UT Horizon Fund Aims to Build, and Capture, Value from Its Startups

Campuses at the University of Texas, such as the MD Anderson Cancer Center in Houston, can boast of star-studded faculties to rival the innovative scientific leadership at UC San Francisco, UC Berkeley and Stanford University. In 2009, the 15-institution University of Texas system was second only to the powerhouse University of California system in the number of patent applications filed, startups spun out from campus inventions, and research dollars raised.

Yet UT ranked only 19th that year in terms of income from licensing its innovations, the Association of University Technology Managers found. That means while there are plenty of inventions coming out of Texas, few have generated big returns for the original institution, like Google's success did for Stanford. The Texas university system has been taking steps to change that ranking and nurture its young companies in an environment much more challenging than California's.

The state of Texas is thinner on the kind of venture capital firms that hover near the big California research universities, eager to finance the next Google or Genentech that springs from the mind of a professor or student.

"The VC environment is less active than Silicon Valley or New York or Boston," says Wei Chen, a UT technology commercialization official.

The UT system sought to change that in 2011 when Bryan Allinson of the UT System Office of Technology Commercialization began working to create a fund that could help UT startups get off the ground. That was the beginning of what's now called the UT Horizon Fund.

"Starting the UT Horizon Fund fitted perfectly within our strategic mission to improve commercialization of technologies out of research at UT System institutions," says Allinson, the founder and executive director of the UT Horizon Fund. "Importantly, it also fits our financial mission to provide a positive return on investment back to UT."

Like other universities, UT has already acquired ownership stakes in spinoff companies by accepting equity as part of the compensation for licensing its intellectual property to startups.

Since the Horizon Fund began operations last year, it has been able to invest aggressively, at a time when many universities can't. The UT Horizon Fund has also pumped more money into seven of the 154 companies that were already part of UT's portfolio. Among those is Rapamycin Holdings of San Antonio, TX, which is evaluating rapamycin, a drug approved to prevent organ rejection, as a treatment for diseases of aging.

The Horizon Fund has also brought two new companies to life by linking innovative faculty members and students with the resources they needed to go into business. One of those is Austin, TX-based M87, founded by a professor-student team that uses software instead of expensive infrastructure improvements to expand cellular coverage for telecommuncations networks.

University venture funds are not new. Back in 1985, for example, the Stanford School of Engineering initiated plans for a venture fund to support the school and its entrepreneurial spinoffs. The school's new dean, Jim Gibbons, persuaded Silicon Valley venture firms to make donations to the school, but use the money to create the Stanford Engineering Venture Fund. The VCs helped invest the funds in growing companies, including startups based on Stanford technology. The University of California also benefits from a seed-stage venture fund whose capital comes from private backers such as VCs and drugmakers. Mission Bay Capital was founded in 2009 to invest in companies whose founders or technologies are associated with the UC system.

So far, the investment money for the UT Horizon Fund has come from the University of Texas fund. The UT Board of Regents approved an initial $10 million for the fund in 2011, and added another $12.5 million this year. Still, that $22.5 million total doesn't match the hundreds of millions of dollars that an established VC firm could raise.

But Allinson says the money helps fill an early funding gap for entrepreneurs just trying to get started. "We look for a win-win-win scenario," he says. "We want to help entrepreneurs commercialize UT technology, fill a crucial funding gap for the early stage startup, and create an opportunity for a return back to co-investors. "

Venture firms used to take big risks on such early startups in the hope of a high rate of return. But their plans have shifted, Chen says. "A lot of firms are moving to later-stage companies," she says. "They want a quick exit."

The Horizon Fund, by contrast, is focused on helping during a company's early days. It helps the new companies make the leap from the university lab and the boost from its small early investments can help a startup attract funding from other investors, says Chen, who heads the New Ventures unit of the Horizon Fund. While the VC community is not large in Texas, the state has an active contingent of angel investors. The Horizon fund is a matchmaker among startups, angels, and venture firms.

The Horizon Fund also links up experienced executives with faculty members and staffers who have great technology ideas, but too little business experience to serve as CEOs of their own startups. They may need a chief executive to take over plans for fundraising and building out the executive team.

The Horizon Fund invests between $100,000 to $2 million in each company it supports. Last year, though, fund officials decided to put up $50,000 to launch a new competition for student entrepreneurs. The winner of the system-wide contest was Jordan Kaufmann, a UT-San Antonio PhD student who used her $50,000 prize to found the Austin, TX-based company Cardiovate, which is using tissue engineering to develop a new kind of graft to treat aortic aneurysms.

The quality of applicants in the pilot competition encouraged the Horizon Fund to raise the top prize money to $100,000 this year, Chen says. Eva Deemer, a second-year PhD student in materials science and engineering at UT-El Paso, won the most recent competition held in Austin on May 2. Deemer is founding an El Paso, TX, company, American Water Recycling, which uses filters made of graphene oxide as a new method to purify the many gallons of water contaminated every day with grease from restaurants and other sources.

The UT Horizon Fund competition heightens the entrepreneurial culture at the system's 15 campuses by holding out the real-world possibility that students can become startup founders before they even graduate. All who participate get the experience of presenting their technology and business plan to a panel of judges that includes venture firm partners, angel investors, and other industry experts. Each team of student finalists is assigned a mentor who helps develop the business plans.

"This whole process, we are hoping, is more than just selecting a winner," Chen says. "Nobody's a loser."

And the contest calls forth more ideas that can turn into patented inventions which then could bring revenue to the UT system. The contest winners receive continuing business mentorship and the possibility of follow-on investments from the Horizon Fund.

Those follow-on investments are a major part of the fund's strategy across the UT system's portfolio. They can reduce or eliminate the dilution of the university's early equity stake in a company as it grows and raises more money from new investors, Chen says. The Horizon Fund allows the university to exercise its right to participate in successive funding rounds.

"That creates value for both the university and the company," Chen says.

For the same reasons, the UT system also collaborates with Osage University Partners of Bala Cynwyd, PA, a venture capital fund that forms partnerships with research institutions that want to keep investing in their portfolio companies, but lack the funds to support them all.

It's too early to gauge the returns from the UT Horizon Fund, but a back-testing evaluation showed the potential for promising returns.

Allinson said that the UT Horizon Fund initiated a back-testing analysis covering startups out of UT System from 2002-2012 that showed three companies generated exits of more than a billion dollars. "The potential for a return is there," Allinson says.

Of course, that means the university system missed some big investment opportunities during the years before they started operating the venture fund. Allinson estimates that if UT System had started the UT Horizon Fund in 2002, it could have invested in 72 of its spinouts and generated a 54 percent return on investment.

University leaders are also aware that its students might be the source of some of its best investments. In 1984, Michael Dell was a 19-year-old premed student at UT-Austin. Still living in a dorm room, he founded the company that was to become Dell Computer with $1,000 from his own savings. Four years later, the company went public, and its market capitalization leapt to $85 million. By 2001, it was ranked as the top computer systems provider worldwide.

“Somewhere in the UT system, the next Michael Dell is at work on a patent-worthy idea,” Chen says.

Source: https://xconomy.com/texas/2013/05/21/ut-horizon-fund-aims-to-build-and-capture-value-from-ut-startups/