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# Technology Transfer Tactics™



The monthly advisor on best practices in technology transfer

*Initiative pushes consistency, speed and ease-of-use in tech transfer practices*

## Ohio IP Promise aims to boost tech transfer, end the exodus of high-tech talent

Frustrated that too many businesses, entrepreneurs, venture capitalists and potential research partners have been looking elsewhere for opportunities in the high-tech arena, the state of Ohio, along with its 14 public and two private universities in the region, has announced an initiative aimed at showcasing to the world that the state is open for business.

Called Ohio IP Promise, the new effort is not just a public relations campaign, but rather a collective push to get all of the state's major research institutions on the same page when it comes to making it easy for business and industry to license home-grown technologies and for entrepreneurs to start new companies in the state.

The approach is also unique in that all of the state's R-1 universities are working in concert to not only elevate technology transfer opportunities in the region, but also to convince their well-educated, high-tech talent that they need not head for the Coasts to build lucrative ventures. The message is: There is plenty of action at home.

### Drive consistency

The idea for Ohio IP Promise began to take shape early this year as Lt. Governor Jon Husted and other representatives from state government were visiting campuses and speaking with different stakeholders in the entrepreneurial ecosystem to fully understand how the system works. Husted clearly saw a process in need of improvement, later telling reporters that the way things had always been done wasn't working.

"My interpretation of that based on my interactions was that [Husted] saw there was room for

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driving greater consistency across the 14 public universities within the state of Ohio as well as some of the private universities in how we transfer technologies into the market,” explains **Kevin Taylor**, the associate vice president of technology commercialization at Ohio State University in Columbus, OH. “There really wasn’t a set of practices and guidelines that were driving the services that were being delivered by the TTOs across the state.”

Consequently, establishing some baseline practices was the focus of what Taylor and some of the other initiative participants refer to as just the first phase of the Ohio IP Promise. This involved several months of groundwork and consultations between the Intra-University Council of Ohio, which includes all 14 of the state universities, and two of the state’s private universities as well.

It should also be noted that the participating universities were hardly dragged to the table. They recognized the need for improvement as well, notes Taylor, and actively participated in a process aimed at delineating how best to move forward.

“We were very thoughtful about how we engaged different stakeholder groups, so while it is important to benchmark your peers and see what they are doing and what is working, it is also important to talk to your customers and stakeholders,” Taylor observes. “We met with entrepreneurs. We met with investors. We met with members of state government, and we met with organizations that support the entrepreneurial ecosystem like Venture Ohio, Innovate Ohio and others.”

Representatives from Ohio IP Promise also met with attorneys who have done deals with universi-

ties so they could provide insight on where the friction points are, notes Taylor. “We tried to meet with each of the different stakeholder groups to make sure that we were hearing directly from them on what their needs were, and also getting their insights on how we could make things more efficient and better.”

### ***Establish guiding principles***

Did this culminate in a one-size-fits-all licensing agreement or process that all the participating universities have adopted? No, but Taylor acknowledges that the idea did come up. “We quickly realized that while there could be benefits of that, within the public universities we have a wide variety of ecosystems ... resources and needs,” he explains. “That is what drove us [instead] to the idea of guiding principles -- the idea that within the context of each of our ecosystems, if we commit to these guiding principles, we will create outcomes that are similar and we will do it in a way that is appropriate for the unique needs or circumstances of our universities.”

Getting consensus from 16 different educational institutions is not necessarily an easy task, but with the assistance and encouragement of the state, the group came together around a set of guiding principles that obligate the participating schools to ensure that they are:

- providing flexibility or choices to potential partners for accessing university IP or sponsoring research;
- being transparent about what the commercialization process will involve and what the terms are up front;
- providing simple and fair guidelines for start-up creation;

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- communicating licensing processes in a clear and prominent way on university websites;
- making it easy for all stakeholders -- including businesses, entrepreneurs and investors -- to engage with clearly defined entry points.
- eliminating impediments that can slow the pace of commercialization.

For instance, each school has agreed to post on its research website step-by-step instructions for how interested partners can go through the commercialization process at the institution, as well as standard option and licensing agreement templates that let both inventors and potential licensees know what their options are with regard to licensing terms.

"Transparency is a critical element of it, but also moving with urgency when we are doing deals and trying to move at the pace of business, making sure we are easy to interact with and that we have good relationships with our faculty and staff -- our innovators as well as those in the community who are bringing key assets to the table like investment dollars or business and technical talent," Taylor explains. "Everything works together, and it is hard to say that one [principle] is more important than another."

## **Sharing resources**

**Geoffrey Pinski**, director of the University of Cincinnati Technology Accelerator for Commercialization (UCTAC), notes that the initiative is in alignment with many steps UCTAC was already in the process of carrying out. "For us, our old approach to IP only resulted in about one new start-up a year, so over the last two years we have been streamlining our processes and this past year we have seen a 400% increase in start-ups -- and we expect that number to grow again this year," he says.

Pinski attributes the uptick to making the commercialization process more transparent and easy to use, creating an express license, and doing a better job of preparing faculty for the rigors of being involved in a start-up. "We recognized that we needed to be more aggressive with IP, and in doing so, we caught the eye of the Lt. Governor and his team," he explains.

Indeed, many of the IP policies in place at the University of Cincinnati and Ohio State

University have served as models for other Ohio IP Promise participants, and the initiative encourages this kind of sharing. "We created a site for the universities where we can share our best practices, all of our documents, all of our inventor guidelines and all of our license agreements so that everyone can benefit," states Taylor. "That was really important for us to do."

## **Streamlining processes**

Case Western Reserve University (CWRU) in Cleveland, one of the two private universities participating in the initiative, signed on to the approach because it is consistent with the university's commitment to take CWRU's technologies to the market, observes **Suzanne Rivera**, the vice president for research and technology management at CWRU. "We participated actively in the statewide working group that performed benchmarking activities to identify best practices for university technology commercialization," she explains.

Rivera notes that while CWRU already maintains a robust web presence and publishes an inventor's manual for faculty, the initiative is obligating CWRU and the other participating universities to be even more transparent. "We have now taken the additional step of loading our agreement templates onto the web so that potential partners can see the template language that frames the customary discussion points for the university in a negotiation," she says. "We hope this will take the mystery out of the process and speed up time-to-agreement execution."

**Mathew Willenbrink**, director of the Technology Partners Office for the University of Dayton, the other private university participating in the initiative, also notes that the new statewide effort has similarly pushed his institution to simplify processes and invite engagement. "In an effort to be more transparent, we modernized the front part of our website, [which contains] the entry points for our various constituents," he says. "We thought all of our procedures were in great alignment [with Ohio IP Promise], but it really helped us clarify that, and publish to the outside world that we have become a little bit more transparent and it is easier to find our information."

One important aspect of the effort that sometimes gets overlooked is a push for univer-

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sities to internally streamline the process between their TTOs and general counsel approval, observes Willenbrink. "Some entrepreneurs have said in the past that this is a challenge for them. They negotiate with TTOs and things seem to be proceeding normally, but then things get held up at the individual general counsel offices for one reason or another," he says. "So a big part of the Ohio IP promise is for schools to ... make sure there is a pretty minimal amount of hold-up between the general counsel and technology transfer."

