The Innovation Blind Spot:

Why We Back the Wrong Ideas and What to do About It

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Synopsis

The Innovation Blind Spot by Ross Baird uncovers the flaws in traditional investment strategy. By answering these questions, Baird brings together the drive for economic prosperity and humanitarian impact:

- How can companies be profitable *and* benefit society?
- Where can we uncover the people and ideas that are largely ignored by traditional venture capitalists?
- How can investors restructure their vetting process to be more equitable and eliminate blind spots?

The Innovation Blind Spot (BenBella Books, Inc, © 2017) provides compelling evidence for looking at entrepreneurship and investment in a new way. Investors and entrepreneurs often come from the same narrow set of high-profile schools and geographic locations, resulting in support for the same type of people with the same type of ideas. Broadening this matrix is a better way forward:

- diversity in leadership, ideas, and geography yields more successful ventures.
- smaller, more focused ventures and investments are often more profitable and stable.
- solving real problems in agriculture, health, and education has a greater impact than solving problems of convenience.

The key concepts of *The Innovation Blind Spot* can be distilled into the following practices:

1. Adjust one-size-fits-all mentality. Nurturing new ideas requires flexible thinking and investment structures.
2. Expand your community. The people with the best ideas are not necessarily in large, wealthy, metropolitan areas. Look for innovators everywhere.
3. Make work valuable. It is both possible and profitable to fund companies that integrate business goals with community goals.

4. Invest in real issues. Our country has severe deficits in the areas of education, healthcare, and agriculture.

   The United States of America has succeeded over the past 250 years because, at its founding, it had the most educated population in the world, the highest literacy rate among women, and the lowest poverty rate, and the unparalleled economic prosperity of the twentieth century happened because we had the highest rate of entrepreneurship and education worldwide.

Based on *The Innovation Blind Spot: Why We Back the Wrong Ideas and What to do About It* by Ross Baird, we discuss the ways in which venture capitalists can change their investment approaches in order to satisfy the bottom line and have a positive impact on their communities, large and small. We share our interpretations of these methods in the following pages.

Blind Spots in Entrepreneurial Innovation

Blind spots in entrepreneurial innovation fall into three basic categories: How, Who, and Why. Investors may not even realize that blind spots exist within their investment strategy. If they have been satisfied with their methodology, questions about change or reimagining the strategy may not arise. However, anyone who values growth should always be on the lookout for ways to change for the better.

Process

Baird writes about a “one-size-fits-all” mentality in investment strategy that is a major barrier to innovation. In any area, once people find a methodology that works, they tend to stick with it. This may be good for stability, but it is terrible for growth. Venture capitalists tend to look for familiar patterns in opportunities. They feel comfortable with what is familiar. However, there are many good ideas that simply do not fit the established norm.

For example, Baird writes about the whaling industry of the early 1800s. Whaling was an expensive and dangerous endeavor, but whale oil was in high demand. Independent agents would collect money from families to invest in these expeditions. The agents, investors, and ships’ captains developed a payment structure that is still in use today, called “two and twenty”: After a successful voyage, the crew would get 20 percent of the whale fat (the “carry”), investors would retain 80 percent, and the captain would negotiate 2 percent of the entire haul to cover costs. The term “carry” persists in modern business language.

The “two and twenty” structure means that fund managers always make 2 percent on their funds, regardless of their size. As you can imagine, this encourages investment in larger funds over smaller investments. In addition, short-term returns are valued over long-term returns. Investors often would rather make a quick flip and move onto the next than take the time to make sure an investment is of sustaining value. Both of these issues block the way for entrepreneurs whose companies may be smaller and who are in it for the long haul.

