. 1, 3 (2015) ("the federal securities laws facilitate wealth inequality by denying average middle class investors the ability to participate in the private placement . . . securities market"); Rodrigues, *supra* note 41, at 3390–91 ("The dirty little secret of U.S. securities law is that the rich not only have more money – they also have access to types of wealth-generating investments not available, by law, to the average investor.").

45. *See* Darian M. Ibrahim, *Crowdfunding Without The Crowd*, 95 N.C. L. REV. 1481, 1486 (2017) ("Scholars have long-cited a funding gap between investors and startups. . . . Crowdfunding was also designed to democratize startup investing, so that 'ordinary Americans' could have a chance to own the next Facebook or Twitter before they are public (and commanding a much higher stock price).") (citations omitted); Schwartz, *supra* note 43, at 156 (citing one study finding that twenty-eight percent of crowdfunding issuers had a woman on the executive team, a much higher percentage than startups funded by angels or venture capitalists); *id.* at 160–61 (noting that traditional entrepreneurial finance disadvantages women, minority, and other entrepreneurs without connections).

46. *See* Bender, *supra* note 44, at 25 (noting that before crowdfunding, middle class investors were excluded from potentially lucrative private placement opportunities); Schwartz, *supra* note 43, at 169 ("One of the primary goals of equity crowdfunding is to create an inclusive method of raising capital where any entrepreneur can have a chance to pitch their business idea to the crowd, regardless of their age, wealth, connections, or gender.").

especially non-accredited ones, this mechanism offers access to early-stage investments that have been historically unavailable.

Crowdfunding, somewhat obviously, should not be viewed as a viable alternative to venture capital for two main reasons. First, the cash raised from crowdfunding investors is insufficient to carry a startup past its initial capital needs. From 2015-2018, the median startup sought to raise around \$55,000 in a crowdfunding campaign.[47] A startup was legally prohibited from raising more than \$1 million from crowdfunding in any given year – with that number just being raised to \$5 million.[48] Compared to the venture capitalist's initial round average of over what crowdfunding allows and significantly over what it actually commands,[49] it is clear that the most promising startups on a path to a successful exit will have to seek cash beyond the crowd.[50]

Second, crowdfunding campaigns supply startups with only cash, not value-added services. The crowd, by definition, is comprised of widely dispersed individuals who cannot offer the same value-added services as venture capitalists. I have previously argued that savvy entrepreneurs that do not need value-added services in the early stages of their startup's life should use crowdfunding because they can obtain a better valuation when selling equity.[51] In other words, the decoupling of money from value-added services allows more efficient pricing on the cash part of the investment. Most entrepreneurs, especially as the startup grows, will need value-added services, however, and the geographic dispersion and relative lack of sophistication of crowdfunding investors means entrepreneurs must look beyond crowdfunding for these services. Crowdfunding can forge a path to venture capital, and should only exist in conjunction with it.

C. Venture Debt

Venture lending is another source of capital for startups. The puzzle I

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47. *See* Ibrahim, *Crowdfunding Without The Crowd*, *supra* note 45, at 1506 (referencing research that found issuers sought to raise only \$55,000 per offering).

48. *See* Schwartz, *supra* note 43, at 158 ("issuers may only raise about one million dollars a year" from crowdfunding); see also 17 CFR § 227.100(a)(1) (2021) (raising the number to \$5 million).

49. *See supra* note 26 and accompanying text.

50. Schwartz, *supra* note 43, at 156 ("crowdfunding issuers are overwhelmingly early-stage companies with just a couple of employees and little to no revenue or assets").

51. Darian M. Ibrahim, *Equity Crowdfunding: A Market for Lemons?*, 100 MINN. L. REV. 561, 590 (2015) ("In short, the inherent passivity of [crowdfunding] investors—a seeming negative—would actually appeal to entrepreneurs who wish to *unbundle* the cash and value-added service components of traditional entrepreneurial finance.") (emphasis in original).

posed in my article *Debt as Venture Capital* was as follows: why do early-stage startups with no collateral or revenue receive billions of dollars in loans that have to be repaid?[52] A traditional bank would never make these loans—the interest rate payments could never make up for the default risks, as most startups fail.[53]

The puzzle is explained by an implicit deal worked out with venture capitalists. Venture lenders do not lend until a startup has secured an initial round of traditional venture capital. Once that startup receives traditional venture capital, the venture capitalist's funds are used partially to grow the startup, and partially to repay the venture lenders.[54] Why would venture capitalists allow their funds to be used for this purpose rather than go exclusively towards growing the startup? It is because venture debt provides the venture capitalist some advantages. Venture capitalists rely on venture lenders to monitor the startup's burn rate (since they hold the startups deposit accounts)[55] and extend the "runway" until the next round of traditional venture capital is needed.[56] This means the original venture capitalist – the one with the implicit deal with the venture lenders – suffers less dilution when the next round of equity is eventually sold to a new investor (as the equity is worth more later, and less has to be sold for the same investment amount).

The problem with venture debt as a replacement to traditional venture capital is evident: venture debt only exists *with* traditional venture capital. Venture capitalists pay off the venture debt. Therefore, venture debt will never replace traditional venture capital, but will only co-exist with it. Just as with angels and crowdfunders, the venture capitalist is essential to all of them.

III. THE LARGE CORPORATION AS VENTURE CAPITALIST

This Part turns to large corporations as a potential non-fringe player in

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52. Darian M. Ibrahim, *Debt as Venture Capital*, 2010 U. ILL. L. REV. 1169 (2010).

53. *Id*. at 1175 (noting startups "do not appear to be borrowing candidates whose high risks are worth the limited rewards. To avoid defaults, lenders will prefer companies with positive cash flows and tangible assets that can serve as collateral should cash flows fail.").

54. *Id*. at 1185 (explaining venture lenders "loan to start-ups in exchange for VCs' implicit guarantees of loan repayment").

55. *Id*. at 1195 (noting venture lenders monitor startups "in unique ways that add value to VCs' own monitoring efforts," including using debt repayment obligations as a disciplining mechanism and tracking the startup's bank accounts).

56. *Id.* at 1196 (explaining that extending the time until the next venture capitalist round "is important because it helps the [previous venture capitalists] avoid [greater] dilution.").

entrepreneurial finance. Organizational bureaucratic hurdles within large corporations have long thought to be incompatible with truly disruptive innovation.[57] Speed — being the first to market and being able to pivot quickly when necessary — is vital to innovation. These are things venture capitalists do well.[58] Conversely, they are not attributes associated with large corporations.[59]

If slogging through bureaucratic mud implies a poorly run organization, Clayton Christensen points out that well-run organizations get disrupted by life-changing innovations too.[60] First, while entrepreneurial employees at established corporations may want to pursue game-changing disruptive innovations, middle managers are focused on pleasing existing high-end customers though incremental improvements on existing products and services.[61] Coupled with these asymmetric *motivations* are asymmetric *information* problems, meaning that entrepreneurial employees' ideas do not make their way up the corporate ladder to the decision-makers that could

57. Eyal-Cohen, *supra* note 23 at 194 ("Entrepreneurial firms and large conglomerates have often been viewed as antipoles. While the former has been portrayed as young, creative, and flexible firms, the latter symbolized corporations with much bureaucracy, hierarchy, and stagnation.") (citations omitted).

58. Lemley & McCreary, *supra* note 9, at 9 (discussing the "need for speed" in entrepreneurship).

59. *See* Eyal-Cohen, supra note 23, at 207–08 (2019)

> Although economies of experience generally constitute a beneficial feature of intrapreneurship by lowering the costs of innovation research and production, increases in age and scope may result in enlarged costs. This phenomenon is referred to as diseconomies of experience, and it can occur for a variety of reasons. For instance, established firms may suffer from duplication of efforts and office politics. Firm beurocracy and lower-level organizational inertia often directly correlates to firm size and can undermine innovativeness. Other factors such as increased bureaucratic processes, multi-level administrative procedures, controlling management, and adherence to traditions can also hinder innovation in established firms.

