Osage fund's 'co-investment' concept wins support from top universities

The proof of the pudding, when it comes to venture capital funds, is in the selling, and Osage University Partners has clearly met the test; the recently closed fund has met its target size of $100 million. And the fund has also apparently hit a sweet spot with universities using a unique co-investment feature, allowing schools to get more skin in their start-ups by participating in later funding rounds. These rounds are often passed on by TTOs because they don't have the money to participate, and the result is a dilution of their ownership stakes. But with Osage's co-investment strategy, universities can get in on the later rounds and the fund's management keeps a piece of the action for its trouble -- and its cash.

The new fund has inked deals with a who's who of top-tier universities, including the California Institute of Technology, Columbia University, Duke University, University of California at Berkeley, University of Florida, University of Michigan, University of Pennsylvania, and Yale University.

Though its principals, citing a crush of media requests and a need to focus on its business activity, declined to be interviewed for this article, participating institutions are clearly excited about the concept.

"It is unique because they make use of investment rights that universities have, but for the most part do not exploit," says **Fred Farina,** assistant vice president of the TTO at the California Institute of Technology. "Universities do licenses, they do start-ups, and a lot of the time they will get equity. They often have the right to invest in follow-on financing rounds, but they would have to put cash into those rounds -- and very few have done it. This fund was set up for this very purpose -- to step in and invest on behalf of the universities and then share a percentage of the proceeds with the universities."

Carol Mimura, PhD, assistant vice chancellor for intellectual property and industry research alliances at the University of California, Berkeley, sees similar benefits. "We accepted the invitation to have a ready source of future investment capital that will maintain our equity positions in start-up companies as they continue to raise additional capital," she says. "Historically, the university has not participated in subsequent rounds of investment, resulting in dilution of our original shares, so the Osage connection is both timely and welcome."

The University of Illinois at Urbana-Champaign, which recently became an associate partner with Osage, faced some unique challenges, but was able to overcome them. "What they propose to do is extremely valuable to us," says **Mark A. Kaczor,** JD, CLP, senior technology manager in the Office of Technology Management, "but we have a constraint -- Illinois Ventures, our own in-house fund. But Osage worked out a deal that if both went into the investment they would split the returns 50/50."

Kaczor sees the "real value" of the fund in the protection it offers against dilution. "What they call pre-emptive rights, we call participation rights; there are paragraphs in the stockholder agreements that allow you to participate in an investment round to maintain your investment," he says. "If you were at 10% and did nothing in a subsequent round and were then at

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way to make lean start-up work is getting everybody to focus on being successful, not just on putting on a show," Ries stresses. "It can be uncomfortable for the TTO, the inventor, the lawyers and everybody involved, because they have to give a little in the service of a more successful company."

Can the effect of the lean start-up model be quantified? Will a TTO that adopts it actually create more successful companies? Probably, Ries says. "The nice thing about the business plan-driven approach to commercialization is that it's pretty boilerplate," he comments. "Any competent MBA can do it his or her sleep. But that's not helping the company succeed. Under 'lean,' we can figure out what's wrong faster. We've seen in Silicon Valley that the reason the cost of starting a company is dropping is we have a better method for running experiments. It's not that you get smarter all of a sudden, it's that you can be surprised more often. So the success rate will be higher."

Part of the reason lean works better, he adds, is the Internet. "The good news is even the most complicated technology in the world, one for which developing a prototype will take a long time -- which is rare, by the way -- has customers who are easily reachable on the Net. So you can do a market test and give customers an opportunity to pre-order. You'll know their response relatively quickly."

He adds: "It's a completely new paradigm. Once people go down the rabbit hole, they don't come back. It just doesn't happen. Some people don't keep trying it because they have political barriers, but the ones who get it right adopt it.… This represents an incredible opportunity for an innovative TTO, an incredible opportunity for someone to base a career on."

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5%, you'd need to come up with capital equivalent to the 5% you lost.

"Previously, we did not yet have a situation where there was an oversubscribed round, so whether we had a pre-emptive right has been moot; there has been room for all comers," he continues. "But it *is* possible, and Osage's experience with University of Pennsylvania start-ups has reached the point where they are highly valued and everyone wants in -- and some want to get exclusivity. The pre-emptive right in the license allows you to add money to protect your position; currently we don't have the capital to protect our investment." Illinois Ventures, he notes, did offer protection, but most of the revenue went to the university -- not his department.

