

Trend Watching: A Disciplined Approach to Innovation
by Michelle Bruno

Trade Show entrepreneurs are always looking for the next big thing. No one wants to lead the way in presenting yesterday's ideas to an audience. Observing trends and converting them into innovative products and services is an important way for organizations to remain relevant and competitive. While plenty of great ideas have come to trade show professionals while walking the dog or staring into the morning cup of coffee, experts at www.trendwatching.com believe that using a disciplined approach to spotting, organizing and capitalizing on trends is more effective. Using their five trend watching tips, exhibition industry organizers and suppliers can learn how to convert trends into profitable products and services.

Understanding what a trend is, and what it is not, helps aspiring trend watchers know what to look for. Trendwatching.com defines a trend as "a manifestation of something that has unlocked or newly serviced an existing (and hardly ever changing) consumer need,* desire, want or value." Human needs such as those described by *Maslow's hierarchy of needs* change very little, they say. Trends such as "changes in societal norms and values, breakthroughs in technology or a rise in prosperity," for example, are responses to human needs. Trends are not long term predictions. Rather, they are observations of what is already happening. Using these definitions as a guide to test whether an observation or piece of information constitutes a trend is a good first step.

Trends are generally tracked at three levels. *Macro* trends evolve in the social, technological, economic, environmental and political arenas. *Industry* trends are generally tracked using competitive analysis, trade publications and market research. *Consumer* trends are those innovations being revealed in consumer products, services and the media. According to Trendwatching.com, "all three levels of trends constantly converge, impacting each other, if not overlapping." Industry trends are at the mercy of macro and consumer trends, they say.

Keeping an open mind, looking cross-industry and asking questions are the keys to success in trend watching. Trendwatching.com recommends looking for anything *new*; new products, new attendee behaviors, new companies wanting to exhibit, for example, and then asking "why." In other words, ask why an exhibitor that manufactures high performance auto parts has introduced a line of "green" products, or why attendees suddenly start bringing spouses to the show, or why a company offering industrial hoses wants to participate in a home and garden show.

Looking cross-industry for trends expands the opportunities for inspiration according to the experts. Every industry has its own *innovation competence*; new ideas that excite consumers and shape their expectations. Under this principle, consumers come to expect the benefits of innovation in one industry to cross over to other industries as well. For example, having experienced the convenience of ATM machines, consumers began expecting self check-out lanes at the grocery store, check-in kiosks at the airport and elsewhere. How long will it be before most tradeshow registrations are done on site at self check-in kiosks?

Trend spotters look for innovation using a wide range of resources, such as trade and consumer magazines, blogs, RSS feeds, reports, tours, conferences, other trade shows, competitors, catalogs, advertising at large, online chat rooms, colleagues, friends, etc. Trendwatching.com recommends using blog search engines such as *Technorati* and *Google Blog Search* to find blogs on any topic or an RSS aggregator to receive feeds on any topic. By entering search phrases such as “exhibition trends,” or “consumer trends,” “world’s first trade show,” for example, tradeshow trend watchers can use *Google Alerts* and *Technorati Mini* to receive news and web-based updates on specific topics. Show organizers may consider developing an in house trend group drawing on the observations of staff at various levels and different departments, or adopting trend tracking into the agenda of exhibitor advisory board meetings. Counterpart associations, exhibitions and conferences across the globe can also be valuable resources for spotting trends.

In order to put the trends in context and observe how they relate to one another, Trendwatching.com recommends creating a *Trend Framework* or matrix that lists all of the trends being tracked both vertically and horizontally in order to determine connections between trends and ultimately establish how a particular trend addresses a human need. The matrix helps trend watchers make the transition from trend *tracking* to trend *spotting*. For example, perhaps the green meetings trend is somehow related to the emergence of female tradeshow executives which are both manifestations of the human need for the safety of resources. New trends in the matrix will naturally relate to pre-identified trends. Those observations and innovations that do not fit into any pre-existing category of the matrix could signal the emergence of an entirely new trend.

Once the trends are categorized and identified, the final step in trend watching is to apply the information. Exhibition industry trend setters can use the information to shape the organization’s vision, develop new brands and business concepts and create new products, services, customer experiences, marketing and advertising campaigns. How many exhibition industry organizations have a green meetings policy, division, product, service, vision or marketing campaign as a manifestation of the green trend? Identifying trends is a critical business practice that leads to innovation and appeals to the entrepreneurial instincts of exhibition industry leaders.