Willenbrink notes that the University of Dayton has an added advantage with respect to this particular issue because he is both the director of technology transfer at the school and a member of the general counsel's office, so he gets to do the direct approvals for TTO deals. "However, it has been very helpful to enter [this initiative] because it has helped us clarify and modify our procedures so that they are in alignment with the best practices in the state."

Willenbrink adds that as a private school, the institution was under no pressure to join the initiative. "It was really a public effort, and we specifically asked to be a part of it because we saw the power of it, and how important it was to get all the [major research universities] in the state together," he says. "Not only did we [choose to participate], Dayton also took a leadership position in helping to form the Ohio IP Promise."

### ***Make it easy to engage***

Even OSU, with its vast resources and experience in technology transfer, has found new ways to make it easier for stakeholders to engage, and these improvements are having an impact. "On our website now, there is one page you can go to where you can find everything from our patent/technology license agreements and sponsored research agreements to technology licensing guidelines and faculty-creator start-up guidelines," Taylor reports. "Many, many times over the past three weeks we have been able to point our customers and important stakeholders to that page and to those materials that, prior to this [initiative], they didn't have access to."

In the past, people would have to go to multiple places to get the information and resources they

needed, notes Taylor. "We have made it much easier for them to access the information, and there is information that is available that was never available before," he says. "From that standpoint, I think the early success is the fact that we are getting asked for information and we are able to direct people in a very simple way to material that is transparent and very accessible. That alone is going to help bring people into the process and help move things forward."

Taylor notes that there was value in having all the research officers from participating universities get together and align around how to best advance research commercialization activity. "It was really powerful, and it allowed us to share best practices with one another and to collaborate more effectively," he says. "I think ultimately that is going to pay great dividends to the inventors associated with the universities in Ohio."

There is added strength in tackling technology transfer improvement as a large group, observes Pinski. "Doing this together gives us all visibility and an opportunity to remind the rest of the country that, hey, we are doing this," he says. "You can see we are being aggressive, thoughtful, and trying to push the needle as far as we can to explore how to commercialize technologies."

Willenbrink agrees, stressing that this is just the first step in a multi-step process. "This is announcing to those people who were flying over [the region] that Ohio is open, ready for business, professional, and ready to serve your needs on your terms," he says.

So what do steps two, three and four entail? That isn't yet clear, but further action will be based on results, suggests Taylor. "We have made it clear all along that we are committed to continuous improvement, and inherent in continuous improvement is measuring how you are doing with your current approach and looking for ways to make the customer experience better and to drive better outcomes," he says. "We are committed to staying tightly coupled with our customer base and stakeholders, measuring the effectiveness of what we are doing and continuing to challenge ourselves to make the customer experience as good as possible, and to make it as easy as possible for technologies to be transferred out of the university so that they can have impact on people."

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## Don't lose your university's IP to faculty "consulting time"

It's the response that tech transfer leaders never want to hear when approaching a faculty member about intriguing new intellectual property: "Oh, I did that as part of my consulting work for a company. It wasn't done on university time."

As most tech transfer professionals can attest, heated disputes can arise when university leaders do not agree. Ugly, expensive litigation can result. Even if the university prevails in the end, relationships with faculty and outside companies can be irretrievably broken. That's why tech transfer leaders should take extensive precautions to avoid such disputes, which will require carefully constructed policies and written agreements.

With the changing nature of the workplace, particularly the 24/7 workday and the ability to work remotely, "university time" becomes more and more difficult to define, says **Sally L. Byrne**, JD, partner with the Culhane Meadows law firm in Boston, MA.

In addition to inventions conceived or developed on "university time," the university should seek ownership for inventions that were developed using the university's resources, she says, regardless of faculty's claims of "when" they were conceived.

It is well worth the effort to avoid ownership disputes through proper policies and procedures, adds **Jeffrey B. McIntyre**, JD, partner with the Oblon, McClelland, Maier & Neustadt law firm in Alexandria, VA. Companies will understandably try to claim ownership of IP if they paid for the research in a consulting agreement, and universities tend to take a broad view of how their faculty use their work hours.

Both sides may refuse to budge, especially when there is the potential for a significant payday stemming from the IP.

"When it does happen, it's a mess. You have to come to some type of settlement about the rights, but at that point the toothpaste is out of the tube," McIntyre says. "Nobody's going to be truly satisfied in the end, and you will just wish you had taken steps to avoid that kind of confrontation."

Once a dispute arises, the university is at a disadvantage, McIntyre says. The company may have much more to gain from revenue generated by the IP than whatever the university would earn in licensing it, he says, and the company may already have deeper pockets and more willingness to pur-

sue litigation. Unless the prior agreements are very clear about ownership, the university can face an uphill battle in the courtroom, he says.

### **Start with IP policy**

The risk of disputes can be minimized with a solid IP policy, Byrne emphasizes. The university should have a written IP policy that clearly defines the scope of IP that the university owns, requiring faculty members to assign and promptly disclose any inventions to the university. That policy could also include a dispute resolution process for resolving disputes relating to IP, she says. The university also should require each faculty member to sign a written invention assignment agreement on the first day of their employment, Byrne adds.

"This is critical because, as a general rule, absent an express assignment to the employer, the inventor will be the owner of the invention. There's an exception if the employee was hired to invent, and the subject invention is the type of invention that the employee was specifically hired to invent," Byrne says.

Those policies and procedures are widely followed already, but she advises taking further protective measures. "The university should also require the faculty member to sign an invention-specific assignment before the patent application is filed, and possibly also when the disclosure is first submitted to the university. The university should have procedures in place, such as routine audits, to be sure that it has written invention assignment agreements on file for all faculty members."

### **Clearly define consulting**

That still leaves the issue of consulting time. To address it, the university should have a written policy that clearly describes the outside activities permitted for faculty members, Byrne says. It should define the amount of time that the faculty member can spend on outside activities and should state that all outside activities must be consistent with the policies and objectives of the university, she says.

"Some universities require faculty members to obtain permission before entering into a consulting arrangement and/or to provide status updates at predetermined intervals. Some universities go further and require faculty members to disclose all inventions to the university, even those that might not fall within the scope of university-owned IP, subject to the university entering into an appropriate confiden-

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## Consulting time

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tiality agreement,” Byrne says. “This could alert the university to any potential problems.”

Byrne notes it is helpful if the outside activities policy describes problems that can arise when the faculty member enters into a consulting agreement with a third party, such as how the consultant could inadvertently bind the university, the consulting researcher could end up assigning university IP to the third party, or the faculty member could agree to non-compete language that would prevent him or her from fulfilling his or her obligations to the university.

Some universities have standard clauses that the faculty member is advised to include in all consulting agreements, Byrne says. These clauses put the third party on notice that the faculty member has obligations to the university that supersede the faculty member’s obligations to the third party and helps to avoid some of the problems noted above, she explains.

### Check for IP disclosure

When a faculty member’s employment ends, the university should seek confirmation from the faculty member that he or she has disclosed all inventions that require disclosure under the IP policy, Byrne advises. The university also should have

training programs to ensure that the faculty members understand the policies, she says.