Gary Hamel & Michele Zanini, *More of Us Are Working in Big Bureaucratic Organizations than Ever Before*, HARV. BUS. REV. (July 5, 2016), https://hbr.org/2016/07/more-of-us-are-working-in-big-bureaucratic-organizations-than-ever-before [https://perma.cc/7LFE-FEGV] ("[O]ur research suggests that bureaucracy is not inevitable; it's not the inescapable price of doing business in a complicated world. Rather, it's a cancer that eats away at economic productivity and organizational resilience.").

60. CHRISTENSEN, *supra* note 6, at xvi-xx.

61. CHRISTENSEN, *supra* note 6 at xxii; *cf.* Eyal-Cohen, *supra* note 23, at 199 (explaining successful intrapreneurship depends on "the ability of middle-level managers to promote [intrapreneurial] initiatives, and the capacity of top management to allow viable entrepreneurial initiatives to influence the corporate strategy.").

greenlight them.[62] Instead, they get stuck in middle management, suffering a slow death.

A. What is Corporate Venture Capital?

Corporate venture capital sprung out of the innovator's dilemma. If large corporations do not participate in disruptive innovations, they will ultimately be displaced. Corporate venture capital is a way for corporations to get in on the action without changing the core of the parent company's business. A common definition of corporate venture capitalist is "the form of a separate corporate venture entity that is exclusively funded by the sponsoring corporation."[63] The employees of the corporate venture capitalist arm are either long-term employees of the parent corporation or venture capital partners hired away by the corporate venture capitalist.[64] Compensation for these corporate venture capitalist employees is a hot issue—how does corporate venture capitalist employee compensation resemble the lucrative carried interest of a venture capitalist employee without producing jealousy among other employees of the parent corporation?[65] Or is it more along the scale of other salaried employees at the parent corporation.

Despite these details to iron out, corporate venture capital is becoming an increasingly common feature of large corporations.[66] Large corporations in the tech industry are sitting on piles of cash, and many think they need to put it to work to continue their growth rates that Wall Street favors.[67] As of

62. *See* CHRISTENSEN, *supra* note 6, at 33–34, 94–97 (specifying the organizational hurdles that get in the way of creating disruptive technologies within a large corporation).

63. Tobias Weiblen & Henry W. Chesbrough, *Engaging with Startups to Enhance Corporate Innovation*, 57 CMR BERKELEY 66, 70 (2015). This is not necessarily the case, however. While some corporate venture capitalist units "are structurally separated from the parent corporation" with "full investment discretion," others "are embedded within a business unit [of the corporation] and request approval and funding on a deal-by-deal basis." Drover, *supra* note 7, at 1834.

64. Drover, *supra* note 7, at 1834–35.

65. Drover, *supra* note 7, at 1835 (noting that while corporate venture capitalist employees expect windfalls, "pressures to maintain pay equality across the corporation imply that many corporate venture capitalists receive little more than straight salary.").

66. Drover, *supra* note 7, at 1841 ("A notable feature of CVC—versus other players in the market for entrepreneurial finance—is that it is part of very large (and often global) corporations.").

67. *See, e.g.*, Pippa Stevens, *Here are the 10 Companies with the Most Cash on Hand*, CNBC (NOV. 7, 2019) (Ranking the top 10 companies based on cash on hand), https://www.c

2019, corporate venture capital participation in startup funding has reached a record high.[68] In 2019, corporate venture capitalists participated in twenty-five percent of all VC-backed deals, and corporate venture capitalists invested alone (without VCs as co-investors) in ten percent of their deals.[69]

Large corporations such as Google (Alphabet), Salesforce, and Intel are typically among the most active corporate venture capitalists.[70] By way of example, Google's corporate venture capital programs consistently rank at the top of corporate venture capitalist activity.[71] First, there is GV (formerly Google Ventures).[72] GV is a limited partnership with Google's parent company Alphabet as its sole limited partner.[73] GV invests in life science, healthcare, artificial intelligence, robotics, security, and transportation startups at all stages.[74] GV has three hundred active portfolio companies with $5 billion under management.[75] Among its investments are Uber, Nest, Stripe, Robinhood, and One Medical Group.[76] Google also formed an alternative intelligence-focused corporate venture fund, Gradient Ventures, in 2017.[77] Gradient primarily invests in early-stage rounds[78] and takes a minority stake in the startups in which they invest.[79] CapitalG, Google's growth capital arm, is yet a third Google corporate venture capitalist operating with Alphabet as its sole limited partner.[80] This Article could go

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nbc.com/2019/11/07/microsoft-apple-and-alphabet-are-sitting-on-more-than-100-billion-in-cash.html [https://perma.cc/TQP9-LWVG].

68. *See* CB INSIGHTS, *The 2019 Global Corporate Venture Capital Report*, ("Globally, corporate venture capitalists participated in 3,234 deals worth $57.1 billion in 2019.").

69. *Id.*

70. *Id.*

71. *Id.*

72. GV, https://www.gv.com/?utm_source=startup_google&utm_medium=site [https://perma.cc/Y85B-AS3P] (last visited Oct. 30, 2020.)

73. *Id.*

74. GV PORTFOLIO, https://www.gv.com/portfolio/ [https://perma.cc/Y7TM-AE66] (last visited Oct. 30, 2020).

75. GV, *supra* note 72.

76. GV PORTFOLIO, *supra* note 74.

77. Anna Patterson, *Introducing Gradient Ventures*, ENTREPRENEURS BLOG (July 11, 2017), https://blog.google/technology/ai/introducing-gradient-ventures/ [https://perma.cc/AX8U-24TN].

78. Dave Smith, *Google Launched an In-House AI Fund to Help Startups Turn Sci-Fi into 'Nonfiction'*, BUS. INSIDER (July 11, 2017, 4:52 PM), [https://perma.cc/N8E4-SMWY].

79. *Id*.

80. CAPITALG ABOUT US, https://capitalg.com/about/#our-story [https://perma.cc/HXC9-Y7AQ] (last visited Oct. 30, 2020). CapitalG invests globally in consumer and enterprise companies that have established product market fit and are ready to scale. CapitalG has over $3 billion under management and has invested in Airbnb, Credit Karma, and Lyft. *See*

on about specific corporate venture capitalists, but the information is readily available elsewhere.[81]

B. Benefits of Corporate Venture Capital

1. To Corporations

As one commentator describes it, partnerships between legacy companies and startups are "stealing the show."[82] Corporations are discovering benefits from smaller-scale relationships with young companies, notably through corporate venture capital programs. Corporate venture capital investments in startups can be more targeted, cheaper, and more successful than acquisitions.[83] Large corporations, especially large tech corporations, engage in corporate venture capital for both financial and strategic reasons. Financially, owning part of a startup that turns out to be the next big thing produces huge gains for the parent company's balance sheet.[84] Strategically, investing in startups that compliment, or perhaps even have the potential to disrupt, the parent company's business is a solution to the innovator's dilemma.[85] One study observes that while "internal R&D of large corporates typically focuses on furthering and enhancing current lines of business . . . many large companies are engaging with startups as a form

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CAPITALG FAQS, https://capitalg.com/faqs/ [https://perma.cc/8C5U-MMWK] (last visited Oct. 30, 2020); CAPITALG OUR PORTFOLIO, https://capitalg.com/about/#our-story [https://perma.cc/T3DS-NS7K] (last visited Oct. 30, 2020).

81. *See, e.g.*, *The Most Active Corporate VC Firms Globally*, CBINSIGHTS.COM (Mar. 28, 2019), https://www.cbinsights.com/research/corporate-venture-capital-active-2014/ [https://perma.cc/5C25-RXP9]; *United States Corporate VC Investors*, CRUNCHBASE (last visited Sep. 13, 2021), https://www.crunchbase.com/hub/united-states-corporate-vc-investors [https://perma.cc/9JFD-9Q73].

82. Jim Stengel, *Apple, Google and Other Titans are Snatching up Start-ups to Fuel Innovation. The Secret Behind Their Successful Corporate Coupling*, CNBC (Sept. 23, 2019, 10:00 a.m.), https://www.cnbc.com/2019/09/23/why-apple-google-are-snatching-up-start-ups-to-fuel-innovation.html [https://perma.cc/CRC9-XSG8].