Mergers and Acquisitions: Investment Bankers Facilitate Growth in Business Value **By Michelle Bruno**

Mergers and Acquisitions have always been a part of the exhibition industry landscape. In any given year, five percent or less of companies change hands. However, the number of event-related M&A transactions has been small in comparison with the total number of events. For example, with more than 10,000 B2B events in the U.S., there were only 66 exhibition and conference transactions in 2007 valued at \$1 billion. The relative low volume reveals some characteristics and strengths that are unique to the exhibition industry. Specialist investment banking firms have capitalized on these strengths while helping to standardize the M&A process and nurture a culture of performance and value from which the industry has benefited.

“Exhibition industry transactions over the last nine months have remained relatively insulated from the media concern over the economy,” say the experts. “In general, the event industry is as strong now as it was a year ago. The major event buyers—strategics and private equity backed platforms—are still actively looking for add-on acquisitions,” says Richard Mead, managing director of investment banking firm The Jordan Edmiston Group, Inc. (JEGI). From the perspective of Kathleen Thomas, managing

director of investment banking firm BerkeryNoyes everything is *status quo*. “We have seen no negative impact in volume or pricing on mid- to small-market deals,” she adds.

In the top 200 B2B exhibitions, ownership has changed very little over time. Part of the reason is that it is difficult to find multiple competing events serving the same industry sector. “What this suggests is that the exhibition industry is very clever at finding niche opportunities to provide an in-person service that is not being met, or met well, by other events. Plus, the event industry is quick to identify new information needs, particularly in the marketing services, technology and communications sectors,” explains Mead. Further, the rate of consolidation in the industry is restrained by that fact that “private owners tend to have a fierce desire to remain independent, and there is a growing dependence by associations on the events that they own as the major revenue source,” he says.

Investment banking firms specializing in the exhibition industry began emerging in the late 1980s. Since most event transactions are under \$200 million—a small figure as mergers and acquisitions go—boutique companies with a unique understanding of the dynamics of the event business began working with owners to negotiate transactions. “As more than ‘realtors’ for exhibition properties, investment banking firms play a much larger role,” says Kathleen Thomas. “On the sell side, we identify appropriate buyers, position the selling company in its best possible light, facilitate due diligence and negotiate definitive documentation, all with the goal of maximizing the value received by our seller clients. On the buy side, we represent buyers in identifying, evaluating, securing financing and negotiating transactions to buy businesses,” says Thomas.

Investment banking firms have changed the way that events are bought and sold. By making the process more competitive, prices have risen dramatically. In addition to helping companies negotiate a sale or purchase, investment banking companies help both sides prepare for the transaction. JEGI’s Mead offers advice to event producers looking to buy or sell. “The process is complicated and involves considerable preparatory work before the business is shown to buyers. A controlled process works in the best interests of all parties. Buyers appreciate dealing with an experienced advisory firm, because they know the process will be efficient and less time-consuming. At the same time, a well-run process allows sellers to focus on being great operators and ensure that their business continues to perform during the sales process,” he says.

Design Thinking

Thinking like a designer can transform the way you develop products, services, processes—and even strategy.

by Tim Brown as published in the Harvard Business Review June 2008

Thomas Edison created the electric lightbulb and then wrapped an entire industry around it. The lightbulb is most often thought of as his signature invention, but Edison understood that the bulb was little more than a parlor trick without a system of electric power generation and transmission to make it truly useful. So he created that, too.

Thus Edison’s genius lay in his ability to conceive of a fully developed marketplace, not simply a discrete device. He was able to envision how people would want to use what he made, and he engineered toward that insight. He was not always prescient (he originally believed the phonograph would be used

mainly as a business machine for recording and replaying dictation), but he invariably gave great consideration to users' needs and preferences.

Edison's approach was an early example of what is now called "design thinking"—a methodology that imbues the full spectrum of innovation activities with a human-centered design ethos. By this I mean that innovation is powered by a thorough understanding, through direct observation, of what people want and need in their lives and what they like or dislike about the way particular products are made, packaged, marketed, sold and supported.

Many people believe that Edison's greatest invention was the modern R&D laboratory and methods of experimental investigation. Edison was not a narrowly specialized scientist but a broad generalist with a shrewd business sense. In his Menlo Park, New Jersey, laboratory he surrounded himself with gifted tinkerers, improvisers and experimenters. Indeed, he broke the mold of the "lone genius inventor" by creating a team-based approach to innovation. Although Edison biographers write of the camaraderie enjoyed by this merry band, the process also featured endless rounds of trial and error—the "99% perspiration" in Edison's famous definition of genius. His approach was intended not to validate preconceived hypotheses but to help experimenters learn something new from each iterative stab. Innovation is hard work; Edison made it a profession that blended art, craft, science, business savvy and an astute understanding of customers and markets.