There are some legal limitations on how much you can restrict consulting work, Byrne notes. A handful of states -- California, Delaware, Illinois, Kansas, Minnesota, North Carolina -- have limits on the types of inventions that an employee can be required to assign to the employer, she says. For example, California does not enforce assignments of employee inventions that an employee developed entirely on his or her own time without using the employer’s equipment, supplies, facilities or trade secret information except for those inventions that either relate -- at the time of conception or reduction to practice -- to the employer’s business or actual or demonstrably anticipated research or development or result from any work performed by the employee for the employer.

The university should look to its own state law to determine whether limits apply, she advises.

### Keep it separate

Separation is key to avoiding ownership disputes, McIntyre says. This includes separation in every way, not just conceptually but also physically.

“Separate notebooks, separate files in your computer system. You’re trying to create some line

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## Incentivize researchers to avoid ownership disputes

If you don’t want researchers to improperly claim promising IP was developed on consulting time, provide them with the incentives to focus their best efforts on their university work, suggests one entrepreneur.

That will mean allowing researchers to do what they prefer to do, says **JiNan Glasgow George**, a former USPTO patent examiner and engineer turned entrepreneur in Durham, NC. Many researchers want to be able to focus on their research and still be rewarded financially for their efforts, she says. That can be the appeal of consultancies.

“Ultimately it’s about alignment of interests. We have to allow researchers to do what they prefer to do, and for most of them that means research, not learning how to become an entrepreneur,” Glasgow George asserts. “Allow the researchers to benefit from commercialization with the right incentives, from licensing and revenue sharing with researchers in the right amount, and they won’t be as tempted to spend their time on consulting that can lead to ownership disputes.”

Tech transfer leaders sometimes feel they are fulfilling that need by encouraging researchers to commercialize their own IP through start-ups, but for many faculty members that is not an appealing option, she says. A sig-

nificant proportion of tech start-ups fail because researchers were pushed into entrepreneurial positions they didn’t want and weren’t qualified for, Glasgow George says, but the faculty may have felt that was their only real option for reaping financial benefits.

Faster licensing also can help, she says. Faculty researchers often complain that licensing deals take too long to work through the tech transfer office.

Researchers also need good communication from tech transfer, particularly after disclosure of IP, she says. A researcher who feels like the tech transfer office is working in partnership to make the most of the IP will be less inclined to work around the edges of the system to find rewards in consulting.

“If there is trust and a track record from the tech transfer office, then researchers will be confident they can get a return on their invention through the office and the disclosure. That hopefully will prevent a lot of claims that the IP came through consulting work,” she says. “This has a lot to do with the culture of the university and the tech transfer office. Does it allow the faculty and researchers to keep the role they want and not carry the burden of commercialization?”

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## Consulting time

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of demarcation of what is being done for the private sector,” he says. “This will benefit both parties in the end, because if the work truly was done on consulting time, that clear separation will show that and there won’t be any dispute to argue about.”

The faculty member should be clear about the nature of any consulting research, and the university should insist that the scope of the research be narrowly defined, McIntyre says. Of course, that scope should be defined in writing.

“If everyone is clear about the very limited scope of the research using compound X for purpose Y, and the IP in question involves something else, there can’t be much of an argument,” he contends. “You have an agreement you can point to, and if it’s narrow and specific in describing the research, the answer should be clear.”

Universities also can reduce the risk of these disputes by properly incentivizing faculty and making clear that they can reap rewards from the university licensing their IP, McIntyre notes. They may then be more likely to keep research narrowly focused in consulting agreements, keep records separate, and notify the university of IP opportunities, he says. (See the story on p. 150 for more on incentivizing faculty.)

“You want to avoid situations in which the faculty member’s only interest is in getting the consultancy money, because he thinks that if the university owns it he won’t get any rights,” McIntyre says. “If faculty think their paychecks from the university are the only reward they get for developing IP, they are not going to be motivated to do the things that keep that IP under the university’s control.”

### Peel the onion

Disputes about ownership may require investigation after the fact, says **Paula Estrada de Martin**, PhD, JD, a life sciences and biotechnology patent attorney with the law firm of Baker Donelson in New Orleans, LA. The university can dig into the work habits and research details to help determine whether the work was done on university time or consulting time, she says.

“When you peel back the layers of the onion, you might find out that, well, really, the faculty member was using the campus e-mail, doing some preliminary research in the university lab, and contacting the company during work hours,” she says. “Some of this can be avoided by checking in with

the researchers while this is going on, making sure that they’re staying within the parameters of the consulting agreement. The most prolific researchers are the ones you want to monitor most closely.”

Estrada de Martin’s law firm provides seminars to faculty investigators at some client universities on how to avoid ownership disputes, pointing out to them that proper agreements and work division procedures protect their interests as well as the those of the universities and the companies.

“Anything you can do to address the problem up front will be time well spent,” she says.

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## Guest Column

*Equity should be budgeted to avoid over-dilution*

### Beware of employee equity, the credit cards of the venture community

By **Dror Futter**

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When hiring venture executives and employees in the early stages of a university start-up, the buzz centers around equity. For successful ventures, these equity rights, often issued when the equity is worth pennies a share, hold the potential of delivering great wealth to those fortunate enough to receive them. However, there is an often ignored drawback to equity compensation -- simply stated, it is the credit card of the venture world. As opposed to salaries that directly impact budgets, equity grants are “painless” and only upon exit of the venture does the true cost of the grants become apparent.

The painlessness of equity grants makes it a very

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tempting compensation tool for cash-strapped early-stage start-ups. But these ventures often risk making outside equity grants to employees who, while important in the short term, will not have a significant long-term impact on the company. Many ventures fail to recognize that equity needs to be budgeted and, as a result, “spend” too much too early, leaving less available for additional grants to round out the leadership team and make other critical hires.

For university spinouts that often need to hire a large part of their future executive teams, mistakes in early equity grants can unnecessarily dilute founders’ and university’s common stock positions.

To understand the impact of dilution on a founder’s stake, **Figure 1** shows a hypothetical ownership summary that reflects typical ownership through financing rounds and how the dilution plays out. As the figure shows, while the nominal value of the founder’s stock is increasing, even in a successful venture, the founder’s ownership percentage declines steeply as a result of dilution. In the hypothetical, the company has raised a total of \$41 million in four funding rounds. Each of the funding rounds represented an “up round” where the pre-money represented a significant increase from the post-money valuation of the prior round. Yet the founders’ share dropped from 30% to 12% -- in other words, a smaller piece of a larger pie.

The average successful tech start-up exits for \$240M after a series of raises totaling approximately \$40M of capital. This amount of capital is typical of the industry, and it is distinct from the need to refresh the start-up’s option pool across each financing.

The purpose of raising capital can be evaluated across three categories that fuel a start-up engine into wild success: 1) value inflection; 2) employee compensation; and 3) growth. Venture investment is a double-edged sword: by accepting investment, a founder loses control and ownership; but without investment that same founder cannot feed the engine that creates value. Driving a start-up through a value inflection point can be achieved through both quantitative and qualitative milestones, but it should be simply thought of as the means by which a \$1M investment can create a large valuation uptick in a subsequent

fundraising round. In most companies, employee compensation is the largest expense, and certain skillsets and geographies garner surprisingly high salaries. Lastly, fueling growth with investment capital is the tool that allows companies to expand their team, footprint, facilitation, and marketing.