83. *Id.*

84. Yahoo's investment in Alibaba is a good example. *See* Sue Decker, *An Insider's Account of the Yahoo-Alibaba Deal*, HARV. BUS. REV. DIGITAL ARTICLES (Aug. 6, 2014), at 2–8, https://hbr.org/2014/08/an-insiders-account-of-the-yahoo-alibaba-deal .

85. *See* Weiblen & Chesbrough, *supra* note 63, at 70 ("Corporate VCs not only pursue financial performance, but should also support their corporate parent's strategic goals (e.g., by backing startups making complementary products and services)."); Rita Waite, *Corporate VC vs VC: Corporate Venture Capital's Priorities Differ from Institutional VCs*, CB INSIGHTS (Feb. 5, 2016), https://www.cbinsights.com/research/corporate-venture-capital-institutional-venture-capital/ [https://perma.cc/8U4R-3XJU].

of external R&D that is more focused on penetrating growth markets."[86] This is a good summation of the draws of corporate venture capital programs to the parent corporation.[87]

2. To Startups

Corporate venture capitalists offer important value-added services to startups. Many are similar to what venture capitalists provide. Entrepreneurs, however, may prefer corporate venture capitalists because large corporations "have established distribution lines, strategic partners, deep domain intelligence, not to mention an experienced sales force and a global presence."[88] Google, for example, offers a Startup Residency Program through its corporate venture capitalist, Gradient Ventures.[89] Program residents, which are some of Google's best engineers, product managers, designers, and business development partners, work directly with the portfolio companies in a variety of forms, ranging from one-off office hours to full time for a period up to twelve months.[90]

In one study, corporate venture capitalists were described as "more active in providing [portfolio companies with] connections to customers, but less active in connecting new hires and providing operational guidance."[91] The same study found that venture capitalists "spend more time helping their companies and have more board seats than corporate VCs."[92]

The structure of private venture capital funds also places extreme pressure on venture capitalists to cause startups to exit early. This is because

86. Brian Park & Erik P.M. Vermeulen, *Debunking Myths in Corporate Venture Capital: What Works, What Doesn't, and How to Make it Happen*, 12 J. US-CHINA PUB. ADMIN. 764, 766 (2015).

87. Samir Kaji & Jessica Peltz-Zatulove, *Inside the Minds of Corporate Venture Capitalists*, CB INSIGHTS (Dec. 10, 2015), https://www.cbinsights.com/research/inside-corporate-vc-minds/ [https://perma.cc/B85P-DA6D] (finding an estimated seventy-six percent of corporate venture capitalist investment is funded through the parent firm's balance sheet).

88. *Id.* at 766.

89. GRADIENT VENTURES, https://www.gradient.com [https://perma.cc/ZAY8-TSHY] (last visited Oct. 30, 2020); *From Google to AI Startups: Welcoming the Gradient Residents*, GRADIENT VENTURES BLOG (Mar. 27, 2020), https://www.gradient.com/blog/articles/welcoming-the-gradient-residents/ [https://perma.cc/6B7T-QJ75].

90. *See From Google to AI Startups: Welcoming the Gradient Residents*, supra note 89 (explaining how the Gradient Residents program is designed to address the unique challenges company founders face).

91. Gompers, *supra* note 34, at 17.

92. Gompers, *supra* note 34, at 17.

venture capital funds have ten year life spans, by design.[93] The venture capitalist draws down funds from the fund's limited partners when it finds startups to invest in.[94] The venture capitalist puts those funds to work, and through its board seats etc., must cause its portfolio startups to exit within a few years after investment in order to return funds to the limited partners before the fund expires.[95] If the limited partners made a profit on the last fund, the venture capitalist can likely get them to re-up for the next fund.[96] This time-pressured exit mechanism is thought to work well to discipline venture capitalists and thus startups, but may not work for portfolio companies who wish to stay private longer. In fact, without robust secondary markets to allow trading in private startups stock before an IPO or trade sale, unicorns could not come to be.[97] And staying private longer is the trend.

Corporate venture capital, on the other hand, does not have the same time pressures to satisfy its parent corporation. There is no fund with an expiration date. Therefore, a startup might prefer corporate venture capital because it can stay private longer, not having investors push for a quick acquisition or premature IPO.[98]

93. Gilson, *supra* note 28 at 1074.

94. *See Darian M. Ibrahim*, *The New Exit in Venture Capital*, 65 VAND. L. REV. 1, 8 (2012) (citing Gilson, *supra* note 28, at 1071) (finding that a typical venture capitalist puts up only one percent of the fund's capital).

95. *See* Gilson, *supra* note 28, at 1071 ([The venture capitalist] "will be in partial liquidation during much of its term because realized profits from exiting an investment are required to be distributed to the limited partners on an annual basis.") (citations omitted).

96. *Id*. at 1074

> "Assuming that the [general partner of a venture capitalist] has invested most of a fund's capital by the midpoint of the fund's life, the [General Partner of a venture capitalist] then must seek to raise additional capital for a new fund in order to remain in the venture capital business."

97. *See* Ibrahim, *The New Exit in Venture Capital*, *supra* note 94, at 16–23.

98. *See* Song Ma, *The Life Cycle of Corporate Venture Capital*, 33 REV. FIN. STUDIES 358, 388 (2020)

> "Success rates of investments do not correlate with CVC duration. . . . This somewhat surprising finding suggests that CVCs are strategically focused, and are willing to continue investing even when the firm may be financially unpromising in a traditional investor's view. This may also be consistent with the view that CVCs are willing to patiently invest in certain companies because they have means of absorbing strategic benefits while [venture capitalists] cannot."

3. To Society

Corporate venture capital may also offer societal benefits beyond traditional venture capital. It is well documented that venture capital employees are overwhelmingly male and white.[99] The National Venture Capital Association-Deloitte Human Capital Survey captured critical data on the workforce at U.S. venture capitalists in 2019.[100] Over three hundred firms participated in the study, providing information on over 5,000 employees in the venture capital industry.[101] The results show that racial and ethnic minorities are underrepresented in the venture capitalist industry compared to the U.S. workforce as a whole.[102] Data from participating firms show that only four percent of the overall workforce was black, and they comprised three percent of investment positions and three percent of investment partner positions.[103] Hispanic employees accounted for seven percent of the overall workforce, and they comprised four percent of investment positions, but only four percent of investment partner positions.[104] While women comprised the same percentage of the venture capitalist workforce as they did in the 2016 and 2018 surveys, forty-five percent, they continued to have less representation in investment and leadership positions.[105]

Not only is this underrepresentation of women and minorities a problem for venture capitalists, but it also has trickle down effects to startups seeking their investment. Research shows that uncorrected implicit biases cause predominantly white-male venture capitalists to invest in white-male entrepreneurs.[106] In 2016, male entrepreneurs raised $58.2 billion from

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99. Benjamin P. Edwards & Ann C. McGinley, *Venture Bearding*, 52 U.C. DAVIS L. REV. 1873, 1877 (2019); Jennifer S. Fan, *Innovating Inclusion: The Impact of Women on Private Company Boards*, 36 FLA. ST. U. L. REV. 345, 346 ("[T]he[re are a] lack of women in the rarefied world of venture capital"); Lynnise E. Phillips Pantin, *The Wealth Gap and the Racial Disparities in the Startup Ecosystem*, 62 ST. LOUIS L.J. 419, 444 (2018) (noting that venture capitalist is "another industry dominated by White males") (citation omitted).

100. *NVCA–Deloitte Human Capital Survey*, DELOITTE, https://www2.deloitte.com/us/en/pages/audit/articles/diversity-venture-capital-human-capital-survey.html [https://perma.cc/8AAY-FHKC] (last visited Oct. 30, 2020).

101. *Id*.

102. *Diversity & Inclusion in the VC Industry*, DELOITTE, https://www2.deloitte.com/content/campaigns/us/audit/survey/diversity-venture-capital-human-capital-survey-dashboard.html [https://perma.cc/K45R-3A4V] (last visited Oct. 30, 2020).

