

Jackie Hutter, MS, JD
The Hutter Group, LLC
IP ***Business*** Strategy
Decatur, GA

Web: www.JackieHutter.com
www.PatentMatchMaker.com

Blog: www.ipAssetMaximizer.com

50% of Venture Capital Investment is Lost: How Your Clients Can Improve These Odds Using the *Right* Patent Analytics

The Skinny on the Quality of Venture Capital-Related Investment Decisions

If you are a counselor of venture capital firms or entrepreneurs who own start-up companies that are targets of venture capitalists, you might already be familiar with the high rate of failure associated with such investments. Nonetheless, you may be surprised to find out that 50% of all money invested in venture capital is a loss.¹ This figure, which is based upon separate research projects by a Chicago Graduate School of Business (“GSB”) professor and a former Chief Economist at the Securities and Exchange Commission, indicates that the actual return on venture capital investment is not much different from the average annualized returns on the smallest NASDAQ stocks. In particular, the return on venture capital investment from 1987 to 2001 in these smallest stocks was 62% as compared to the 59% mean return of venture capital funds.

¹ Arlene Jacobius, Pensions and Investments Online, September 19, 2005, available at, <http://www.pionline.com/apps/pbcs.dll/article?AID=/20050919/PRINTSUB/509190734/1031/TOC>, retrieved April 20, 2009.

This 59% figure certainly does not reflect the investing public's general perception that venture capital return on investment markedly outweighs what one can obtain on the stock market. And, it is this apparently erroneous assumption of perceived higher return that presumably justifies the higher risks your venture capital and entrepreneurial clients associate with venture capital. Investor perception certainly does not match investment reality for your clients who play in the venture capital space.

Why this disconnect between perception and reality on venture capital returns? Professor Cochrane, the Chicago GSB professor, posits that, in effect, traditional methods of measuring venture capital return do not take into account the fact that ventures that are a total loss disappear and are not measured. Because these losing ventures are not around to be measured for calculation of rate of returns, Professor Cochrane states that this survivor bias significantly skews the rates of return on venture capital. His simple explanation of the effect of these missing numbers is telling (quoting from the Jacobius article): "They collect the returns for everybody that is around," he said. "It is like collecting data from everyone still in the casino: They're not asking the people on the bus ... who are on their way home."

How Your Clients Can Improve The Quality Of Their Business Decisions

From the Jacobius article, it appears that there is much room for improvement in your venture capital clients' investment decision-making, as well as the quality of entrepreneur's decisions regarding their start-up companies. As an IP Business Strategist and Consultant, I am a strong advocate of using knowledge and information to reduce risk and improve the rate of return on investment. I firmly believe that venture capitalists, and entrepreneurs who are seeking venture capital investment, can improve the quality of their business and investment decisions by collecting and analyzing business information available in published patent data.

When one knows how to extract and analyze the right data in patents, significant business insights are effectively "hiding in plain sight." In short, valuable business

information is available for the taking by smart entrepreneur and investors. And, why wouldn't your client seek to gain knowledge that could reduce the strategic uncertainty of her investment decisions to better manage decision-making risk?

In particular, before your venture capital firm client invests in a new business idea for a new venture, why wouldn't she want to know whether the business idea is ownable in the long term or whether she will possess the opportunity to innovate freely in relation to that business idea? Or, why wouldn't she want to know whether another firm has invested \$100K or more in patent rights alone in the new business idea that she is investigating for investment? This, and other, valuable business insights and information are embedded in published patent filings.

For your start-up entrepreneur client, patent filing information can also provide valuable insights to provide enhanced long term business value and raise the value of her start-up company to venture capital investors. For example, patent filing information can reveal where the entrepreneur should focus her patenting efforts beyond the parameters of her specific inventive concept. By undertaking a competitive review of what others have sought to protect in her relevant product or technology area, your client can better understand the full breadth of patent rights obtainable. This can allow your client to gain enhanced patent claim scope that can serve to prevent competitive knock-offs of her product or technology concept. As a result, her start-up company's value to venture capital investors can be significantly increased.

Your Clients Don't Just Need Patent Analytics, They Need Patent Analytics That Provide The Right Business Insights

However, it is not enough for your clients to collect and graph published patent data to obtain insights that will improve the odds of making the right investment decisions. Rather, specific business-focused data collection and analysis methodology is necessary for successful use of patent data for use by your clients. This is easier said than done.

In my experience as an actual purchaser of patent analytics costing upwards of \$20K per single business question, I found that the vendors that collecting and analyzed the patent data generally had no basic understanding of the business questions that my company required answering. As such, these patent analytics vendors' products were effectively useless to answer our business team's investment and innovation questions. Put simply, these vendors' products did not provide my team with actionable business insights. I thus learned an expensive lesson about patent analytics: the data collection must be based upon the right foundation for the results to have any value. In other words, with patent analytics it is "garbage in, garbage out."