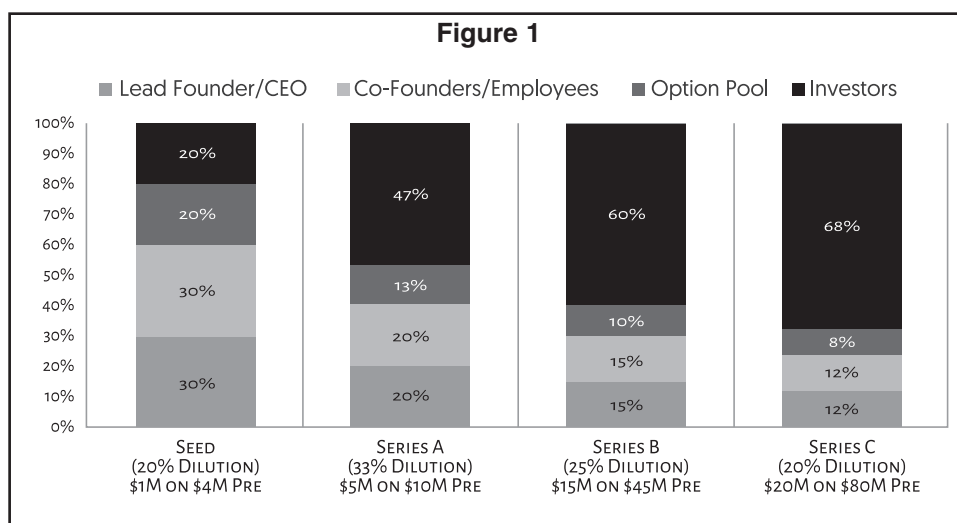
In the typical funding and exit described in the hypothetical, the founders, founding team, and employees were diluted over time. While 12% of a \$240M exit is definitively a life-changing event, the path to even larger personal upside can only be achieved by reducing dilution and increasing valuation.

The dilution equation is simple ( $\text{\$-raised}/\text{\$-valuation}$ ), but the implications of driving the numerator to \$0 or the denominator to unicorn status is much more nuanced. When founders are building their cap tables, they should think about how taking more dilution will ultimately create a bigger pie to take a slice of down the road. For founders and their university tech transfer partners, this dilution can be exacerbated by poor choices in equity grants to employees.

### Holistic approach to compensation

Ideally, employee compensation should address three goals -- recruitment, performance and retention. When on-boarding employees, ventures have several economic “levers” at their disposal, each of which serves as a different form of incentive. While the true cost of equity grants is often deferred to exit, ventures should balance these levers to achieve the goals of compensation, while minimizing the size of dilutive equity grants. A company’s primary levers are:

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- **Base Compensation** -- Start-ups typically can pay less than their established peers because of the equity compensation usually provided. However, it is important that this compensation be competitive with other start-ups in the same geography and that it meets the basic “living wage” requirements of recruits.

- **Benefits and Perks** -- This is often where ventures try to distinguish themselves in recruiting. Ping pong tables, beer on tap, gym memberships, etc. are viewed as relatively inexpensive ways for ventures to set themselves apart. However, these benefits can add up to substantial sums of money and are typically the first things eliminated by struggling ventures.

- **Bonuses** -- Less common for early stage companies (except for sales professionals who often work on a partial commission basis), bonuses are very effective in driving employees towards discrete, shorter term goals. It is critical that the basis for the payment of a bonus or commission and the timing of the payment is clearly laid out.

- **Equity** -- Granting equity to employees and other service providers has two main goals. First, it creates long term alignment since all recipients are incentivized to increase the value of the company as a whole rather than meet narrow metrics. Second, since equity is often granted subject to multi-year vesting, it creates a cost for leaving the company which serves as a form of golden handcuffs.

## **A more detailed look at equity**

Equity grants can take several forms, the most common forms are:

- **Stock Options (Incentive Stock Options (ISOs)/Non-Qualified Stock Options (NQOs/NSOs)**

-- Employees are given the option of purchasing common shares of the company upon the payment of an option strike price equal to the fair market value of the stock at the time of grant.

- **Restricted Stock Awards** -- These are actual grants of shares in the company, usually subject to a company repurchase option (reverse vesting) and transfer restrictions. These grants are taxed immediately as income and as a result, they are usually made only when the granting company has minimal value.

- **Restricted Stock Units** -- These units are issued to an employee through a vesting plan after remaining with their employer for a particular length of time. RSUs give an employee an interest

in company stock but they have no tangible value until vesting is complete. The value of the stock received at the completion of vesting will be taxed as ordinary income.

- **Stock Appreciation Rights** -- The recipient is not actually given shares. Instead the recipient receives a contractual obligation from the employer to make a payout equal to the value of the appreciation of a specified number of shares upon the occurrence of a specified event or the passage of a specified period of time.

*(Editor's note: For a chart that describes each form of equity grant in greater detail, please go to <https://rimonlaw.com/employee-equity>.)*

Options are the most common form of incentive for venture-backed companies. However, when company valuations are still low, restricted stock awards offer certain tax advantages. Restricted Stock Units tend to be granted more frequently by later stage companies. There are several concepts that apply to all equity grants:

- **Tax “Clock”**. When it comes to equity grants, founders should be aware that they are working under a ticking tax clock. Assuming the company increases in value, its share price is increasing as well. This impacts both stock and option grants. If stock is granted to an employee, it must be reported as compensation to the employee. As a result, the employee will have an immediate tax liability upon receipt for the fair market value of the stock. The exercise price of a stock option has to be set at the then current fair market value of the stock or it may be considered deferred compensation under Section 409(a) of the tax code. Assuming the company is increasing in value, the longer a company waits to grant an employee option, the higher that tax will be for stock grants and the higher the strike price will be for options. Companies also have to be careful that stock/options are valued on the date the grants are actually completed. It is not uncommon for companies to delay formally documenting grants, and back-dating grants can have serious legal consequences.

- **Vesting**. To achieve the goal of promoting employee retention, equity grants are usually subject to vesting. Vesting is implemented in different ways for stock grants and options, but the goal is the same -- at the point where vesting ends, an employee leaving the company before the end of the vesting period will generally suffer an adverse consequence with respect to the unvested portion of the equity/options. Under certain circumstances, the adverse consequence is extended to vested shares.

*continued on page 154*

Although there is no legally required vesting structure, the most common vesting structure is known as "4 years with a 1 year cliff." Under this structure, the shares remain unvested until the first anniversary, when 25% vests. The remaining 75% vests in equal monthly installments over the following three years. In situations where the employee has already worked a significant period of time before the grant of equity/options, a portion of the grant may be fully vested immediately.

