

The Spinout Option

Reviewing the Policy Considerations in Licensing to Spinouts



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Spinout Activity in US Universities

- New Companies (Spinouts) Resulting from U.S. University Licensing –FY 2005
 - **628 New Companies formed in FY 2005**
- Spinouts formed since 1980
 - **5,171 (60% still operating in 2005)**
- 128 Institutions had at least one spinout in 2005
- Most Prolific Spinout Activity in FY 2005
 - **MIT with 20**
 - **University of California System - 19**
 - **CalTech – 15**
 - **University of Florida - 13**



Policy Issues with Spinouts

- Ownership: To Assign/Not to Assign?
 - **Often heard from VCs and investors: A start-up must own its IP**
 - **Myth: Exclusive license (with all rights of ownership) is sufficient**
- Risks of Assignment
 - **Bankruptcy**
 - **Stranding of IP**



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Policy Issues with Spinouts

- Taking Equity
 - **Upside: Licensor/owner benefits from company success whether or not its patent is used**
 - **Downside: Long payout period (if ever); certain liability exposures depending upon size of equity position etc; potential for “bad press” if things go wrong**



Policy Issues with Spinouts

- Major Policy Issue: Conflict of Interest
 - **Recognizing the Conflicts that Occur**
 - o Inventor with dual commitments (start-up and university)
 - o University as a shareholder
 - o University as board member
 - o University management as individual shareholders
 - o The Technology Transfer Office as dealmaker



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Policy Issues with Spinouts

- Minimizing Conflicts
 - **Limiting faculty inventor's participation**
 - No line management
 - One-day a week rule for consulting
 - Permit "leaves" of up to 2 yrs.
 - **University as a shareholder**
 - Best practice: Equity shares of no more than 10-15%. MIT uses a 5% rule
 - **University as board member**
 - No, except individual serving in individual capacity



Policy Issues with Spinouts

- Minimizing Conflicts
 - **University management as individual shareholders**
 - o Should be treated as prohibited conflict
 - **The Technology Transfer Office as dealmaker**
 - o Individual/family precluded from investing until stock goes public and university divests



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Criteria for a Spinout

- Requirements for new ventures
 - **The Idea**
 - **More than one application is preferred – platform for expanding – if single application new company will most likely get acquired at some point**
 - **The business concept/what is the need and who is the customer - i.e. is there an unmet need?**



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Criteria for a Spinout

- Requirements for new ventures
 - **Capital**
 - **Does the Idea have strength**
 - Strong patent protection
 - Minimal competition
 - Can it be policed/processes often can't be
 - **Does the venture have development resources or partnerships?**
 - **Is the inventor committed to help?**



Spinout Management Team

- CEO
 - **Expertise in managing new ventures**
 - o Raising capital
 - o Operating a business
 - o Motivating employees
 - o Marketing



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Spinout Management Team

- CFO
 - **Managing financial sources/VCs**
 - **Managing budgets**
 - **Stock issues**
- CLO
 - **Stock issues**
 - **IP protection**
 - **Employee contracts**



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Role of the Inventor

- Generally considered crucial to success, but not in line management
- Typical Inventor services:
 - **Science Advisory Board**
 - **Consultant**
 - **Board member (maybe)**



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Spinout Assets Required

- Realistic long-term business plan
 - Liquid Funds for R&D including salaries
 - **Sources**
 - VCs
 - Banks
 - Private Investors
 - Government small business programs
 - **Other requirements for fund-raising**
 - Agreements with key employees
 - Loan guarantees
 - Facilities
 - Rights to 3rd party IP that may be needed
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Spinouts that Failed

- Reasons for “spinout failure”
 - “idea” fails
 - Weak IP protection
 - Mismanagement (weak leadership)
 - Management with wrong experience
 - Unrealistic financial projections
 - Key personnel leave
 - Insufficient assets to pursue infringers
 - Acquired and buried



Valuing the Spinout Deal with Equity: (Based on U.S. and U.K. experience)

- Figures based on spinout raising \$1M in investment
 - Venture Investor 33%
 - Research Institution licensing IP only .. 5-7%
 - Research Inst. adds incubation 10-15%
 - Total Research Institution 15-22%
 - Employee stock option pool 20%
 - Founding entrepreneurs 25-32%
- (if no incubation, entrepreneur shares rise



The Bank Boston Study (1995)

The Impact of MIT on Innovation

- 4,000 MIT-related companies formed
- Revenues produced would be world's 24th largest economy and employ 1.1M people
- Critical factors in where to locate startups (1,300 founders surveyed)
 - **Quality of life**
 - **Proximity to key markets**
 - **Access to skilled professionals**
 - **Access to skilled labor**
 - **Low business/transaction costs**
 - **Access to universities**



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Building Clusters: What it Takes (based on biotech experience)

- Three main biotech clusters in the U.S.
 - San Francisco Bay area and northern California
 - San Diego California area (southern California)
 - Boston/Cambridge, Massachusetts (more than 280 companies = 20% of U.S. biotech companies)



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Building Clusters: What it Takes

- **Ingredients needed:**
 - **Role models who have founded companies and can advise entrepreneurs**
 - **People skilled in new-company management**
 - **Retaining newly graduated skilled employees**
 - **Service sector support**
 - **Technology Transfer from surrounding universities and research centers**
 - **Angel investors**
 - **As cluster grows, venture capital arrives and locates**
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