103. *NVCA-Deloitte Human Capital Survey*, *supra* note 100.

104. *Id*.

105. *NVCA-Deloitte Human Capital Survey*, *supra* note 100, at 5.

106. Edwards & McGinley, *supra* note 99, at 1877; Fan, *supra* note 99 at 354 ("[F]ew

venture capitalists, while female entrepreneurs raised only $1.46 billion.[107] Additionally, startups founded by black females raised an average paltry sum of $36,000.[108]

Morgan Stanley launched the Multicultural Innovation Lab to learn more about the funding gap facing businesses, including startups, owned by women and minorities.[109] Their research determined that investors do not necessarily see a problem.[110] In fact, nearly eight in ten investors said that women and minority entrepreneurs receive the right amount, or more, capital than their business models deserve.[111]

One barrier to increasing diversity inside of venture capital firms is how they recruit.[112] Typically, venture capitalists have recruited from the C-suites of large tech companies, from entrepreneurs that they have previously worked, or from other venture capitalist firms—all candidate pools

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women-led businesses receive private equity funding despite the fact that women-owned firms have some of the most rapid rates of growth"); Pantin, *supra* note 99, at 442 ("Because wealth is concentrated among primarily White individuals and funding streams to entrepreneurs mirror where the wealth already exists, the result is White male entrepreneurs receiving the majority of startup financing.").

107. Edwards & McGinley, *supra* note 99, at 1881 (citing Valentina Zarya, *Venture Capital's Funding Gender Gap is Actually Getting Worse*, FORTUNE (Mar. 13, 2017)).

108. Edwards & McGinley, *supra* note 99, at 1882 (citing Doree Shafrir, *How Ingrained is Sexism in Silicon Valley? Ask the Women Trying to Get Funding*, CUT (Apr. 27, 2017)); *see* Pantin, *supra* note 99, at 428 ("Black women are the fastest growing group of female entrepreneurs. The rates of entrepreneurship are on the rise, but entrepreneurs of color are not having the same financial success at raising money within the entrepreneurial ecosystem as their White cohort.") (citations omitted).

109. *The Growing Market Investors Are Missing*, MORGAN STANLEY 1, 1 (2018), https://www.morganstanley.com/pub/content/dam/msdotcom/mcil/growing-market-investors-are-missing.pdf [https://perma.cc/6JUF-3QWF].

110. *Id.*

111. *Id.* at 3. ("The median investment by equity investors in business opportunities is nearly $1 million. Yet, for women and minority-owned businesses (WMBEs), median investments are only $213,000 and $185,000, respectively.").

112. Women are underrepresented in the VC industry; this may signal a pipeline issue. *See* Siri Chilazi, *Advancing Gender Equality in Venture Capital*, HARV. KENNEDY SCH. 1, 9 (2019), https://wappp.hks.harvard.edu/files/wappp/files/gender_and_culture_in_vc_literature_review_final.pdf [https://perma.cc/KA2S-SVSS]

> "There is a very strong perception that there are not enough qualified women to fill the VC pipeline. The data, however, call this argument into question. Women make up more than 40% of the student body at the top ten U.S. business schools, as well as 36% of entering investment bankers and 45% of entering management consultants. Moreover, women earn the majority of *all* postsecondary degrees and are even close to parity in science and engineering degrees specifically. The fact is that there are *significantly* more women with the requisite backgrounds for venture capital than there are female VCs."

comprised of mostly white men.[113] Recent societal movements and shifting public opinion may be helping, however. Black professionals have reported being inundated with inquiries from headhunters and venture capitalist talent recruiters.[114]

Because women and minority entrepreneurs still have more difficulty obtaining financing than their white male counterparts, they engage in "venture bearding,"[115] or attempting to pass as male or otherwise cover their stigmatized identities and deflect attention from their differences with investors.[116] For example, a woman may increase her chances of accessing social and economic resources by shifting a masculine identity into the foreground.[117] Unfortunately, venture bearding is a common strategy.[118]

Corporate venture capitalists may be able to rectify these biases, however. Large corporations are more public, and thus more concerned, with their images.[119] Discriminating against women or minorities turns off

113. Theodore Schleifer, *Silicon Valley Pledged to Break up the Boys' Club of Investing in 2018. How Did It Do?*, VOX (Dec 31, 2018, 12:13 PM), https://www.vox.com/2018/12/31/18157815/silicon-valley-diversity-one-year-venture-capital-analysis [https://perma.cc/D2XS-HX2X;] *see* Fan, *supra* note 99, at 351 ("In corporate America at large, only one in five C-suite executives is a woman. For women of color, that number is far lower--one in twenty-five.") (citations omitted).

114. Nitasha Tiku, *Black Tech Founders Say Venture Capital Needs to Move Past "Diversity Theater"*, WASH. POST (June 10, 2020), https://www.washingtonpost.com/technology/2020/06/10/racial-gap-vc-firms/ [https://perma.cc/KA6C-5ZDJ]. One black general partner revealed that he received roughly twenty-five "hard inquiries" about roles at other investment firms, not including the "soft inquiries" from recruiters who have just checked in.

115. Edwards & McGinley, *supra* note 99, at 1877.99

116. Edwards & McGinley, *supra* note 99, at 1877–79 ("As a term, *venture bearding* aims to convey deflection, concealment, drag, and the projection of an idealized masculinity.") (citations omitted); *see also* KENJI YOSHINO, COVERING: THE HIDDEN ASSAULT ON OUR CIVIL RIGHTS (2006) (discussing covering in general).

117. Edwards & McGinley, *supra* note 99, at 1888–1900 (discussing how explicit preferences for men to make investment decisions, explicit beliefs about male superiority, systemic problems in workplace cultures, and implicit bias all present unique challenges for female entrepreneurs in securing capital).

118. Edwards & McGinley, *supra* note 99, at 1873; Ridhi Tariyal, *To Succeed in Silicon Valley, You Still Have to Act Like a Man*, WASH. POST (July 24, 2018), https://www.washingtonpost.com/news/posteverything/wp/2018/07/24/to-succeed-in-silicon-valley-you-still-have-to-act-like-a-man/ [https://perma.cc/TA9P-TJLF].

119. *See* Tom C.W. Lin, *Incorporating Social Activism*, 98 B.U. L. REV. 1535, 1546 (2018) ("[C]hanges in social expectations about corporate behavior have also altered corporate social activism. Many in society and within corporations now expect businesses and executives, particularly those at large public companies, to engage with the critical social issues of today.") (citations omitted); Jennifer S. Fan, *Woke Capital: The Role of Corporations in Social Movements*, 9 HARV. BUS. L. REV. 441, 452–53 (2019)

customers and public investors.[120] Large corporations are disciplined by public stock markets and perhaps consumer markets in a way that privately-funded venture capitalists are not.[121] Diverse boards are becoming more common for public corporations, and it follows that corporate venture capitalists used to that culture will be more willing to implement gender and/or racial diversity on startup boards they fund, too.[122]

Venture capitalists that fail to correct for bias in their capital allocation processes miss profitable opportunities. Evidence now reveals that gender diversity actually *improves* financial performance at venture capitalist firms.[123] Recently, a venture capitalist firm released the results from ten years of investing data.[124] It found that firms with a female founder performed sixty-three percent better than its investments with all-male

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> In the not-so-recent past, corporations remained silent on social issues. Now, silence may have negative ramifications. There is a societal expectation that companies with more than $15 billion in annual revenue will weigh in on social issues. A 2016 study by the Public Affairs Council reported that "more than three-quarters of these companies said they experienced increased pressure to weigh in on social issues." Typically, publicly traded corporations experienced more pressure than private companies to engage on various social issues. . . . Employees and consumers, particularly millennials, expect and may even demand that corporate leaders speak up.

(citations omitted).

120. *See* Elizabeth Hirsh & Youngjoo Cha, *Employment Discrimination Lawsuits and Corporate Stock Prices*, 2 SOC. CURRENTS 40, 52 (2014) ("[P]ublicly traded firms subject to Title VII sex, race, and national origin discrimination lawsuits suffer a loss in stock market value immediately following the announcement of a legal settlement or verdict.").

