

Searching for Overlooked Opportunities? Try Healthcare, Says VC

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Al Waxman has an agenda. The founder of Psilos Group — an 11-year-old healthcare-focused venture capital firm with offices in San Francisco, Santa Fe, and New York — wants more VCs to forget about backing Web startups and electric cars and start focusing instead on finding startups that can meaningfully improve the nation’s disastrous healthcare system.

Waxman isn’t interested in drug discovery. As he says, “that’s not our thing.” Instead, he says there are plenty of opportunities to create efficiencies around retiree health benefits, medical records and the like, and that it’s only American to start chasing them down — now.

For what it’s worth, Psilos’s biggest hit to date has been Active Health Management, a company that advised businesses and public health organizations on how to improve healthcare based on the information they share about patients. It raised \$74 million from about 10 investment firms beginning in 1998, and sold to Aetna for \$450 million several years ago. Waxman calls it an “8x” for Psilos.

We talked Friday afternoon for a few minutes.

What’s your own your funding situation right now?

We’re within one deal of our third [and most recent] fund being fully invested. We closed that fund with a little more than \$300 million in 2006. We raised two funds prior: we raised about \$140 million in 2001 and \$120 million in 1999.

So you’re in the market.

We can’t comment on that.

But you want to talk about why not enough investors are paying attention to this country’s massive healthcare expenditure problem. Why now?

First, because healthcare costs are rising at 6 percent annually, and there are many, many innovative ideas that we see on a regular basis — not all of which we can invest in. Speaking as someone who’s in the industry, there’s real opportunity here. Second, as an American, this problem has the capacity to become worse than the subprime problem if we ignore it. We could see the end of Medicare and worse if we don’t bring some of the same innovation we brought to financial systems and elsewhere.

I’ve never known a VC to invite more competitors into the fold. Are you having trouble finding co-investors?

The fact is that there are nowhere near enough VCs focused on this area. About \$10 billion was invested in what’s commonly called healthcare last year, but roughly half of that total went into biotech, or drug discovery. But when you hear people talk about the healthcare crisis in this country,

nobody says that we don't have enough drugs. They say we have a very unproductive system — one that's much worse than in other developed parts of the world.

Meanwhile, there are a lot of entrepreneurs focused on medical devices or on health information technology who are looking for investment out there. They're looking to create more access, broaden insurance, and add IT to reduce wasteful overhead and increase operability.

What's the problem with the venture industry in your view? Everyone's too focused on clean tech?

I think it's a focus problem. Where you live in Silicon Valley, where there's a large amount of venture capital, it's been focused more on high tech and biotech. It's also the case that to invest in healthcare, you have to develop a staff that's knowledgeable in that area. But more VCs need to make a decision to do that. We saw when we started Psilos that there was going to be a big crisis. But the crisis is bigger today, and the opportunities are larger.

How do you become knowledgeable enough to convince investors you know what you're doing? Don't most healthcare VCs have PhDs?

My PhD is in physics. It was [as the as the former president and CEO of] Diasonics [one of the first medical companies to provide ultrasound and magnetic resonance imaging in the U.S.] that it became pretty clear to me that the healthcare economics of the U.S. were pretty much upside down, and that we were spending much more money than was being spent in Western Europe and we weren't getting anything for it.

To answer your question, yes, I think investors should have some experience. But Reggie Herzlinger [one of the nation's leading advocates for consumer healthcare reform] teaches large numbers [of Harvard Business School students] a class called Who Killed Healthcare, and she's a very smart person who talks about these issues in a very similar fashion as we do and trains a lot of graduate students to go into the industry and look for things like what we're doing. It's also happening at Duke University. So people are really focused on the issue. We don't see an absence of people who understand it, but an absence of people in venture capital who understand it.

But, for example, does it really make sense for an IT investor to switch into healthcare?

Absolutely, especially those focused on issues of productivity. The one thing you have to understand is the business you're selling into. Just like SAP has to understand why customers would buy its products and services, you have to understand what problem you're trying to solve.

You also have to understand that whole concept of reimbursement. In healthcare, the customer is the patient and is disconnected from the cost and the process of how things get paid. So the normal economic conditions don't always work right. [Potential investors] have to be aware of the flow and reimbursement in healthcare, which is very different.

How much impact do you think President Obama's proposed stimulus package might have on your field and the number of VC entrants in it?

I think many of LPs already get the need to tackle this whole healthcare crisis. I think there's generally less rapture with the idea that we need a new drug. I don't think that's where the healthcare economy is going. It's not that we won't find drugs that fix diseases that are incurable today, but they take years and require billions of dollars, and that's not what we're do. We're in the business of helping to find and create working and scalable healthcare companies.

A lot of public pension funds also have healthcare benefits to worry about so they are interested in working to find solutions. It's why Health Evolution Partners, which has a philosophy very similar to ours [it's focused on funding companies that drive changes in how healthcare is financed, organized, and delivered] was funded by CalPERS for \$700 million — to help find solutions for CalPERS. It's a double bottom line investment.

Then you don't necessarily believe the stimulus package will make much difference in the level of interest paid to healthcare systems and services?

I believe the Obama Administration is committed to solving this problem. But every administration starts out committed to solving this problem of our unmanageable inflation in healthcare costs. The good news is that we don't think this is an unsolvable problem. I mean, we're either going to find a way to fix it or we're going to have to ration healthcare.

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