Design thinking is a lineal descendant of that tradition. Put simply, it is a discipline that uses the designer's sensibility and methods to match people's needs with what is technologically feasible and what a viable business strategy can convert into customer value and market opportunity. Like Edison's painstaking innovation process, it often entails a great deal of perspiration.

I believe that design thinking has much to offer a business world in which most management ideas and best practices are freely available to be copied and exploited. Leaders now look to innovation as a principal source of differentiation and competitive advantage; they would do well to incorporate design thinking into all phases of the process.

Getting Beneath the Surface

Historically, design has been treated as a downstream step in the development process—the point where designers, who have played no earlier role in the substantive work of innovation, come along and put a beautiful wrapper around the idea. To be sure, this approach has stimulated market growth in many areas by making new products and technologies aesthetically attractive and therefore more desirable to consumers or by enhancing brand perception through smart, evocative advertising and communication strategies. During the latter half of the twentieth century design became an increasingly valuable competitive asset in, for example, the consumer electronics, automotive and consumer packaged goods industries. But in most others it remained a late-stage add-on.

Now, however, rather than asking designers to make an already developed idea more attractive to consumers, companies are asking them to create ideas that better meet consumers' needs and desires. The former role is tactical, and results in limited value creation; the latter is strategic, and leads to dramatic new forms of value.

Moreover, as economies in the developed world shift from industrial manufacturing to knowledge work and service delivery, innovation's terrain is expanding. Its objectives are no longer just physical products; they are new sorts of processes, services, IT-powered interactions, entertainments and ways

of communicating and collaborating—exactly the kinds of human-centered activities in which design thinking can make a decisive difference. (See the sidebar “A Design Thinker’s Personality Profile.”)

A Design Thinker’s Personality Profile

Consider the large health care provider Kaiser Permanente, which sought to improve the overall quality of both patients’ and medical practitioners’ experiences. Businesses in the service sector can often make significant innovations on the front lines of service creation and delivery. By teaching design thinking techniques to nurses, doctors and administrators, Kaiser hoped to inspire its practitioners to contribute new ideas. Over the course of several months Kaiser teams participated in workshops with the help of my firm, IDEO, and a group of Kaiser coaches. These workshops led to a portfolio of innovations, many of which are being rolled out across the company.

One of them—a project to reengineer nursing-staff shift changes at four Kaiser hospitals—perfectly illustrates both the broader nature of innovation “products” and the value of a holistic design approach. The core project team included a strategist (formerly a nurse), an organizational-development specialist, a technology expert, a process designer, a union representative and designers from IDEO. This group worked with innovation teams of frontline practitioners in each of the four hospitals.

During the earliest phase of the project, the core team collaborated with nurses to identify a number of problems in the way shift changes occurred. Chief among these was the fact that nurses routinely spent the first 45 minutes of each shift at the nurses’ station debriefing the departing shift about the status of patients. Their methods of information exchange were different in every hospital, ranging from recorded dictation to face-to-face conversations. And they compiled the information they needed to serve patients in a variety of ways—scrawling quick notes on the back of any available scrap of paper, for example, or even on their scrubs. Despite a significant investment of time, the nurses often failed to learn some of the things that mattered most to patients, such as how they had fared during the previous shift, which family members were with them, and whether or not certain tests or therapies had been administered. For many patients, the team learned, each shift change felt like a hole in their care. Using the insights gleaned from observing these important times of transition, the innovation teams explored potential solutions through brainstorming and rapid prototyping. (Prototypes of a service innovation will of course not be physical, but they must be tangible. Because pictures help us understand what is learned through prototyping, we often videotape the performance of prototyped services, as we did at Kaiser.)

Prototyping does not have to be complex and expensive. In another health care project, IDEO helped a group of surgeons develop a new device for sinus surgery. As the surgeons described the ideal physical characteristics of the instrument, one of the designers grabbed a whiteboard marker, a film canister, and a clothespin and taped them together. “Do you mean like this?” he asked. With his rudimentary prototype in hand, the surgeons were able to be much more precise about what the ultimate design should accomplish.

Prototypes should command only as much time, effort and investment as are needed to generate useful feedback and evolve an idea. The more “finished” a prototype seems, the less likely its creators will be to pay attention to and profit from feedback. The goal of prototyping is not to finish. It is to learn about the strengths and weaknesses of the idea and to identify new directions that further prototypes might take.