121. *See* Lin, *supra* note 119, at 1545–46

> In past times, corporate executives feared a bad newspaper story; today, they dread a bad viral video or negative trending hashtag that can hurt their brands or stock prices exponentially more than a bad newspaper story. . . . The broad reach and deep impact of social activism powered by new information technology means that businesses are frequently engaged in social issues whether they want to be or not.

(citations omitted).

122. Fan, *supra* note 99, at 350 ("A full 60% . . . of the U.S. unicorn companies have all-male boards, as compared with nearly 5% of Fortune 500 companies.").

123. *See* Edwards & McGinley, *supra* note 99, at 1922; *see also* Chilazi, *supra* note 112, at 2–4 (finding that gender diversity among investors boosts financial performance for VC firms, gender-diverse portfolio companies appear to be better investments, lack of gender diversity is associated with decreased financial performance in VC, and gender inequality hits the bottom line directly).

124. Edwards & McGinley, *supra* note 99, at 1904 (citing *First Round: 10 Year Project*, FIRST ROUND, http://10years.firstround.com [https://perma.cc/54TH-Z72L]).

founding teams.[125] Researchers also found that VC firms that increased their female partner hires by ten percent, observed a 1.5% spike in overall fund returns each year, and had 9.7% more profitable exits.[126]

C. Drawbacks of Corporate Venture Capital

Despite the benefits corporate venture capital can offer corporations (and their investors), startups, and society as a whole, corporate venture capital is not without its drawbacks. Well-known venture capitalist Fred Wilson once said, "he will 'never, ever, ever, ever' invest alongside a CVC again. . . ."[127] There are several reasons why corporate venture capitalists are not displacing venture capitalists as the kings of Silicon Valley quite yet.

First, corporate venture capital has been more cyclical in its availability to startups than traditional venture capital. For example, during the dot.com boom, quarterly corporate venture capital investments peaked at "$6.2 billion at the beginning of 2000 and then tumbled to $848 million in the third quarter of 2001."[128] As the article notes, "[w]hile private VC investments also ebb and flow as the economy changes, the shifts in corporate VC investments have been particularly dramatic."[129] This unsteadiness in the face of short-term adverse market conditions "certainly contributes to the low regard with which many private venture capitalists view in-house corporate VC operations."[130] But this trend and the sentiment behind it may be shifting. Many of the articles viewing corporate venture capital as a fad were written during the dot.com times of two decades ago. More recent articles suggest corporations have seen the benefits of long-term engagement with startups and are less likely to pull back when macroeconomic conditions worsen.[131]

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125. Edwards & McGinley, *supra* note 99, at 1904.

126. This is an impressive figure given that only 28.8% of all VC investments have profitable exits. Edwards & McGinley, *supra* note 99, at 1922 (citing Paul Gompers & Silpa Kovvali, *The Other Diversity Dividend*, HARV. BUS. REV. (July 2018), https://hbr.org/2018/07/the-other-diversity-dividend [https://perma.cc/8J9R-UKX4]).

127. Park & Vermeulen, *supra* note 86, at 764.

128. Henry W. Chesbrough, *Making Sense of Corporate Venture Capital*, HARV. BUS. REV. 90, 90 (2002).

129. *Id.*

130. *Id.* at 92.

131. *See* Weiblen & Chesbrough, *supra* note 63, at 68 ("[T]he growth and increasing viability of startup firms, and their attendant disruption, create a new imperative to develop more agile, rapid means for large companies to engage with the startup community"); James Thorne, *Corporate VC Firms Buck 'Tourist' Reputation With Pandemic Dealmaking*,

Second, only corporate venture capitalists with a strategic focus have historically done well. A strategic focus means investing in related, often complimentary or competitive, products or services to the corporate venture capitalist's parent company. Thus, Facebook's corporate venture capital programs will support its app developers, but will not invest in non-related products or services. On the one hand, this is a positive, as corporations "must be aware of their value proposition towards a startup—how they can add value to startups that already have access to [traditional] VCs, incubators, and other support institutions."[132] On the other hand, a strategic focus limits means that a wide swatch of startups may be automatically rejected for funding by the likes of Google, Facebook, and Salesforce corporate venture capitalists because they are developing technologies unrelated to those core businesses.

Third, Mark Lemley and Andrew McCreary have recently argued that the most common exit strategy for startups—acquisition by an established company in the same field, or trade sale[133]—is actually harmful for innovation more broadly.[134] This is because the acquiror often views the startup as a potential threat, and shelves its potentially disruptive technology post-acquisition.[135] They note that "Facebook, Google, and Oracle have all bought and shut down competing firms, sometimes in the same day."[136] If Lemley and McCreary are correct, this same possibility exists in corporate

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PITCHBOOK (Sept. 28, 2020), https://pitchbook.com/news/articles/corporate-vc-firms-pandemic-dealmaking-rate-bucks-tourist-reputation [https://perma.cc/9BFU-WW78]

> CVC firms are cementing their presence in the startup ecosystem in a year when they could have retreated to the sidelines. So far in 2020, these investors have participated in 25.5% of all US venture capital deals, on pace to match a recent high in 2018, according to PitchBook data. That activity defies a perception that CVCs are part of a class of tourist investors that tend to back off in difficult economic circumstances. Such was the case following the global financial crisis. . . .

132. Weiblen & Chesbrough, *supra* note 63, at 68.

133. Eyal-Cohen, *supra* note 23, at 195 (noting that large corporations "have served as an exit hub for private entrepreneurship.").

134. Lemley & McCreary, *supra* note 9, at 101.

135. Lemley and McCreary discuss "killer acquisitions," where the acquiring company has been known to shelve the potential that they acquire the same day. Lemley & McCreary, *supra* note 9, at 63 ("[T]ech giants often buy up promising startups only to shut them down. Sometimes this is intentional. Economists have documented cases of 'killer acquisitions'. . . .").

136. *Id.* at 64; *see also* Matthew Wansley, *Beach Money Exits*, 45 IOWA J. CORP. L. 151, 201 (2019) ("[I]n some cases, the anticompetitive acquirer may not have a plan to develop the potentially competing product or use the startup's assets at all.").

venture capitalist.[137] Corporate venture capitalists can invest in startups that are potential threats at an earlier stage and for far cheaper than acquiring them later – but with the same result. Through board seats, and informal influence post-investment, corporate venture capitalists can slow down or shelve a startup's technology before it challenges the parent company's core business.

While the competitive threats from corporate venture capital may appear even greater than for corporate acquisitions of the same startup later, Lemley and McCreary suggest corporate venture capital is actually less problematic. Indeed, they observe that, "Some incumbents might choose to buy a minority position in their emerging rivals . . . . So long as this position is not one of significant or controlling influence, it's less problematic than acquisitions."[138] And it is a risk worth taking because without allowing corporate venture capital investments or trade sales, we might never get disruptive innovation off the ground in the first place.[139]

IV. LEGAL CONSIDERATIONS FOR CORPORATE VENTURE CAPITAL

The preceding Part examined the pros and cons of corporate venture capital from an economic and innovation take. This Part examines unique legal considerations that may differentiate corporate venture capitalist from its traditional counterparts. The three legal considerations discussed in this Part are disclosure, antitrust, and conflicts of interests.

By way of preview: venture capitalists are notoriously secretive about their investment returns. As privately-funded limited partnerships, they are

137. A study also found that entrepreneurs were less likely to seek corporate venture capitalist when the corporate venture capitalist's parent could imitate the startup's technology. G. Dushnitsky & J.M. Sahver, *Limitations to Interorganizational Knowledge Acquisition: The Paradox of Corporate Venture Capital*, 30 STRATEGIC MGMT. J. 1045 (2009).

138. Lemley & McCreary, *supra* note 9, at 80. Countering their own counterargument, however, they find that startups "are less likely to compete aggressively if they share investors," implying that corporate venture capitalist investment can cause a startup to pivot away from challenging the parent corporation's business. Lemley & McCreary, *supra* note 9, at 80.