People and Location

Investors are drawn to familiarity in other areas as well, including the people with whom they invest. Baird provides some impressive statistics:

- During the period between 2007 and 2012, 10 percent of global financing was distributed to graduates of these six universities: Stanford, Harvard, Berkeley, MIT, NYU, and UPenn
- Since the mid-1990s, startup funding has increased by 300 percent in California, New York, and Massachusetts (home to five of the six universities mentioned above)
- In 2015, 78 percent of startup funding in the US and half of global startup funding went to California, New York, and Massachusetts

Furthermore, some investors will not consider a company if a visit requires them to make a connecting flight.

As it is with many opportunities, in the investment world, it is often more about who you know than how great your idea is. This particular blind spot to innovation in the US, leads investors away from practically an entire country of people with entrepreneurial potential. Investing in who you know leads to support of the same ideas and people with the same background as the investors. Nothing new can come of this. Even more detrimental is the fact that investors go even further and will only invest in people who actually *look* like them.

The Innovation Blind Spot cites data that demonstrates a clear preference for certain types of entrepreneurs. The following is a list of favored entrepreneurs, with most favored on top and least at the bottom:

- Attractive men
- Men
- Women
- People of color

It seems extraordinary that reasonable people would have such biases, but they were proven to exist even when just the voice of the entrepreneur was heard and he/she was not seen, and even when an idea was presented in writing, with only a name at the top (male vs. female or traditional white name vs traditional African American name). In 2015, female founders received less than 5 percent of US investment dollars, and African-American and Latino founders received less than 1 percent. Innovative ideas are being lost to tremendous bias.

Bottom Line vs Community Benefit

One of the main blind spots Baird writes about is “two-pocket thinking.” This is the notion that it’s necessary to separate our work from our values. Baird spends many pages of *The Innovation Blind Spot* demonstrating that the opposite yields a better result on all fronts. He advocates the integration of what we do with why we do it. After reviewing over 150 companies valued at more than 1 billion USD (so-called “unicorn” companies), he found that only 15 percent of them were focused on solving the world’s biggest problems.

Investors who come from privileged backgrounds are typically not experiencing these problems: food scarcity, poor educational resources, and an inability to afford healthcare and stable housing. They are often looking to solve problems of convenience (think Uber or Blue Apron) rather than real world problems like access to a grocery store or paying student loans. Because typical venture capitalists don’t encounter these issues in their everyday lives, the country has not moved much toward innovative ideas to solve such problems.

Not only are decision-makers sometimes blind to important issues, but foundations are only required to give 5 percent of their assets to charitable causes on an annual basis. The other 95 percent can be invested according to the foundation’s own design, usually towards making more money for the foundation. In addition, because funds are often managed through an outside firm, those investments sometimes support institutions whose values are in opposition to the foundation’s core mission. Investment should align with values.

Innovative Changes to Investing

The Innovation Blind Spot provides great examples of venture capitalists and unique entrepreneurs who have made money and a difference together. Their success is dependent upon solving real-world problems in practical, innovative, and sustainable ways, and in creating a collaborative relationship. The most successful new companies have a woman co-founder and employees who have direct experience with these problems, possess a variety of skills, and represent diverse backgrounds.

Authentic Ideas

An authentic idea for innovative investors is a problem that exists in the real-world and whose solution would have a positive impact. Microfinancing is one such idea. Baird uses his mentor, Bob Pattillo, as a model for this type of entrepreneurship. Pattillo was a successful CEO in the real estate business looking for impactful ways to invest when he learned about the concept of microfinancing: the practice of making small loans to entrepreneurs whom banks would see as too risky for investment.

After reading that one company’s microfinance loans were being repaid at over a 99 percent rate, and visiting the gifted leader of a village bank (the name given to microfinance loan organizations) in Bangladesh, Pattillo recognized the strength and potential longevity of this structure. He used his connections to encourage some large financial institutions to invest in a private equity fund whose sole purpose is to invest in microfinance banks globally. Pattillo then sold his real estate company and invested all of his net worth into this new venture.