The design that emerged for shift changes had nurses passing on information in front of the patient rather than at the nurses' station. In only a week the team built a working prototype that included new procedures and some simple software with which nurses could call up previous shift-change notes and add new ones. They could input patient information throughout a shift rather than scrambling at the end to pass it on. The software collated the data in a simple format customized for each nurse at the start of a shift. The result was both higher-quality knowledge transfer and reduced prep time, permitting much earlier and better-informed contact with patients.

As Kaiser measured the impact of this change over time, it learned that the mean interval between a nurse's arrival and first interaction with a patient had been more than halved, adding a huge amount of nursing time across the four hospitals. Perhaps just as important was the effect on the quality of the nurses' work experience. One nurse commented, "I am an hour ahead, and I have only been here 45 minutes." Another said, "[This is the] first time I have ever made it out of here at the end of my shift."

Thus, a group of nurses significantly improved their patients' experience while also improving their own job satisfaction and productivity. By applying a human-centered design methodology, they were able to create a relatively small process innovation that produced an outsize impact. The new shift changes are being rolled out across the Kaiser system, and the capacity to reliably record critical patient information is being integrated into an electronic medical records initiative at the company.

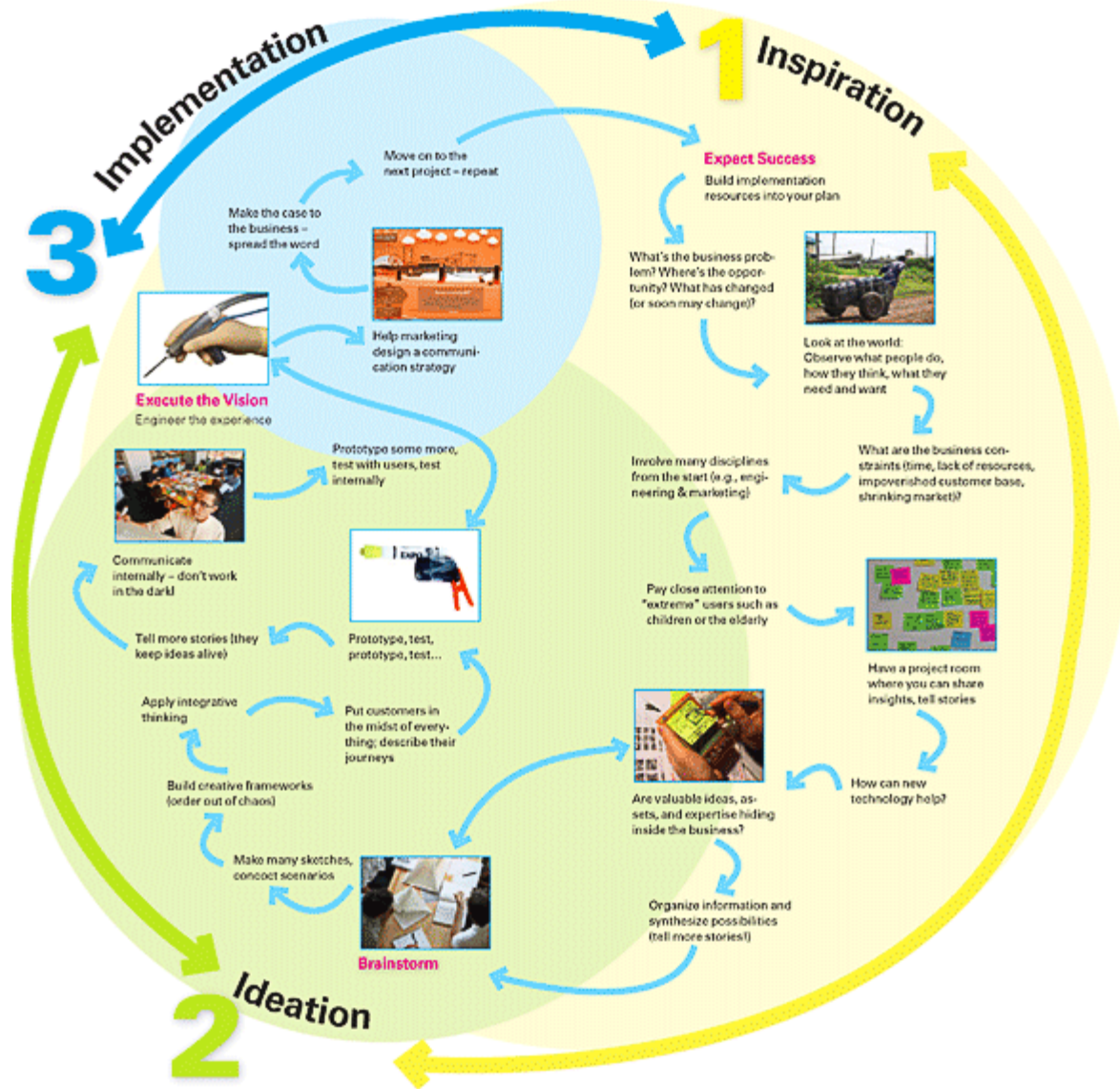
What might happen at Kaiser if every nurse, doctor, and administrator in every hospital felt empowered to tackle problems the way this group did? To find out, Kaiser has created the Garfield Innovation Center, which is run by Kaiser's original core team and acts as a consultancy to the entire organization. The center's mission is to pursue innovation that enhances the patient experience and, more broadly, to envision Kaiser's "hospital of the future." It is introducing tools for design thinking across the Kaiser system.