139. Lemley & McCreary, *supra* note 9, at 69 ("[W]e should be wary not just of the ex post consequences of incumbent acquisitions, but the ex ante consequences of preventing them – because then we'll really never see Schumpeterian competition get off the ground."); Gordon M. Phillips & Alexei Zhdanov, *Venture Capital Investments and Merger and Acquisition Activity Around the World* (Nat'l Bureau of Econ. Rsch., Paper No. 24082, 2017), https://www.nber.org/papers/w24082 [https://perma.cc/WK6D-7TQT] ("While mergers of firms that are horizontally competing may indeed reduce innovation, general policies where a large firm is prevented from buying a smaller firm may have deleterious effects on the *ex ante* incentives to conduct R&D by the smaller firm. . . .").

not required to disclose financial performance, and have even threatened to exclude limited partners from venture capitalist funds if they were to disclose their gains from venture capitalist investments.[140] This Part explores whether securities laws will force corporate venture capitalists to be more transparent. Second, following Lemley and McCreary's line of argument, if corporations acquiring their startup competitors exacerbates antitrust concerns in the technology industry, then corporate venture capital might raise the same concerns.[141] Finally, corporate venture capital investors sitting on startup boards may face divided loyalties – as fiduciaries to the startups on whose boards they sit, and to the parent corporations that put them there. How do they serve both interests?

A. Disclosure Requirements

The world of venture capital is long on lore and short on empirics. With more data on the venture capital industry as a whole, we might see a less rosy picture of venture capital than the sexy one portrayed in the media. Independent studies have found that venture capital returns are heavily skewed toward the top firms.[142] Yet venture capitalists on all rungs of the

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140. *See infra* notes 143–145 and accompanying text.

141. Lemley and McCreary are not discussing corporate venture capital in their article. I am simply extending their concerns about trade sales to that realm.

142. *See* Richard Smith et al., *VC Fund Financial Performance: The Relative Importance of IPO and M&A Exits and Exercise of Abandonment Options*, 40 FIN. MGMT. 1029, 1037 (2011)

> These are a subset of the 6,206 conventional US VC funds we identified from VE. For the 1,285 with IRR data, the simple average IRR is 13.7%, a return that perhaps is below common perceptions of typical VC fund returns. The IRR distribution is highly skewed, with the top 10% of funds reporting IRRs of 39.2% or greater.

Wade T Brooks & Robert E Wiltbank, *Tracking Angel Returns*, ANGEL RES. INST. 9 (2017), https://angelresourceinstitute.org/reports/tracking-angel-returns-2017-update.pdf [https://perma.cc/7WUN-FWXZ]

> Returns are not normally distributed, but are skewed such that 10% of all exits generated 85% of all cash. This concentration of returns is consistent over all studies of venture investing . . . Angel investing, like formal VC, is a homerun game, where many investments result in losses, but the occurrence of large homeruns are the key driver of the rate of return.

Chilazi, *supra* note 112, at 4

> [A] slightly older study examining VC firms between 1986 and 1999 found that 29 firms invested $21 billion (14% of industry capital) and returned $85 billion

totem pole are historically unwilling to release performance results. State pension funds, as heavy investors in venture capitalist funds, have run into hot water with venture capitalists when laws of the pension funds' home states might require the pension funds to disclose the results of their venture capitalist investments.[143] In fact, several states amended their laws so that pension funds could keep these investment results private.[144] Otherwise, venture capitalists were threatening to exclude those pension funds from future investments.[145]

Will corporate venture capital be any different in terms of transparency? Perhaps. First, large corporations might voluntarily disclose investments that further gender and race progress as a public relations matter.[146] Second,

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> in that time, a 3.6x multiple, while the remaining crop of more than 500 firms invested $160 billion and returned $85 billion, a 0.4-0.6x multiple on average. Thus, a very small number of top VC firms drives the returns for the entire industry.

(citation omitted).

143. Arleen Jacobius, *States Act to Make Public Funds 'Dance Partners' Again*, PENSIONS & INV., Aug. 8, 2005, at 4

> Executives of the top-tier private equity funds - reluctant to have sensitive performance data released - responded by rejecting these pension and endowment funds as investors or limiting asset and performance information they were given. . . . [A] few top-tier firms such as Sequoia Capital, Charles River Ventures and U.S. Venture Partners declined to accept any public pension fund or endowment limited partners because they did not want even fund return information released. Last year, Sequoia Capital asked the $3.5 billion University of Michigan endowment and the $62 billion University of California pension and endowment funds to leave its venture capital fund.

144. *Id.*

> State legislators across the country now are giving their public fund executives tools to help them get back into top private equity funds. New laws in Colorado, Michigan, Virginia, Maryland, Utah and Texas limit the information public funds are required to release. A bill in Illinois is awaiting the governor's signature, and in California and Pennsylvania, bills on the issue have been introduced.

Arleen Jacobius, *Colorado Oks Law: Disclosure Exemption; States Try to Ease Rules to Help Public Plans Stay in Private Equity Funds*, PENSIONS & INV., Apr. 5, 2004, at 1 ("Legislators in three states are trying to allay public pension executives' fears that they would be excluded from top-tier private equity funds if forced to publicly disclose information about their private equity and venture capital investments.").

145. *See supra* notes 143, 144.

146. More than thirty large corporations have agreed to new disclosures of private race, gender and ethnicity workforce data. This data release was the result of a broader initiative and push by the New York City comptroller and three retirement funds. BLOOMBERG, *Amazon and GM Among 34 Companies to Disclose Private Diversity Data*, L.A. TIMES (Sept. 28, 2020),

perhaps securities law requires more disclosure about corporate venture capital activities. Public corporations must disclose "significant subsidiaries" in a 10-K filing.[147] In May 2020, the SEC adopted amendments to its rules and forms to clarify the "significance tests" in the "significant subsidiary" definition in Rule 1-02(w), Securities Act Rule 405, and Exchange Act Rule 12b-2.[148] These amendments were aimed to improve the application of these rules and "to assist registrants in making more meaningful determinations of whether a subsidiary or an acquired . . . business is significant."[149] Effective January 1, 2021, a "significant subsidiary" is defined as a subsidiary, including its subsidiaries, which meets the conditions of one of the three specified tests: the Investment Test,[150] Asset Test,[151] or Income Test.[152] The threshold for all three tests is ten

5:25 PM), https://www.latimes.com/business/story/2020-09-28/amazon-workplace-diversity-data [https://perma.cc/3A4L-PRQC]. Consistent with this broader social initiative, corporations might take this disclosure further to share investment information regarding diversity. *See* Richard F. Lacaille, *Diversity Strategy, Goals & Disclosure: Our Expectations for Public Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE 1 (Sep. 13, 2020), https://corpgov.law.harvard.edu/2020/09/13/diversity-strategy-goals-disclosure-our-expectations-for-public-companies/ [https://perma.cc/B26R-KL9Y] ("State Street Global Advisors will ask companies in our investment portfolio to articulate their risks, goals and strategy as related to racial and ethnic diversity, and to make relevant disclosure available to shareholders.").

147. 17 C.F.R. § 229.601(b)(21) (2020).

148. Press Release, Sec. and Exch. Comm'n, SEC Adopts Amendments to Improve Financial Disclosures About Acquisitions and Dispositions of Businesses (May 21, 2020), https://www.sec.gov/news/press-release/2020-118 [https://perma.cc/4JFW-SGFT].

149. *Id.*

150. The Investment Test is met for dispositions and acquisitions "when the registrant's and its other subsidiaries' investments in and advances to the tested subsidiary exceed 10 percent of the aggregate worldwide market value of the registrant's voting and non-voting common equity, if applicable." 17 C.F.R. § 210.1-02(w)(1)(i) (2021).

151. The Asset Test is met "when the registrant's and its other subsidiaries' proportionate share of the tested subsidiary's consolidated total assets (after intercompany eliminations) exceeds 10 percent of such total assets of the registrant and its subsidiaries consolidated as of the end of the most recently completed fiscal year." 17 C.F.R. § 210.1–02(w)(1)(ii) (2021).

