# Corporate Structure for Technology Infrastructure

Companies that develop technology in new market areas face risk from not applying the technology in a manner that is understood or useable by their targeted market – or the technology may simply be ahead of the market demand. The base technology may be sound, but a company that misses its market usually does not have a second chance.

Follow-on companies that take advantage of the learning experience of the now-defunct first company to market have a greater chance of success. This document discusses a time-tested approach that the author has applied to an Internet startup as a means of minimizing risk and broadening the number of participating partners, while maintaining flexibility for future mergers and acquisitions in the industry.

Monolithic Corporations vs. Holding and Operating Companies

Innovative, technically based companies that develop discontinuous new paradigms expose themselves to several types of risk: market not ready, value proposition improperly articulated, market grows slower than expected, etc. Most of the risk lies with the customer-facing aspects of the business. The innovative technology and processes underlying and supporting the customer-facing business can in most cases be repurposed into supporting other potentially viable customer-facing businesses.

Separating the technology infrastructure developed by the company from the customer-facing business produces a group of related companies, as shown below. This diagram is modified from an actual diagram developed for a client:
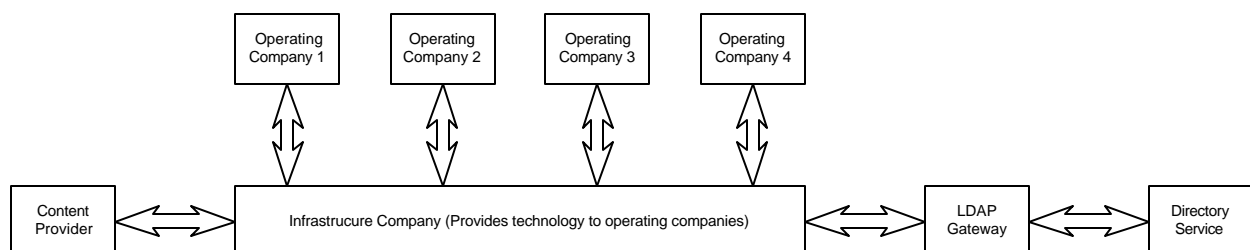
In the diagram above, four possible operations companies are envisioned, all leasing their technology from the holding company. Each operations company has a different business model. The interface for each operations company to the infrastructure is common, however.

The valuation of the group of companies would be much greater than if all the assets and activities were held in one company.

The operations companies would pay for fixed and variable costs incurred by the infrastructure company, plus a one-time setup charge, plus a base cost per month. Any applicable royalties for content would be computed by the infrastructure company, but would be paid instead directly to a content provider. The infrastructure company would not be responsible for the content flowing through it (like telcos.) The motivation here is for the operating companies to assume all risk.

Infrastructure Company

The infrastructure company (actually a holding company) would develop and maintain functional components for the operating companies under an ASP model. Any development specific to one operating company's needs would either be developed by the infrastructure company at arms length, or by an outside company using the APIs published by the infrastructure company.

The infrastructure company would not build a brand, and would not be exposed to market risk.

Operating Companies

Each operating company would have a different business plan, and would seek to build individual brands. Risk from customer-facing operations would be held solely by the individual operating companies.

Barriers to entry and time to market for successive operating companies would be less than vertically integrated companies. Operating companies might compete against each other, using different business models. Arms length parties might launch customer-facing operating companies in competition to those launched by the original founders, but the founders would still benefit since they would own the infrastructure company that would provide products and services to all customer-facing companies.

Conclusion

Using technology holding companies to separate out the risk incurred by customer-facing ventures is not new. In general, however, Internet companies have not used this tried-and-true corporate strategy. Now that the dot-com bubble has burst, investors have a renewed interest in business fundamentals. One should expect to see more holding companies in the Internet marketplace as the business use of the Internet continues to mature.

About the author

Michael Slinn is a technical business strategist. He consults in the Internet Business to Business (B2B) and Business to Consumer (B2C) arenas, and focuses on server-side architecture and technical/business strategy.

No longer can executives make high-level decisions without regard for technology and simply direct their technical staff to execute - the business strategy must be integrated with a technical strategy. This is particularly true in Internet startups and business makeovers. Michael facilitates the development of a total business technology concept. Few people can sit in a technical / marketing / business discussion and contribute in all areas, but that is Michael's unique strength.