How Design Thinking Happens

The myth of creative genius is resilient: We believe that great ideas pop fully formed out of brilliant minds, in feats of imagination well beyond the abilities of mere mortals. But what the Kaiser nursing team accomplished was neither a sudden breakthrough nor the lightning strike of genius; it was the result of hard work augmented by a creative human-centered discovery process and followed by iterative cycles of prototyping, testing and refinement.

The design process is best described metaphorically as a system of spaces rather than a predefined series of orderly steps. The spaces demarcate different sorts of related activities that together form the continuum of innovation. Design thinking can feel chaotic to those experiencing it for the first time. But over the life of a project participants come to see—as they did at Kaiser—that the process makes sense and achieves results, even though its architecture differs from the linear, milestone-based processes typical of other kinds of business activities.

Design projects must ultimately pass through three spaces (see the exhibit "Inspiration, Ideation, Implementation"). We label these "inspiration," for the circumstances (be they a problem, an opportunity or both) that motivate the search for solutions; "ideation," for the process of generating, developing and testing ideas that may lead to solutions; and "implementation," for the charting of a path to market. Projects will loop back through these spaces—particularly the first two—more than once as ideas are refined and new directions taken.



Sometimes the trigger for a project is leadership's recognition of a serious change in business fortunes. In 2004 Shimano, a Japanese manufacturer of bicycle components, faced flattening growth in its traditional high-end road-racing and mountain-bike segments in the United States. The company had always relied on technology innovations to drive its growth and naturally tried to predict where the next one might come from. This time Shimano thought a high-end casual bike that appealed to boomers would be an interesting area to explore. IDEO was invited to collaborate on the project.

During the inspiration phase, an interdisciplinary team of IDEO and Shimano people—designers, behavioral scientists, marketers and engineers—worked to identify appropriate constraints for the project. The team began with a hunch that it should focus more broadly than on the high-end market, which might prove to be neither the only nor even the best source of new growth. So it set out to learn why 90 percent of American adults do not ride bikes. Looking for new ways to think about the problem, the team members spent time with all kinds of consumers. They discovered that nearly everyone they met rode a bike as a child and had happy memories of doing so. They also discovered that many Americans are intimidated by cycling today—by the retail experience (including the young, Lycra-clad

athletes who serve as sales staff in most independent bike stores); by the complexity and cost of the bikes, accessories and specialized clothing; by the danger of cycling on roads not designed for bicycles; and by the demands of maintaining a technically sophisticated bike that is ridden infrequently.

This human-centered exploration—which took its insights from people outside Shimano’s core customer base—led to the realization that a whole new category of bicycling might be able to reconnect American consumers to their experiences as children while also dealing with the root causes of their feelings of intimidation—thus revealing a large untapped market.

The design team, responsible for every aspect of what was envisioned as a holistic experience, came up with the concept of “Coasting.” Coasting would aim to entice lapsed bikers into an activity that was simple, straightforward, and fun. Coasting bikes, built more for pleasure than for sport, would have no controls on the handlebars, no cables snaking along the frame. As on the earliest bikes many of us rode, the brakes would be applied by backpedaling. With the help of an onboard computer, a minimalist three gears would shift automatically as the bicycle gained speed or slowed. The bikes would feature comfortably padded seats, be easy to operate, and require relatively little maintenance.

Coasting

Three major manufacturers—Trek, Raleigh, and Giant—developed new bikes incorporating innovative components from Shimano. But the design team did not stop with the bike itself. In-store retailing strategies were created for independent bike dealers, in part to alleviate the discomfort that biking novices felt in stores designed to serve enthusiasts. The team developed a brand that identified Coasting as a way to enjoy life. (“Chill. Explore. Dawdle. Lollygag. First one there is a rotten egg.”) And it designed a public relations campaign—in collaboration with local governments and cycling organizations—that identified safe places to ride.