**Budgeting equity**

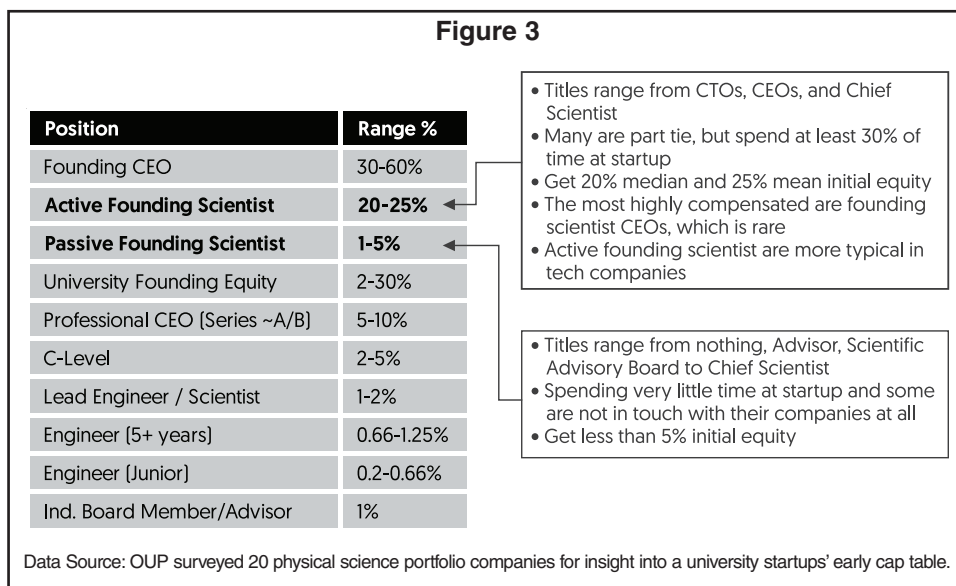
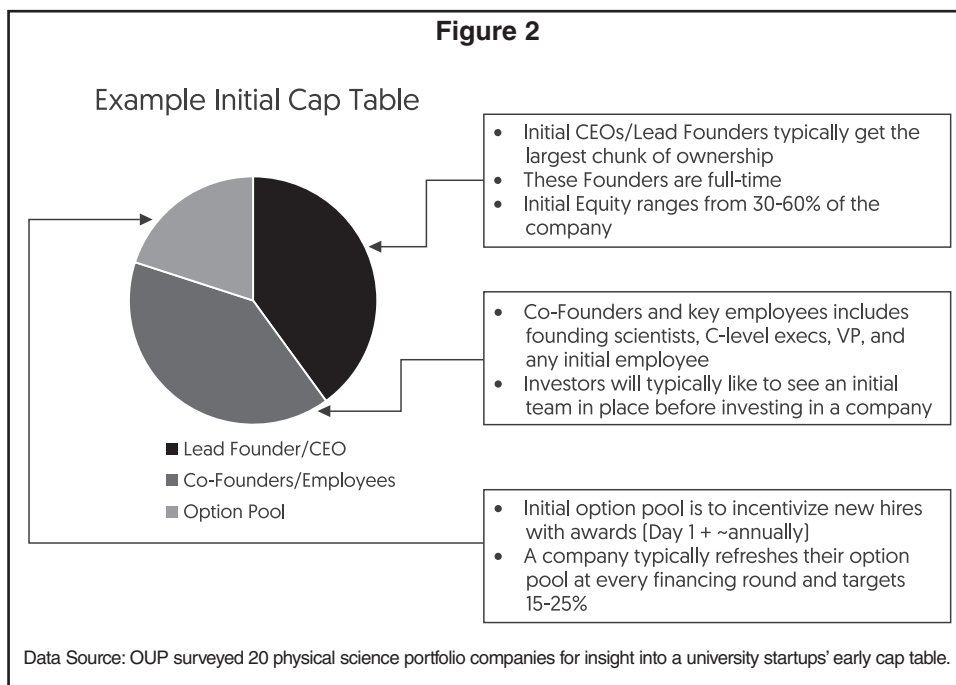
So, how should a university start-up allocate equity across its founders? **Figure 2** shows a breakdown of the typical initial founder's split in a physical sciences company. **Figure 3** provides a more detailed breakdown of typical pre-financing equity compensation per employee level for a university spinout.

What is most noteworthy about this chart is the relatively small grants given to employees below the C-Suite level. These ranges should be kept in mind by ventures making grants to early hires. Even if a web designer is critical to the initial success of a venture and is willing to work for below-market wages, the individual has skills that in most cases are easily replaceable in the future. As a result, a grant of even 0.2% equity may be over-generous and unnecessarily deplete the equity budget.

On the other hand, the chart makes it clear that not all members of the management team are created equal. In most start-ups with two to four founders, there is often one charismatic leader who should be incentivized with a disproportionate share of equity. This Lead Founder/CEO typically receives the largest chunk of ownership, around 30-60%. If there is no CEO or lead in place, part of this piece

would be set aside for a CEO who is brought on later. Co-founders and other key employees such as founding scientists, C-level executives, VPs, and initial employees should share in approximately 40% of equity allocation. The remaining ~20% option pool should be preserved for future hires. At each round of financing, the option pool should be refreshed (dilution!) to 15-20% until a full C-Suite has been hired. Employee options are issued throughout the lifecycle of the company to employees to fight against dilution. It is challenging to maintain employees at a high equity level throughout the course of a start-up, as there are few instances where you can significantly top off an employee's equity piece.

*continued on page 155*





**Equity** continued from p. 154

The Founding CEO is someone who intends to stay with the company over the long haul, carrying it from launch to exit. An Active Founding Scientist can be a principal investigator or graduate researcher who has developed the technology at a university, or a PI who bucks the norm and commits to taking leave from the university for two to three years. The Active Founding Scientist commonly assumes the role of CSO and CTO and leaves university for at least one year on sabbatical to work for the start-up full-time.

By contrast, a Passive Founding Scientist may only be involved once a week or once a quarter with the company. Very rarely, the Active Founding Scientist has the temperament and bandwidth to run as a founding/first/interim CEO, and should be rewarded with equity akin to Founding CEO. Despite their life's work being a part of the start-up's mission, most faculty fall into the category of Passive Founding Scientists, which typically should only be rewarded with 1-5% equity to create a clean cap table.

What is the value in having a founding scientist on the team and on the cap table, especially if his/her involvement would be limited? Once the founding scientists return to the university, their time is best spent on strategic efforts like hiring, R&D, or broad business relationships; assigning an operational role to a part-time employee would be unrealistic. Keeping a founding scientist on the cap table not only allows access to new developments in that lab in the related space, but more importantly to a pipeline of students from the lab. In addition, founding scientists often have high research connections with major companies that will trigger research collaborations and/or commercial agreements for the start-up. An affiliation with the university and high-profile researcher can help the company with fundraising and customers as well.

### **Not one-size-fits-all**

Start-up compensation is not a one-size-fits-all proposition. It depends on many factors such as the financial situation of the venture and its future financing needs, the market for talent in which it competes, and the prospects -- real or perceived -- of the venture. What founders and other holders of common shares, such as universities [via their TTOs], need to keep in mind is that similar to credit card debt, poor use of equity has a cost -- most of it borne by the common shareholders. Ventures

should use all compensation tools at their disposal that create the right balance of incentives and current versus future costs.