As one example of patent analytics "garbage," one vendor, who offered a patent analytics product for \$25-30K for a single business question, presented example data to us in his sales pitch regarding complex patent portfolio where the business conclusions were based upon published patent assignment information. The analytics vendor affirmatively stated that because the primary inventor named on this portfolio's moved from Tennessee to Arizona, we should be concerned because he likely had gone to work for a major competitor of ours. He further stated that our company should be concerned that our major competitor was entering a new technology area in which the inventor was a renowned expert.

These conclusions seemed reasonable because they were supported by Patent Office assignment data, as well as other signals informally observed by our marketing team. We therefore considered investigating this competitive threat more thoroughly and addressed making preliminary steps toward evaluating a new product introduction in our competitor's apparent new technology area. Before doing so, however, one of our team members contacted a former colleague of his who had worked in the same department as the inventor who now worked for our competitor.

Our team member found out that the inventor moved to Arizona not to work for our competitor, but to tend to his ailing mother. This intelligence revealed that the inventor was working in a wholly different product area at our competitor than he had

worked at while being a prolific inventor at the Tennessee company. The technology area did not pose a competitive threat to our company. Fortunately, we found out this was the case before investing significant time and effort into the patent analytic vendors' conclusions from patent assignment data.

Interestingly, the patent analytics vendor did not consider any alternative reasons for the inventor's change of residence, other than that he presented. In his view, if the data revealed by his analysis said it, it must be true. But, it wasn't the data that was the problem, it was the conclusions he presented to us. If we would have been more credulous about his conclusions, we would have wasted considerable corporate resources chasing his erroneous assumption about our major competitor's activities.

How Your Client Can Select the *Right* Patent Analytics

In the world of start-up company management and attendant venture capital investment, information is undoubtedly power that can fuel your clients' decision-making processes. But before your client spends good money on patent analytics to improve the payback from her business decisions, she must ensure that the data and insights she obtains are based upon methodology that extracts actionable business insights from patent filings. As shown above, selection of the wrong analysis methodology could be worse than her not conducting patent analytics at all because her investment decisions could be influenced by information that provides the wrong business conclusions. Only those methodologies that are founded on methodology that extracts the business purpose from patent filings can provide your client with investment-grade insights from patent filings.

Methodologies I recommend to my venture capital and entrepreneurial clients use a combination of data and legal analysis to extract the business information from patent filing data. Importantly, the business question must be well defined prior to starting the analysis. A broad business question will lead to comparably, and likely non-insightful, answers. Anyone seeking business answers from patent information should therefore spend considerable time up-front clearly defining the business or investment

question they seek to obtain an answer to, and also in communicating this to the patent analyst.

I also believe that the best patent analytics vendor is not the one who demonstrates that its data analysis techniques are the most efficient in analyzing 1000's of patent documents to provide attractive and succinct pictures of the data in landscape form. Indeed, rarely would a well-defined business question lead to more than several hundred relevant patent documents at most. This number of patents typically can be reviewed at a high level by a trained patent analyst. As such, when selecting a patent analytics vendor, your client should move past the charting and picturing aspects of the sales pitch, to better understand how the vendor will work with your client to define and answer the specific business question.

Furthermore, I strongly recommend that your client seeks a patent analytics vendor whose methodology centers on reviewing the patent filing documents *not for what they say, but for what they claim*. The claims provide the relevant business information because that is what your client's competitors seek to prevent them from doing. In other words, this exclusionary aspect is what matters because it defines what your client can and cannot do (or patent). In my experience few patent analytic vendors truly understand that this aspects of patents, a fact which significantly lowers the value of most product offerings.

Only after the patent analytics vendor analyzes the claims for relevance to the specific business question does your client care about who might own the patent filing or what they might wish to accomplish with it. This means that the vendor should present your client not with graphs, pictures and analysis of 1000's of patents, but rather, with substantive analysis of a fraction of this number of patent documents that are directly or substantially directly related to your client's business question. In my experience, better analysis of a more precisely generated library of patent filing documents provides clients with more readily actionable business insights from patent information.

Conclusion

Given that more than 50% of venture capital investment is lost, there is certainly room for improving the quality of the decision-making processes involved. I believe that patent analytics can serve a critical need in this regard. At a minimum, those entrepreneurs and venture capital investors who use such information are obtaining an additional piece of information that is not commonly used to make investment decisions today. The critical factor for those seeking to use patent analytics to improve their investment decisions is to make sure the vendor they choose for such information is providing them with the right information in accordance with the methodologies set out in this article.