Although many others became involved in the project when it reached the implementation phase, the application of design thinking in the earliest stages of innovation is what led to this complete solution. Indeed, the single thing one would have expected the design team to be responsible for—the look of the bikes—was intentionally deferred to later in the development process, when the team created a reference design to inspire the bike companies’ own design teams. After a successful launch in 2007, seven more bicycle manufacturers signed up to produce Coasting bikes in 2008.

Taking a Systems View

Many of the world’s most successful brands create breakthrough ideas that are inspired by a deep understanding of consumers’ lives and use the principles of design to innovate and build value. Sometimes innovation has to account for vast differences in cultural and socioeconomic conditions. In such cases design thinking can suggest creative alternatives to the assumptions made in developed societies.

India’s Aravind Eye Care System is probably the world’s largest provider of eye care. From April 2006 to March 2007 Aravind served more than 2.3 million patients and performed more than 270,000 surgeries. Founded in 1976 by Dr. G. Venkataswamy, Aravind has as its mission nothing less than the eradication of needless blindness among India’s population, including the rural poor, through the effective delivery of superior ophthalmic care. (One of the company’s slogans is “Quality is for everyone.”) From 11 beds in Dr. Venkataswamy’s home, Aravind has grown to encompass five hospitals (three others are under Aravind management), a plant that manufactures ophthalmic products, a research foundation and a training center.

Aravind's execution of its mission and model is in some respects reminiscent of Edison's holistic concept of electric power delivery. The challenge the company faces is logistic: how best to deliver eye care to populations far removed from the urban centers where Aravind's hospitals are located. Aravind calls itself an "eye care system" for a reason: Its business goes beyond ophthalmic care per se to transmit expert practice to populations that have historically lacked access. The company saw its network of hospitals as a beginning rather than an end.

Much of its innovative energy has focused on bringing both preventive care and diagnostic screening to the countryside. Since 1990 Aravind has held "eye camps" in India's rural areas, in an effort to register patients, administer eye exams, teach eye care and identify people who may require surgery or advanced diagnostic services or who have conditions that warrant monitoring.

In 2006 and early 2007 Aravind eye camps screened more than 500,000 patients, of whom nearly 113,000 required surgery. Access to transportation is a common problem in rural areas, so the company provides buses that take patients needing further treatment to one of its urban facilities and then home again. Over the years it has bolstered its diagnostic capabilities in the field with telemedicine trucks, which enable doctors back at Aravind's hospitals to participate in care decisions. In recent years Aravind's analysis of its screening data has led to specialized eye camps for certain demographic groups, such as school-age children and industrial and government workers; the company also holds camps specifically to screen for eye diseases associated with diabetes. All these services are free for the roughly 60% of patients who cannot afford to pay.

In developing its system of care, Aravind has consistently exhibited many characteristics of design thinking. It has used as a creative springboard two constraints: the poverty and remoteness of its clientele and its own lack of access to expensive solutions. For example, a pair of intraocular lenses made in the West costs \$200, which severely limited the number of patients Aravind could help. Rather than try to persuade suppliers to change the way they did things, Aravind built its own solution: a manufacturing plant in the basement of one of its hospitals. It eventually discovered that it could use relatively inexpensive technology to produce lenses for \$4 a pair.

Throughout its history—defined by the constraints of poverty, ignorance and an enormous unmet need—Aravind has built a systemic solution to a complex social and medical problem.

Getting Back to the Surface

I argued earlier that design thinking can lead to innovation that goes beyond aesthetics, but that does not mean that form and aesthetics are unimportant. Magazines like to publish photographs of the newest, coolest products for a reason: They are sexy and appeal to our emotions. Great design satisfies both our needs and our desires. Often the emotional connection to a product or an image is what engages us in the first place. Time and again we see successful products that were not necessarily the first to market but were the first to appeal to us emotionally *and* functionally. In other words, they do the job and we love them. The iPod was not the first MP3 player, but it was the first to be delightful. Target's products appeal emotionally through design and functionally through price—simultaneously.

How to Make Design Thinking Part of the Innovation Drill

This idea will grow ever more important in the future. As Daniel Pink writes in his book *A Whole New Mind*, "Abundance has satisfied, and even over-satisfied, the material needs of millions—boosting the significance of beauty and emotion and accelerating individuals' search for meaning." As more of our

basic needs are met, we increasingly expect sophisticated experiences that are emotionally satisfying and meaningful. These experiences will not be simple products. They will be complex combinations of products, services, spaces and information. They will be the ways we get educated, the ways we are entertained, the ways we stay healthy, the ways we share and communicate. Design thinking is a tool for imagining these experiences as well as giving them a desirable form.