*The authors wish to thank Manny Stockman and John Lee of OUP for their help and expertise on sections of this article that pertain to equity budgets and appropriate equity allocation for early stage university startup companies.*

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## **'Executives into Business' program offers pay linked to key milestones**

Northern Accelerator -- an innovative partnership among a network of UK universities in England's North East -- Durham, Newcastle, Northumbria and Sunderland -- is driving a step-change in research commercialization. Connecting academics and business leaders and providing funding and business support, it's accelerating the translation of outstanding research into commercial opportunities, forming sustainable businesses and creating more and better jobs.

While Northern Accelerator is now a broader program of support backed by £4.9 million from Research England's Connecting Capability Fund, it started life as a £0.9M ERDF (European Regional Development Fund) funded project at Newcastle and Durham universities, helping potential spin-out businesses engage high-quality business leaders at an early stage. Its 'Executives into Business' program continues as a core part of Northern Accelerator today.

### **Finding quality management**

University researchers typically produce around 100 disclosures annually across Durham and Newcastle universities. Of these, typically 10 to 15 represent strong commercial opportunities for which the university would look to build a business case to spin out a company. Only a few of these achieve long-term commercial success, and two of the key stumbling blocks -- as any TTO can attest -- are finding quality leadership, and the related ability to secure investment.

*continued on page 156*



Recognizing this challenge, Newcastle University adopted an ‘acceptable management solutions’ policy five years ago. To spin out a business, one of the following solutions must be adopted:

1. One of the founder academics chooses to leave the employment of the university to become CEO or equivalent of the spin-out and the university agrees that the academic has the necessary skills to be a success in that role; or

2. The founder academics continue to pursue their academic careers together with an agreed-upon (time and terms) involvement with the spin-out. The university, in consultation with the academics, identifies and recruits an external CEO.

While the second option was much preferred, funding restrictions meant universities traditionally attracted executives to spin-outs through ‘sweat-equity,’ providing shares in the business for time invested, which is a viable option only for a few candidates.

Northern Accelerator overcomes this challenge of attracting experienced, talented business executives during the pre-incorporation phase, offering the executives remuneration in addition to traditional ‘sweat equity.’ The school’s unique ‘Executives into Business’ model proved highly successful, attracting a strong pool of candidate executives from an international base, bringing a diversity of approaches and expediting access to investment.

Under the model, financial reward is available to executives for achieving key deliverables -- for example, business plans, commercial contracts, or investment secured -- which de-risks their participation. Used alongside sweat equity, this has broadened the candidate pool, improving early-stage access to experienced, high-quality management, which in turn has improved investment readiness.

### How are execs recruited?

Through active networking, Northern Accelerator has attracted executives from beyond the region and from outside of the university innovation environment. Potential executives register their interest online via a Dynamic Purchasing System hosted by one of the partner universities.

“We look for candidates to articulate their relevant experience, and they are then approved to join the ‘Executives into Business’ candidate

pool,” says **Roy Sandbach** OBE, chair of Northern Accelerator’s Advisory Board.

When a spinout opportunity arises, it is shared with the candidate pool. Candidates can then bid for the opportunity, and applications are reviewed by a panel including tech transfer experts from the relevant university and the academic founder.

### Key milestones and remuneration

Northern Accelerator’s funding allows the program to offer executives up to £30,000 in addition to shares in the business. Executives are paid on delivery of key milestones. While this is negotiated in each individual case, it typically looks like the breakdown shown in **Figure 1**, with payouts occurring at completion of a business model, university approval, legal documents, and initial capital raised.

The amount of equity offered to the incoming CEO is negotiated and differs in individual cases, but is also typically pegged to achievement of key milestones, increasing as each goal is reached.

### Impressive results

Northern Accelerator has transformed spin-out activity at Newcastle and Durham universities, increasing the number of spin-out businesses from an average of 1.8 per year in the five years preceding the program, to 10 spin-outs in the 2018-2019 academic year alone. Though Sunderland and Northumbria do not yet have as established a history of research commercialization, adding them to the network and establishing a collaborative approach has deepened pre-existing relationships and was vital to securing funding to develop the broader Northern Accelerator program.

The program succeeds on multiple levels, de-risking spin-out opportunities for executives, enhancing access to networks, business experience and investment for the fledgling companies, and

*continued on page 157*

**Figure 1: Typical milestones**

	Equity %	Fee
Production of viable business model	5%	£10-12.5k
University approval	2.5%	£2.5k
Spin-out legals completed	2.5%	£2.5k
Seed capital raised	5%	£10-12.5k
<b>TOTAL</b>	<b>15%</b>	<b>£25-30k</b>

## Milestones continued from p. 156

benefiting the wider local and national economies.

When the Northern Accelerator first launched, the North East of England had the lowest business density in the UK and low levels of private sector research and development investment. Today, the proportion of R&D spend from university research is well above the national average and research commercialization is a key contributor to growth.

The network has produced two recent and notable spin-out successes -- Magnitude Biosciences, a fast and reproducible system to test compounds for aging, spun out of Durham in 2018, and Atelerix, Northern Accelerator's first spin out. Based on Newcastle research, it offers novel technology for the safe storage and transport of viable cells.

Atelerix's CEO, Dr. **Mick McLean**, was recruited through the project's Executives into Business program. He's a chemist by training, a biologist by inclination, and a businessman by experience.

"Atelerix is an excellent example of the clear benefits of Northern Accelerator. By combining Mick's business skills with the technical excellence of the scientific team's world leading background research, we created a brand new technology business that is making a real and significant commercial impact," reports **David Huntley**, head of company creation at Newcastle.

### **Cultivating an investment pipeline**

Northern Accelerator is now a wider initiative. 'Executives into Business' remains, and the schools taking advantage of it are enhancing access to networks, business experience, and investment sources.

In addition, an 'Ideas Impact Hub' encourages academics to embrace commercialization opportunities, providing training on recognizing and exploiting intellectual property.

Similarly, while pre-incorporation funding takes research closer to commercialization, the Accelerator also offers an 'Innovation Assessment' -- a business readiness diagnostic that helps provide robust due-diligence. Also available is a pot of seed funding money designed to help spin-outs validate their business model and demonstrate value to investors.

The overall vision, Sunbach says, is sustainable impact and fundamental change in the region's innovation ecosystem, developing an ongoing VC fund for spin-outs and a vibrant Northern Accelerator 'alumni' community.

Sunbach is passionate about its potential. "It's

a game-changer for the North East economy, a vital contribution to strategic economic plans and a national exemplar," he says. "It connects world-class university research with proven business expertise, creating viable enterprises that contribute to regional prosperity."

Contact Huntley at [David.Huntley@newcastle.ac.uk](mailto:David.Huntley@newcastle.ac.uk); contact McLean at [mick.mclean@atelerix.co.uk](mailto:mick.mclean@atelerix.co.uk). ►

*Berkeley, Princeton create new leadership positions*

## **Does your university need an innovation czar?**

Universities have been focusing on innovation and entrepreneurship for many years, forming complex research partnerships with major corporations, building incubators and accelerators, hosting an array of competitions, launching and funding start-ups, and encouraging researchers to focus on the commercial potential of their work. On top of all this, some schools -- such as Princeton University and the University of California, Berkeley -- are trying to unify these efforts and reach an even higher level by creating new academic leadership positions.