This is an example of “one-pocket” (vs “two-pocket”) thinking. Pattillo focused on operations that would benefit individual communities around the world, and thus, the world at large. In return, he has also been financially successful, allowing him to support other like-minded entrepreneurs—spreading the wealth and the health that comes with doing good. Baird’s venture capital firm, Village Capital, got its start with a $10,000 bridge loan from Pattillo in 2009. 19 years later, it is still going strong, “seek[ing] innovators who are solving real global problems.”

Assessment vs Forecasting

One of the blind spots to innovative investing is the process by which venture capitalists determine whether or not an idea is worthy of their dollars. Baird points out that investment managers use assessment tools that measure how closely an entrepreneur’s idea resembles other successful ideas. They attempt to fit all new ideas into molds from the past. This type of pattern-recognition mentality blocks innovation and creativity, causing investors to miss out on potentially significant and successful ideas.

Forecasting is a better way to determine whether or not an idea will be successful. Forecasting uses the expertise of people Baird refers to as “makers.” Makers are people directly involved with the concept being evaluated and, therefore, are better at predicting whether an idea has utility and is likely to succeed. Managers, on the other hand, attempt to predict an idea’s potential based on past ventures, which may be completely irrelevant, from an outsider’s perspective.

Forecasting allows investment managers and entrepreneurs to approach a venture from the same side, using collaboration and peer review as a way to build a new enterprise rather than a top-down approach in which managers simply try to suss out all of the ways in which an idea might fail. For example, Village Capital invested in a firm called Emrgy, led by engineer Emily Morris. She developed a means of generating hydroelectric power and had a contract with the City of Atlanta, but still had trouble raising funding because people did not really understand her idea. Through the peer review process, Village Capital determined that Emrgy was an excellent investment.

Opportunity for All

Emily Morris is an example of an entrepreneur with a practical, innovative, and sustainable idea who wasn’t being heard. As the statistics reported here indicate, being female was surely working against Morris. In contrast, Village Capital discovered that, controlling for comparable industries and geographies, their female-run companies outperform male-led firms by 20 percent or more in revenue earned and full- and part-time jobs created. Village

Capital is proof that breaking a long-standing bias and investing in women is good for business.

The next step is erasing the blind spot that prevents investing with people of color. *The Innovation Blind Spot* illustrates the story of Jerry Nemorin, a Haitian American living in Virginia who had an idea for how to solve the consumer debt crisis after the Great Recession of 2008. Nemorin had 3 strikes against him at the outset: he was dark-skinned, lived outside the 3 meccas of venture capitalism, and wanted to solve a problem that affected poor people. He found that typical investors could not relate to the concept of restructuring debt in order to improve credit ratings.

In 2014, Village Capital linked Nemorin with funding partners and he moved his operation to Silicon Valley. His firm, LendStreet, had accrued almost $40 million from private lenders by the middle of 2016. LendStreet successfully and effectively helps people to restructure their debt so that they can continue to pay their bills and make purchases without the cloud of bad credit looming over their heads. However, without innovative investors such as Village Capital and Kapor Capital—Nemorin's Silicon Valley partner—LendStreet would not exist and would not be out there, solving some very real problems.

Topophilia

Baird writes about the American Dream from several angles: who we are, what we stand for, and where we come from. All of these elements contribute to the concept of "topophilia," which literally means "love of place." Baird believes that one of our greatest blind spots is an inclination to look for heroes or individuals to solve problems rather than communities and ecosystems.

The American Dream

The American Dream is a fluid concept, but at its foundation is opportunity. *The Innovation Blind Spot* provides insights into how to create opportunity by eliminating blind spots that prevent entrepreneurs and ideas from being heard. Entrepreneurship is the American Dream in microcosm. Everyone should have an opportunity to at least try to affect change with their idea, and to be judged on their idea alone. As Steve Case (founder of AOL) has said, 250 years ago, America itself was a start-up.

Unfortunately, entrepreneurship has become big business and the end-game has become about making money rather than changing circumstances. Baird reports that a new business emerges every two minutes, but a firm closes up shop every eighty seconds. This is the highest rate of firm termination in the past fifty years. The Economic Innovation Group supports that statistic with their own: right now, there are fewer Americans starting successful enterprises than at any time in the last 100 years.