One example of experiential innovation comes from a financial services company. In late 2005 Bank of America launched a new savings account service called “Keep the Change.” IDEO, working with a team from the bank, helped identify a consumer behavior that many people will recognize: After paying cash for something, we put the coins we received in change into a jar at home. Once the jar is full, we take the coins to the bank and deposit them in a savings account. For many people, it is an easy way of saving. Bank of America’s innovation was to build this behavior into a debit card account. Customers who use their debit cards to make purchases can now choose to have the total rounded up to the nearest dollar and the difference deposited in their savings accounts.

The success of this innovation lay in its appeal to an instinctive desire we have to put money aside in a painless and invisible way. Keep the Change creates an experience that feels natural because it models behavior that many of us already exhibit. To be sure, Bank of America sweetens the deal by matching 100% of the change saved in the first three months and 5% of annual totals (up to \$250) thereafter. This encourages customers to try it out. But the real payoff is emotional: the gratification that comes with monthly statements showing customers they have saved money without even trying.

In less than a year the program attracted 2.5 million customers. It is credited with 700,000 new checking accounts and a million new savings accounts. Enrollment now totals more than 5 million people who together have saved more than \$500 million. Keep the Change demonstrates that design thinking can identify an aspect of human behavior and then convert it into both a customer benefit and a business value.

Thomas Edison represents what many of us think of as a golden age of American innovation—a time when new ideas transformed every aspect of our lives. The need for transformation is, if anything, greater now than ever before. No matter where we look, we see problems that can be solved only through innovation: unaffordable or unavailable health care, billions of people trying to live on just a few dollars a day, energy usage that outpaces the planet’s ability to support it, education systems that fail many students, companies whose traditional markets are disrupted by new technologies or demographic shifts. These problems all have people at their heart. They require a human-centered, creative, iterative and practical approach to finding the best ideas and ultimate solutions. Design thinking is just such an approach to innovation.

The Promise, Perils and Performance of Private Equity

The returns that institutional investors realize from private equity differs dramatically across institutions

Based on the Research of Josh Lerner, Antoinette Schoar And Wan Wongsunwai

Private equity—the class of investments that includes venture capital investments and buyouts—accounts for a relatively small and, to date, little analyzed percentage of overall investments. Studies have shown that institutional investors—such as university endowment funds, corporate and public pension funds, private advisors, banks and insurance companies—generally outperform individual

investors. However, researchers have unearthed virtually no information on the success rates of different types of institutional investors.

A research project conducted by Wan Wongsunwai, senior lecturer in accounting information and management at the Kellogg School of Management, along with coauthors Josh Lerner (Harvard Business School) and Antoinette Schoar (Massachusetts Institute of Technology), has changed that. The team studied previously unexplored records of portfolio composition and fund performance, and found large disparities in private equity investment performance among different institutions.

During the period between 1991 and 1998, the best performers (see figure 1) by far were endowment funds run by universities and foundations. Funds in which endowments invested showed, on average, a 44 percent internal rate of return (IRR). In contrast, investments by private advisors showed a 23 percent IRR, and those by public pension funds 20 percent IRR. Corporate pension funds and banks performed even more poorly, reaching IRRs of 13 percent and just 4 percent, respectively. An extension of the analysis through 2001—covering a period when returns from many funds were at best mediocre—reveals even greater differences. No noticeable changes in those results were caused by correcting for such factors as the time in which the investments were made and the choice between venture capital investments and buyouts.

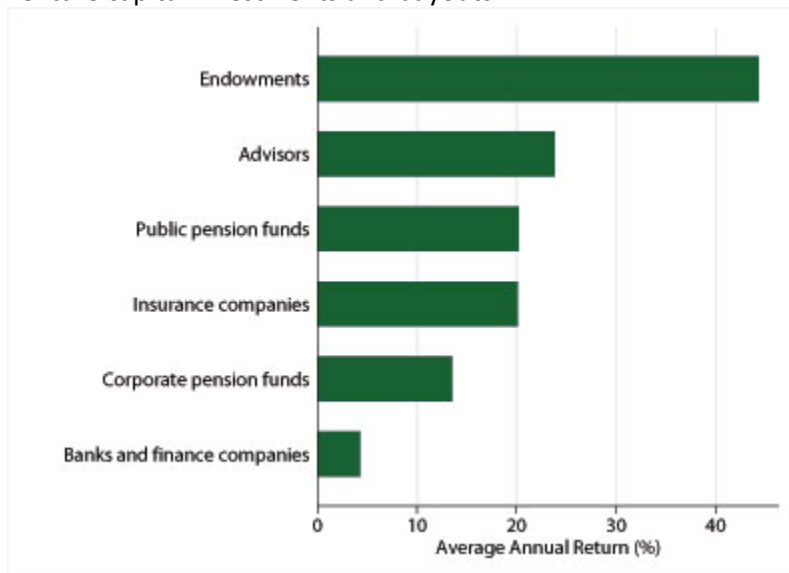


Figure 1: Average annual returns by type of institutional investors in private equity between 1991 and 1998