Kaczor adds that his university was not willing to sign an exclusive arrangement with Osage, but rather wanted to participate on a case-by-case basis. "That's why we signed up as an associate partner," he explains.

According to Farina, the fund will primarily make investments in the start-ups of participating universities. "There will be investments in start-ups of other universities that are not part of the group on a case-by-case basis, but the majority will go to the core group of universities," he says.

Ultimately, says Kaczor, the affiliated universities will share in Osage's profit. He says the percentage that each university receives is determined by a "complicated formula," but adds, "we think it's fair to the universities."

Other benefits seen

Universities participating in the fund also believe they benefit from Osage's expertise. The fund is run by managing partners **Robert S. Adelson** and **Marc Singer**, both veterans of early-stage investing, and by its architect and founding partner **Louis Berneman**, a former AUTM president and long-time tech transfer exec, most recently with the University of Pennsylvania, who since 2005 has headed the tech transfer consultancy Texelerate.

"In addition to the investment capital, Osage offers the kind of hand-holding and management expertise that our angel network currently provides, and leverages what is in place as opposed to detracting from it," says Mimura. "As the newest addition to our innovation network, we are already seeing some synergies between Osage and our local ecosystem that have been in place for decades. For example, an east-coast/west-coast connection was made for a company in the management pool space that may not have

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occurred without this relationship."

Kaczor sees similar benefits. "They look at a lot of investment opportunities," he notes. "If one group of investors is not interested in a start-up, they may know someone else in the investment community who might be, so we can leverage their network. In many intangible ways this is valuable to the university; they are also experienced, knowledgeable investors."

He cites a specific case of "serendipity," in which an inventor at the University of Pennsylvania who was well known to Osage "collaborated with one our inventors -- and it led to a start-up."

Adds Farina, "as we work closely with Osage we get to learn a lot about their due diligence methods -- and that is beneficial to TTOs as well."

As appealing as the fund's co-investment concept is, however, Farina is not convinced this will be the first of many such funds. "I'm not sure, because first of all it is new, and people will want to wait and see how it performs," he observes. "And second, they have rounded up a group of universities that have a high level of start-up activity, and someone else has to come along and try to get other universities."

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think this will be very appealing to VCs and investment companies."

Weighing patent value

Mark A. Kaczor, JD, CLP, senior technology manager in the Office of Technology Management at the University of Illinois at Urbana-Champaign, sees one potential drawback with the concept. "An obvious drawback is if you have a particularly valuable patent you might be contributing [a disproportionate amount of value] unless there is some way of weighting patent value," he offers. "You have to think twice about what you put in there, and when that starts to happen you end up with pools that may not have the highest value in them."

Gray responds: "We do address this, and we do appreciate issues around making participation palatable for a wide array of universities. We envision three forms of weighting for any single patent within the pool:

1. Simple quantitative metric, e.g. non-self forward citations;
2. Automated, statistical quantitative metric, e.g. Innography rating;
3. Qualitative metric, e.g. fielding a rating from a network of qualified subject matter experts."

Of these, he says, "we tend to favor a mix of '1' and '3.' In the absence of an accepted valuation standard, we think weighting by a simple, transparent, observable metric like forward citations balanced with a qualitative metric is a good solution."

So in terms of compensation to the universities, Gray explains, "imagine a hybrid license, with cash up-front and ongoing royalties. The LLC takes a piece, and all the universities take a piece. We are a 100% commission-based broker; we get nothing up front. If a deal is done, we take a piece of the deal." Those numbers, he adds, "have not been finalized quite yet."

At end of the day, Gray adds, the value of the pools will be set by the market. "Everyone knows what the offer will be," he points out. "Say after Labor Day there are five or 10 pools available for exclusive sublicense; everyone will take ample time to look at it, and the market will set whatever price it thinks is appropriate. It's not as if we're forcing something exorbitant on the market."

As for whether universities should consider such pools, Kaczor says that university TTOs "should use all available tools to license our technologies," and in fact, his university just participated in the Ocean Tomo auction in New York.

"There was a collection of 4,731 patents, and one sold for $35 million, so you *can* put together valuable pools of patents," he notes.

Other benefits cited

Another TTO executive who has participat-

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