Princeton recently appointed **Rodney Priestley**, professor of chemical and biological engineering, as the university's first-ever vice dean for innovation, effective February 3, 2020. Meanwhile Berkeley has appointed **Richard Lyons**, professor of economics and finance and former dean of the Haas School of Business, as its first-ever chief innovation and entrepreneurship officer (CIEO), effective January 1, 2020.

### **Fulfilling mission-level goals**

Priestley notes that the philosophy behind his position correlates with the informal motto of the university: "In the nation's service and the service of humanity." As vice dean for innovation, Priestley's focus, he says, will be enhancing innovation and entrepreneurship so the university can share its innovations for the benefit of society.

Princeton has already made considerable progress in building its innovation ecosystem, including creation of the Princeton Innovation Center, a co-working space for start-ups. The university has seen a significant increase in corporate research funding, doubling those dollars in between 2014 and 2018 and establishing partnerships with

Google and Microsoft. “There are many things that are moving in a positive direction, so we thought the time was right to provide academic leadership for innovation and entrepreneurship,” says **Pablo Debenedetti**, Princeton’s dean for research.

Priestley notes that his position will build on what is already an exciting time for innovators at Princeton, where faculty and student start-ups are on the rise. “We recognized the need to create this position to continue to provide for that growth,” he comments. “Also, to steer it in the right direction so it continues to grow.”

It’s a similar view that led to Lyons’ position at Berkeley, where “the ecosystem for entrepreneurship and innovation has evolved tremendously,” Lyons says. He calls the research-driven entrepreneurship there “a wonderful institutional asset that goes up in engineering or business or law, and we connect them a little bit here and there in an ad hoc way. We have technology licensing, and it’s getting stronger and better. But people wanted to know, where is the remaining headroom? What kind of things can we do to pull [everything] together in fresh ways?”

His new position, he explains, “was set up on an abstract notion that we’re a lot better than we used to be, but we feel like there’s still maybe some boundaries that need to be spanned, and also, some new terrain that we might want to go after.”

### **Stronger academic leadership**

The positions at both Princeton and Berkeley are intended to enhance academic leadership in the context of innovation and entrepreneurship. “Princeton is an institution that has very strong faculty governance and initiatives [that] come from the faculty,” Debenedetti states. “[We want to] enhance and build the momentum. For example, we have a very good corporate engagement [group]. We have a very good office of technology transfer, and a lot of the good work that they do is reflected in the statistics on industry funding for research. But providing an academic face and academic leadership makes a big difference on this campus, and that’s what we didn’t have. And so, it will give an entirely new visibility to the activities that are going on and the ones we want to establish.”

Priestley notes his desire to promote greater participation in innovation and entrepreneurship by faculty and students. “One of the things we’d like to do out of this office is more motivation, more encouragement,

more recognition that would create, in addition to the activities that are undertaken, somewhat of a cultural change with respect to how we view ourselves in the framework of innovation and entrepreneurship.”

Lyons explains that at Berkeley, faculty think of themselves primarily as research scholars. Those who think of themselves as inventors or start-up entrepreneurs remain on the periphery. For many researchers, he notes, commercialization activity “is outside the bounds.” But, Lyons also quickly clarifies, “that’s not true of every faculty member at all. There are a lot of terrific scholars who are terrific entrepreneurs, and their identity bounces back between one and the other.... But there’s still a little bit of, ‘we’re scholars first.’”

Lyons’ goal, he says, is to make it “cooler” to be an inventor at Berkeley, and that task is made easier when it’s driven by an academic, rather than from a TTO or other non-academic unit.

### **No threat to blue-sky research**

While the creation of these positions is intended to increase the momentum of commercialization activity among faculty at both universities, fundamental research will also continue to be valued. “This is not a zero-sum game,” Debenedetti stresses. “We’re expanding the horizons of what is possible and encouraging certain activities in addition to, and not at the expense of, other [activities]. Some departments do very, very fundamental research that is not always research with a connection to the industry. What comes to my mind is mathematics. We have one of the world’s great mathematics departments, and we’re delighted that it is the way it is. This initiative aims at broadening activity and providing opportunities, not telling people what they have to do.”

Lyons makes a similar point about the initiative at Berkeley. “Inventor-centric does not mean that humanities and liberal arts don’t matter anymore,” he comments. “It’s just that we have great inventors on campus, and we’re not telling a story fully enough. And maybe there are certain things they need that we are not providing. I think at the very least I can help do that. Maybe it just gives the inventors a little more voice in some of the things that are important to them.”

### **Motivating faculty**

Priestley and Lyons both see providing more recognition to inventive faculty as one of the keys to

*continued on page 159*



their agendas. "The university [could] project to the faculty that it recognizes entrepreneurship as something central to the university's mission, central to the education [mission], and central to the research and scholarship [mission]," Priestley suggests. "Recognizing faculty at the highest levels helps to motivate other faculty to pursue a similar path."

Lyons adds that such recognition can be applied not only to patents and technology advances, but to all forms of the faculty's intellectual creativity that translates into societal benefit. As one example, he cites faculty who write textbooks that are used by thousands. "That's not to say that I'm going to be focusing on textbook writing," said Lyons. "My point is that just having a vision statement helps you to see things like this. It would be very easy to start celebrating the faculty on the Berkeley campus who have the highest-impact textbooks as having done a wonderful thing. We don't celebrate them. We don't even talk about them. We don't know who they are. That's part of the kind of culture shift here, making sure that we're celebrating the things that are just so valuable."

Sharing the successes of inventive faculty with others is another way to help shift the culture, Lyons adds. "I'm going to become the chief storyteller. I want people to see the magic that I'm seeing. People don't have a line of sight into this world, and it should be a source of great pride in what this institution is bringing to society."

### **Defining the position**

Though neither of the "czar" positions have existed previously, both Lyons and Priestley have a firm grip on where they'll be focusing their activity.

Lyons described three broad domains that he will be interacting with: patenting and licensing, the entrepreneurship and innovation ecosystem, and corporate partnerships and relationships.

Lyons will be looking at high-level, broad parameters of patenting and licensing -- for example, whether Berkeley should be participating with equity in more licensing deals. "I'm not going to be in there negotiating a tougher licensing agreement next week," he said. "That's not in this job. It's more about these broad strategic parameters like equity participation."