The team had expected to find some variation among different types of investors in private equity, based on anecdotal evidence. For example, they knew that several academic endowment fund managers had spent several years earning high returns. However, the sharp contrast between endowment funds and the others was a surprise.

What causes the marked differences in performance? Wongsunwai and his colleagues examined several possibilities. First, different types of investors might prefer different risk profiles for the funds in which they invest. Certain investors, such as banks, might use their investment as kinds of loss leaders: “Banks do not invest in private equity only to generate returns,” Wongsunwai explains, “but [also] to get more business.” Second, certain successful private equity funds might limit access by not accepting new

investors, thus allowing only existing investors to participate—a factor that could favor long-established endowment funds at the expense of newer investors.

Analysis showed that those issues have some influence on variations in performance by different types of institutional investors, but nowhere near enough to account for the wide gap. However, the team identified for the first time another factor that does have a significant impact. “Funds in which endowments decide to reinvest show much higher performance going forward than those in which endowments decide not to reinvest,” the team reports in *The Journal of Finance*. “This suggests that endowments proactively use the private information they gain from being an inside investor, while other [institutional investors] seem less willing or able to use information they obtain as an existing fund investor.”

Why should endowments make better reinvestment decisions than other institutional investors? “This might be an access story of a different kind,” Wongsunwai speculates. “It is a matter of relationships that involve private equity players who might, for example, be alumni on the boards of university endowment funds. It is an old boy network.”

Wongsunwai became interested in studying venture capital and private equity after dealing with emerging technology companies in his previous career as an equity analyst. “The idea tied in with my previous work in investment banking, looking at new technology companies,” Wongsunwai recalls. “I was always fascinated by what makes these new companies come about—by the role of venture capital.”

The team quickly found a good reason for the lack of research on the issue: unlike public companies, private equity organizations reveal very little detail about their financial situations. “The disclosure of performance in the private equity business is tricky; the information is not exactly publicly available,” Wongsunwai points out. “Some investors and even private equity firms themselves occasionally provide the information, but so far this is not a widespread trend.”

Plainly, the team faced a difficult job to tease out the needed data. However, it benefited from a trend toward more openness. “Some prominent institutions, such as public pension funds, are pressing for greater transparency so that their members can know more about their investments,” Wongsunwai says. “And the Freedom of Information Act allows any member of the public, including data providers, to ask for disclosures.” He and his colleagues used data from compilations that had previously been unavailable to researchers: (1) Asset Alternatives’ *Directory of Alternative Investment Sources*, (2) the funds database in Asset Alternatives’ *Galante Venture Capital and Private Equity Directory*, and (3) Private Equity Intelligence’s *Private Equity Performance Monitor*. Those sources provided sufficient data for the team to reach its unexpected conclusions.

What advice does Wongsunwai have for investors in private equity? “The message,” he says, “is not to just copy the successful ones and chase past returns. Successful investors seem to know when to terminate relationships with fund managers based not only on how well they have done in the past but also—and more importantly—how well they are expected to do in future.” He adds a cautionary word about the geography of investment in private equity. “Performance overall seems to deteriorate when funds invest in-state or locally,” he says. “For example, if there is a state pension fund forced to invest locally, that may not be a good idea. Political factors can get in the way of financial performance.”

The Show Must Go On
News about the Exhibition Industry Foundation

In 2003, the International Association of Exhibitions and Events (IAEE) and the Center for Exhibition Industry Research (CEIR) recognized the need and potential for greater collaboration and merged their foundations to create the Exhibition Industry Foundation. Since inception, EIF has funded various research and promotion initiatives as well as awarded scholarships to students interested in pursuing a career in the industry.

Funding is provided by EIF for its core goals of research, education and industry promotion. While these programs are primarily delivered through industry collaboration, EIF will also fund initiatives from other organizations or individuals that focus on advancing the industry within these core areas. As an industry-wide resource, EIF will work to avoid duplication of efforts and welcomes collaboration to ensure prudent use of existing resources.

Now, the foundation is actively seeking to raise funds. There has never been a better time to support the exhibitions and events industry. Make your commitment now to support EIF so we can fulfill our goals together.