Communities, Not Heroes

Working in community is the answer to that issue. People need to feel connected to a place and to the people who live there. For someone who doesn't live in the three big venture capital centers, finding funding for a good idea can seem futile. Venture capitalists like Baird are out to change that. Social scientist Robert Putnam points out that organizations that have traditionally brought people together—houses of worship, local recreational activities, and civic organizations—have broken down or dwindled in American society.

Topophilia is a natural way to create connection among people who care about the same things. Quicken Loans, Detroit's largest company, is the largest employer of minorities, has been named J.D. Power's "Best Place to Work" and best in its class for customer satisfaction for mortgage origination and customer experience. By insisting that its workers live in Detroit rather than the suburbs, the leaders of Quicken Loans took a city that had declared bankruptcy in 2013 and developed an ecosystem to support growth. Detroit is on its way up.

Innovative Investment is Good for the Economy and Good for Society

Use Forecasting over Pattern Recognition

Innovation requires going beyond the ordinary, working collaboratively with people who are in touch with the issue in question, and looking to the future rather than the past. Using a forecasting approach to evaluating ideas, with makers as peer reviews, ensures that an idea is fully vetted with an eye towards the future.

Look Everywhere for Ideas

There are people with innovative ideas everywhere. When venture capitalists remain within familiar spheres of geography, entrepreneurship becomes myopic and out-of-touch with the rest of the country/world. There is a whole world beyond Silicon Valley, Boston, and New York City, filled with entrepreneurs who can help move us forward.

Find People Who Don't Look Like You

Use your investment power to deliberately and directly challenge bias. Including women and people of color in the venture capital + entrepreneur equation is smart, profitable, and equitable. Barring over half of the population from the conversation just doesn't make sense, yet people may not be aware that this is happening.

Erase Blind Spots within Your Company

Start with what you know. Look within your own company and seek to erase blind spots in your hiring practices, the process by which you evaluate an entrepreneur's idea, the ways in which you find entrepreneurs and where you find them. Changing policies within can have a larger influence among your business partners.

Invest in One-Pocket Thinking

Keep in mind that what you do and why you do it should be united. Baird proves that when venture capital firms, large and small, invest in entrepreneurs who have practical ideas that solve real-world problems, everyone wins: venture capital firms make money, entrepreneurs establish a viable company, and a community of people benefit from the innovation.

For More Information

The Innovation Blind Spot is a hope-filled book. It takes some dire issues—geographic, gender, and racial bias; broken investment processes; and community deterioration—and offers concrete solutions. From encouraging "one-pocket" investing to examining what it takes to create an ecosystem for change, Baird provides historical, theoretical, and evidence-based foundation for how to back the right ideas.

> **The fundamental debate we have today is not right versus left or business versus nonprofit. It's monopoly versus topophilia. For our innovation economy to succeed in creating a better future, we need to create conditions where everyone is able to play in the innovation game.**

If you've enjoyed our insights on Ross Baird's *The Innovation Blind Spot: Why We Back the Wrong Ideas and What to do About It*, we encourage you to access the other *The Innovation Blind Spot* assets in the Skillsoft library, or purchase the hardcopy.

About the Author

Ross Baird is the founder and CEO of Village Capital, a firm that funds, trains, and invests in entrepreneurs solving the most important problems in society. Since founding Village Capital inn 2009, Baird has supported hundreds of entrepreneurs in more than a dozen countries. He has spent his entire career on the founding teams of start-up enterprises or investing in startups.

Baird also serves on the faculty of the University of Virginia, where he teaches entrepreneurship and impact investing. He has a master of philosophy from the University of Oxford, where he was a Marshall Scholar, and a BA from the University of Virginia.

Also by Ross Baird

Baird has other practical information and tools for entrepreneurs on his website:

https://vilcap.com/the-innovation-blindspot/

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