Domain two of the three Lyons outlined is the innovation and entrepreneurship ecosystem. Berkeley, like many universities, has multiple accel-

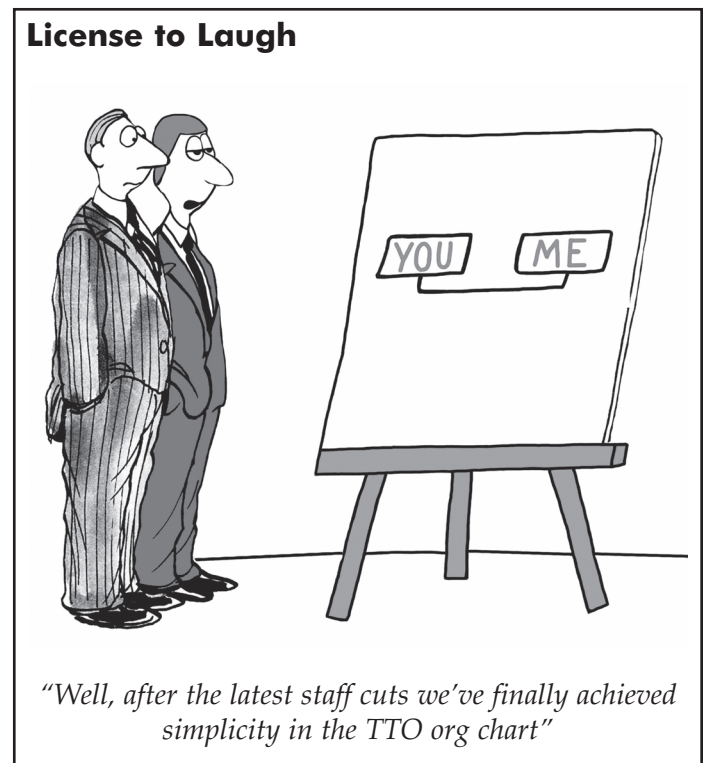
erators, incubators, venture funds, and mentoring programs. As Lyons notes, all of these pieces of the ecosystem do not always work together. "The idea is not that we need more accelerators," he said. "The idea is, how do we pull it all together and make it something more than the sum of its parts? And then maybe see some gaps."

In terms of industry partnerships, Lyons will be bringing his business school background and existing relationships with industry to help deepen the school's corporate ties. He also notes that industry-sponsored research could be enhanced just by getting the right people talking to each other at the right time.

Commenting on Priestley's expected role, DeBenedetti said "the vice dean for innovation will hopefully encourage and motivate more faculty to engage in entrepreneurship activities and will facilitate ways in which researchers can translate their work to commercial or nonprofit endeavors by building connections with research opportunities and the venture capital community. Hopefully what we'll see is an enhancement of the already very solid base that technology transfer has. I don't see a qualitative change. We're very happy with that outfit, but certainly making the whole world of technology transfer more accessible and more visible to faculty and students is something we hope for."

"The office will be actively involved in tech

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## Innovation czar continued from p. 159

transfer, from a range of different approaches, [such as] how can faculty better connect with industry or ... better translate their research," adds Priestley. "I view technology transfer as one of the central foci of the creation of this position. This will involve interacting with the faculty, interacting with alumni, as well as interacting with the current students and the local industries as a means to an end in these activities."

Though there's already plenty commercialization activity, he hopes to act as a force multiplier. "We want to make sure that all the faculty on campus are aware of all the things that we're doing and aware that this office is here and can help them reach their goals in innovation and entrepreneurship. We want to be sure, in the same way that we provide training and teaching [in other areas], that we can perhaps provide training in innovation and entrepreneurship to help senior faculty realize how they can connect with industry as well as help them to develop their own enterprises."

Though his expectations for the job are high, Lyons views positions such as his as necessarily experimental. "We're not creating a new high-level staff position that's going to live forever," he says. "We're going to do this for three years and see what happens. And if the headroom that we thought might be there doesn't end up being there, they should say, 'we're going to roll this up.'"

Contact Debenedetti at [pdebene@Princeton.edu](mailto:pdebene@Princeton.edu); Priestley at [rpriestl@Princeton.edu](mailto:rpriestl@Princeton.edu); and Lyons at [lyons@haas.berkeley.edu](mailto:lyons@haas.berkeley.edu). ►

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## 1) Financial Audits of Industry-Sponsored Research: What to Expect and How to Manage the Process

*Wednesday, November 13, 2019 ~ 1:00-2:00 pm (Eastern Time)*

**Presenters:** **Brynn Tomlinson**, manager at Baker Tilly, specializing in higher education risk and internal audit services and **Kelsey Foreman**, senior consultant in the risk and internal audit and cybersecurity services practice at Baker Tilly

With millions of dollars invested in research, industry sponsors need to ensure that all aspects of their projects are being managed with utmost care. In addition to scope of work, budgeting, and payment obligations, each project's research agreement dictates specific requirements regarding financial management and reporting obligations.

During the lifespan of the research, there may be times where a financial "health check" or audit is requested. It could come by way of routine request, or the sponsor may be observing red flags warranting further investigation. In either case, an audit doesn't have to be a frightening or adversarial exercise. In fact, audits provide an opportunity for both parties to uncover issues, concerns and challenges encountered in the execution of a project. It affords the project manager, project sponsor and research administration team an interim view of what has gone well and what needs to be improved with the project to ensure it is successfully completed.

This one hour program will demystify the audit process so that both parties can come away with valuable insight into the financial well-being of a research project.

We'll discuss what may trigger a financial audit for a non-government sponsored award, identify audit focus areas and common risks, and define potential consequences and results of financial audits. This presentation will also provide Research Managers and Administrators with tips to prepare for a financial audit and how to react to audit findings. Here is a look at the program agenda:

- Understand the reasoning behind a financial audit
- Recognize various causes of a potential audit
- Identify red flags and key risk areas where auditors may focus
- Provide examples of audit results and strategies to prepare for a financial audit

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## 2) Improving Data Integrity: Boost TTO Operations and Gain Reliability in Your Invention Management Database

*Thursday, November 21, 2019 ~ 1:00-2:00 pm (Eastern Time)*

**Presenters:** **Laura A. Schoppe**, president of Fuentek, LLC, and **Becky Stoughton**, a vice president with Fuentek and a Certified Licensing Professional™

Tech transfer offices have a multitude of stakeholders to whom they must provide varying types of information. Inventors want to know the status of their invention disclosures, patents, and licenses. Institutional leadership wants to understand summaries of the same, plus financial information, sliced and diced in various ways. Then there are government agencies and trade associations like NIH and AUTM, as well as economic development agencies and other partners.

And beyond all of that, even more important are the operational insights the TTO needs to function at top efficiency and effectiveness:

- What projects have the highest priority?

*See reverse side for more information or to order >>*

### Data integrity continued ...

- Who is working on what?
- What are the upcoming due dates and decision points?
- What is the status and background of a technology?
- And so much more, often with critical financial, compliance, and legal implications

Your invention management database is a crucial tool in responding quickly and accurately to both operational and stakeholder reporting needs. But all too often the data TTOs produce falls short of needs and expectations due to errors, inconsistencies, and incompleteness. That's why *Technology Transfer Tactics* has scheduled this important distance learning program for November 21st.

Regardless of what type of system you use, you will learn how to significantly improve data collection and reporting to enhance your office's performance and its responsiveness to stakeholders. Here is a look at the program agenda:

- What is data integrity and why is it important?
- Impacts of lack of data integrity
- Start with the end in mind: What types of reports are likely to be needed?
- Understanding the current situation: Where are the holes, errors, inconsistencies?
- Identifying the gap between what you have and what you need
- Standardizing data entry
- Tips and tactics for making data clean-up easier
- Maintaining database integrity going forward
- Case study

**PLUS:** Get answers to your questions during the live, interactive Q&A portion of the program.

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