152. The Income Test is met when:

> (1) [t]he absolute value of the registrant's and its other subsidiaries' equity in the tested subsidiary's consolidated income or loss from continuing operations before income taxes (after intercompany eliminations) attributable to the controlling interests exceeds 10 percent of the absolute value of such income or loss of the registrant and its subsidiaries consolidated for the most recently completed fiscal year; and (2) the registrant's and its other subsidiaries' proportionate share of the tested subsidiary's consolidated total revenue from continuing operations (after intercompany eliminations) exceeds 10 percent of such total revenue of the registrant and its subsidiaries consolidated for the most

percent.[153] These are unlikely thresholds for corporate venture capital arms to reach at current levels.

Further, even if corporate venture capitalist arms are disclosed as significant subsidiaries, the investments that a corporate venture capitalist makes would not require disclosure. Neither amounts pumped into corporate venture capital arms nor those arms' investments into startups are material to a large parent corporation's operations, cash flows, or financial position.[154] Corporations "report realized and unrealized gains and losses based on changes in estimated fair values of 'other investments,'" but more specific details regarding its investments are not included.[155] Often parent firms leave the type of corporate venture capital investments and investees' names unreported.[156] For firms that do disclose their corporate venture capitalist activities, their disclosures are found in various sections of their 10-K filings.[157]

Consistent with the materiality threshold, firms are more forthcoming with information when the amounts invested in their corporate venture capitalist portfolio are higher.[158] Firms also provide more corporate venture capitalist disclosure when dedicated institutional ownership is lower, transient institutional ownership is higher, and industry competition is lower.[159] While firms may voluntarily disclose some corporate venture capitalist information, theories about voluntary disclosure suggest that firms withhold corporate venture capitalist activities for fear of inciting competition.[160] Firms are hesitant to disclose their investments when they are made in ventures falling outside of their business and core industry.[161] Firms want to withhold this information to prevent revealing their strategies concerning future acquisition areas or specific targets.[162]

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recently completed fiscal year.

17 C.F.R. § 210.1-02(w)(1)(iii) (2021).

153. 17 C.F.R. § 210.1–02(w)(1)(i) – (iii) (2021).

154. Sophia J.W. Hamm, Michael J. Jung & Min Park, *How Transparent are Firms About Their Corporate Venture Capital Investments?*, 7 (Apr. 2018) (unpublished manuscript), https ://accounting.wharton.upenn.edu/wp-content/uploads/2018/04/SAC_Jung.pdf [https://perma.cc/5T36-VK2C].

155. *Id.* at 9.

156. *Id.* at 9, 13.

157. *Id.* at 13.

158. Hamm, *supra* note 154, at 4, 27.

159. Hamm, *supra* note 154, at 4.

160. Hamm, *supra* note 154, at 27, 34.

161. Hamm, *supra* note 154, at 27.

162. Hamm, *supra* note 154. at 31, 34

While many corporations disclose no information about their corporate venture capitalist activities, these activities are still disclosed indirectly. Startups may disclose a corporate venture capitalist investment.[163] This information is disclosed through industry trade publications, company press releases, websites, and social media.[164] These announcements typically include how much money was raised, who the investors are, which investor led the round, and what stage the company is in. This announcement serves an important market signaling function for the startups and necessarily discloses a corporate venture capitalist's (or venture capitalist's) involvement.[165]

B. Antitrust Considerations

Lemley and McCreary have exposed the link between the Silicon Valley ecosystem and consolidation of the tech industry.[166] Venture capitalists invest to achieve a successful exit, and now more than ever, that form of exit is selling a startup to a larger competitor in the same tech field.[167] In these instances, tech giants like Google, Facebook, and Amazon have the

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> "However, even after firms announce an acquisition and reveal that the target firm had been a part of its corporate venture capital portfolio, most firms do not disclose financial terms, which prevents investors from fully assessing the financial and accounting implications of a firm's corporate venture capital program on an aggregate or individual deal level."

163. Hamm, *supra* note 154, at 12.

164. Hamm, *supra* note 154, at 11.

165. The SEC is not the only federal agency mandating and monitoring corporate venture capital disclosure. The Federal Trade Commission ("FTC") issued Special Orders in February of 2020 to Alphabet Inc., Amazon.com, Inc., Apple Inc., Facebook, Inc., and Microsoft Corp. Press Release, Fed. Trade Comm'n, FTC to Examine Past Acquisitions by Large Technology Companies (Feb. 11, 2020, 1:00 PM), https://www.ftc.gov/news-events/press-releases/2020/02/ftc-examine-past-acquisitions-large-technology-companies [https://perma.cc/39LZ-NFKV]. These orders required the named companies to provide information about their prior acquisitions that were not reported to the antitrust agencies under the HSR Act. Hamm, *supra* note 154, at 11. Specifically, the FTC requested "information and documents on the terms, scope, structure, and purpose of transactions that each company consummated between Jan. 1, 2010 and Dec. 31, 2019." *Id*.

166. Lemley & McCreary, *supra* note 9, at 4 ("[T]he technology industry has become a winner-take-all affair, with market concentration increasing and one or two firm dominating a wide variety of markets. . . .").

167. Bushra Samimi, *The Antitrust Impact of Venture Capital Firms on Concentration in the Technology Sector*, 11 HASTINGS SCI. & TECH. L.J. 155, 156–166 (2020); Lemley & McCreary, *supra* note 9, at 8 ("[T]he exit strategy for most startups is acquisition, and . . . the most likely acquiror is the very incumbent the startup's technology might otherwise challenge.").

opportunity to acquire startups.[168] This, in turn, increases the tech giants' market power and results in a highly concentrated market that Lemley and McCreary argue could inhibit innovation.[169] Ex ante, however, knowing that tech giants are a viable exit option to startups encourages entrepreneurs to start businesses and venture capitalists to invest in those businesses.[170] As discussed earlier in the Article, the net societal effect on innovation of acquisition-by-competitor is an open question. For our purposes, does it, and by expanding the scope of the inquiry into corporate venture capital, raise antitrust concerns?

Probably not. Using antitrust to limit the reach of tech giants, even through antitrust's preferred lens of giants acquiring potential competitors (as opposed to corporate venture capital), has been largely ineffective.[171] Antitrust is largely focused on horizontal mergers of competitors, not large fish gobbling up smaller ones.[172] Lemley and McCreary recommend antitrust law do more "to limit the sale of innovative startups to incumbents."[173] If antitrust does not reach these acquisitions, however, it has little hope of preventing corporate venture capitalist investments in startups, even Schumpeterian competitors. Still, Scott Hemphill and Tim Wu have recently argued that "nascent competitors" of the type corporate venture capitalists invest in or their parent corporations gobble up through acquisition are vital to competition.[174] They "identify nascent competition as a distinct analytical category and outline a program of antitrust enforcement to protect it."[175]

Moving from theory to practice, Facebook's acquisition activity provides an interesting case study. Facebook acquired the nascent innovator in its Instagram and WhatsApp acquisitions, and matched the competing features of Snapchat after Snapchat turned down its three billion dollar

168. Samimi, *supra* note 167, at 155.

169. Samimi, *supra* note 167, at 155.

170. Phillips, *supra* note 139, at 1 ("While mergers of firms that are horizontally competing may indeed reduce innovation, general policies where a large firm is prevented from buying a smaller firm may have deleterious effects on the *ex ante* incentives to conduct R&D by the smaller firm.").

171. Lemley & McCreary, *supra* note 9, at 91 ("Unfortunately, the existence of antitrust laws regulating mergers has not prevented exit strategies from leading to unprecedented concentration in technology markets.").

172. D. Daniel Sokol, *Vertical Mergers and Entrepreneurial Exit*, 70 FLA. L. REV. 1357, 1363–64 (2018); Alan J. Meese, *In Praise of All or Nothing Dichotomous Categories: Why Antitrust Law Should Reject the Quick Look*, 104 GEO. L.J. 835, 878 (2016).

173. Lemley & McCreary, *supra* note 9, at 94.

174. C. Scott Hemphill & Tim Wu, *Nascent Competitors*, 168 U. PA. L. REV. 1879, 1889–93 (2020).

175. *Id*. at 1881.

acquisition offer.[176] The FTC is conducting an antitrust probe reviewing whether Facebook's acquisitions of Instagram and WhatsApp were anticompetitive.[177] Given the very existence of the probe, Facebook acquiring another social networking rival might be difficult.[178] Whatever the result of the probe, Facebook is likely developing other strategies like corporate venture capital activity to identify emerging industry trends and monitor the competition.[179]

Certainly, corporate venture capitalists who invest in startups would have informational advantages about those startups and their technologies going forward. However, it seems unlikely that antitrust laws will stifle corporate venture capital. Perhaps even the critical authors above would agree that corporate venture capitalist activity is not where antitrust scrutiny should lie – it is premature for an antitrust analysis.

Additionally, Hart-Scott-Rodino (HSR) filings are not required for purchases made for investment only.[180] If corporate venture capitalists can lay claim to that exemption, they will have unlimited discretion to invest in competitors without stoking antitrust concerns. However, given corporate venture capitalist's strategic focus, it is unclear whether this exemption would apply. Even if it does not, HSR filings are only required for transactions over ninety-four million dollars, which should exempt almost every corporate venture capital transaction.[181]

176. Margaret Harding McGill, *Tech's Long Hot Summer of Antitrust*, AXIOS (May 26, 2020), https://www.axios.com/tech-summer-antitrust-24cffcc6-8afc-41f8-9b91-5be6d8269202.html [https://perma.cc/SXL9-3PG6]; Ina Fried & Kia Kokalitcheva, *Scoop: Facebook Establishing a Venture Arm to Invest in Startups*, AXIOS (June 11, 2020), https://www.axios.com/facebook-establishing-a-venture-arm-to-invest-in-startups-91d9ee71-2282-4032-8f31-45b861a6ba9c.html [https://perma.cc/LJW4-3YMU]. Lemley & McCreary, *supra* note 9, at 21 ("Facebook . . . has acquired over ninety companies, mainly startups – building and maintaining its userbase partly by acquiring, and then often shuttering, other services."); Hemphill & Wu, *supra* note 174, at 1885–86 ("WhatsApp posed a nascent competitive threat. . . .Facebook acquired WhatsApp for $22 billion, thereby eliminating the competitive threat.").

177. Jeff Horwtiz, Facebook Says Government Breakup of Instagram, Whatsapp Would Be a 'Complete Nonstarter,' WALL ST. J. (Oct. 4, 2020), https://www.wsj.com/articles/facebook-says-government-breakup-of-instagram-whatsapp-would-be-complete-nonstarter-11601803800 [https://perma.cc/4JQY-P4QX].

178. Fried & Kokalitcheva, *supra* note 176.

179. Fried & Kokalitcheva, *supra* note 176.

180. "Investment-Only" Means Just That, FED. TRADE COMM'N (Aug. 24, 2015), https://www.ftc.gov/news-events/blogs/competition-matters/2015/08/investment-only-means-just [https://perma.cc/W982-9H76].

181. HSR Threshold Adjustments and Reportability for 2020, FED. TRADE. COMM'N (Jan. 31, 2020), https://www.ftc.gov/news-events/blogs/competition-matters/2020/01/hsr-threshold-adjustments-reportability-2020 [https://perma.cc/CDV5-MA9K].

C. Conflicts of Interest

A third potential legal problem facing both venture capitalists and corporate venture capitalists is conflicts of interest. Corporate law imposes duties of care and loyalty on directors, be it of public companies or startups.[182] To meet the duty of care, a director must act on an informed basis.[183] The duty of care is easy to meet, however, and is not the duty that poses the conundrum for venture capital employees acting as directors of the startups in which their funds invest. These directors will generally be informed enough to satisfy their duty of care,[184] and exculpation provisions including Delaware's 102(b)(7) stand as another backstop against legal liability.[185]

The duty that poses the potential problem is the duty of loyalty. To meet the duty of loyalty, a director must serve the corporation on whose board she sits rather than her own interests.[186] By extension, a director's "own" interest includes the interest of another corporation she favors, such as the parent corporation in corporate venture capital, or another portfolio startup the fund has invested in. Given that a venture capitalist director serves two masters, in actuality if not from a fiduciary standpoint,[187] she may have divided loyalties.

Traditional venture capitalists have faced this problem. Claims of "financial tunneling," or harming a less promising startup by diverting funds to a more promising startup in the fund's portfolio, have been lodged against

182. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 367 (Del. 1993) ([T]he "duty of care and duty of loyalty are the traditional hallmarks of a fiduciary.").

183. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) ("[T]o invoke the [business judgment] rule's protection directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties").

184. Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 88 ("[I]f the business judgment rule does anything, it insulates directors from liability for negligence.").

185. *Brehm v. Eisner* (*In re* Walt Disney Co. Derivative Litig.), 906 A.2d 27, 65 (Del. 2006) ("Section 102(b)(7) of the DGCL, which authorizes Delaware corporations, by a provision in the certificate of incorporation, to exculpate their directors from monetary damage liability for a breach of the duty of care.").

186. Iman Anabtawi, *Predatory Management Buyouts*, 49 U.C. DAVIS L. REV. 1285, 1290 (2015) ("Self-dealing offends the very essence of the fiduciary duty of loyalty applicable to corporate managers. According to that duty, managers must place the best interests of the corporation and its shareholders ahead of their personal interests.").

187. A corporate venture capital employee who sits on a startup board but not the board of the parent corporation likely only owes fiduciary duties to the startup.

venture capitalist directors in the past.[188] Corporate venture capital employees serving as portfolio company directors may face an even greater challenge—balancing the interests of the startups they serve as directors with what is best for the parent corporation. What if a director learns, through his service on the startup's board, that a startup's product or service is developing in a way that is likely to harm the parent corporation? Does she tell the parent corporation? Make decisions that hinder the competitive threat? The director is in the position, practically speaking, of serving two masters. This potential problem is minimized, however, by the fact that corporate venture capitalists, even if the lead VC investor in a round, take fewer board seats than venture capitalists.[189] But corporate venture capitalist employees that do serve as directors must not engage in the equivalent of the venture capitalist's financial tunneling to avoid duty of loyalty concerns. In sum, corporate venture capitalists must be cognizant of legal landmines to avoid, most notably conflicts of interest, and develop strategies to avoid them.

V. CONCLUSION

The Article has examined the only potential rival to venture capitalists' dominance of entrepreneurial finance: the large corporation. Large corporations have sufficient capital to fund startups and can offer superior value-added services in some cases. Through their corporate venture capitalist arms, large corporations can keep abreast the most promising entrepreneurs and the emergence of disruptive technologies, which protects their market and industry positions. Compared with venture capitalists, corporate venture capitalists are desirable for several reasons, including increasing diversity within the VC industry.

Important questions remain about corporate venture capital for future law-and-entrepreneurship and law-and-economics scholarship. Will corporate venture capitalist continue to become an even cheaper, earlier window into identifying and addressing competitive threats to dominant corporations? Will corporate venture capitalists continue to co-invest with venture capitalists or begin to crowd them out in technologies where

188. Vladimir Atanasov et al., *Does Reputation Limit Opportunistic Behavior in the VC Industry? Evidence From Litigation Against VCs*, 67 J. FIN. 2215, 2219 (2012) (VCs "could engage in transfer pricing by arranging for one portfolio firm to purchase intellectual property, services, or other assets from another portfolio company at non-arm's-length prices. VCs could also allocate business opportunities un-equally among the firms in their portfolios.").

189. *See* Amornsiripanitch, *supra* note 31, at 539 ("Corporate venture capital investors are far less likely to take board seats, even if they are the lead investor.").

corporate venture capitalists are active? How will the legal landscape develop and impact this equation? Will corporate venture capitalist play a meaningful role in addressing the diversity shortfalls in the VC industry? All of this remains to be seen.