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Friday, January 23, 2009

VCs housing life science startups speed and boost payout

By Alan R. Earls

From the beginning, some venture capitalists have taken a paternal interest in the companies they fund, watching from a distance and offering occasional sage advice. More recently, though, especially for venture capital organizations investing in the life sciences area, that paternal approach has been taken to a new level, with some VCs actually providing services much like those offered by an incubator.

While few, if any, go as far as offering full-scale lab facilities, a growing number of venture firms provide office space, shared services, and sometimes access to facilities, typically at other portfolio companies. Christopher Palatucci, the life sciences practice leader at the executive search firm Polachi & Co. Inc. in Framingham, said he has seen a steady increase in the number of VC firms bringing life sciences companies into their offices, incubator style.

Palatucci claims that even prior to the current economic downturn “the traditional venture model was broken” because it now takes so much longer for VCs to make get to an IPO or sell a company, and even then they “only make three times ROI.” Thus, he says VCs are looking for ways to continue to fund innovation, but at a lower cost and with an improved prospect of success. By helping startups pinch pennies and providing management help and access to other services, VCs hope an incubator-style approach will improve their ROI forecast.

One executive who has been through the experience is Michael Gilman, founder and chief executive officer of Stromedix Inc., now based in Cambridge, who got his company started in the offices of Atlas Venture in Waltham. “I had been working at Biogen Idec and I was trying to figure out what to do next.” Introduced to the principals of Atlas

through a friend, “we all hit it off,” explained Gilman.

Conversations led to a suggestion that he look into an opportunity to develop a fibrosis drug. Atlas offered office space and he went to work, eventually adding four more people with more support from Atlas. Finally, when the process had matured — and when they needed more space than Atlas could provide — Gilman and his Stromedix team got space of their own and a formal round of funding from Atlas.

Bruce Booth was one of the four investment professionals at Atlas when Gilman got involved with the company. The two who eventually joined the Stromedix board were Peter Barrett and Scott Silverman. After Silverman left Atlas last year, Booth joined the Stromedix board for a few months. He’s now a board observer “and I talk to him all the time,” said Gilman.

In terms of facilities, Gilman said, “We were looking for a clinical-stage compound — which is what we got — and that didn’t require a wet lab. Even today, in our own space, we have no labs. Everything’s outsourced.”

Booth said Atlas has taken a similar approach several times in recent years. “We tend to be early-stage investors and we like the opportunity to shape the building and governance of companies,” he explained. More to the point, he noted, many ideas “aren’t completely baked” so an incubation approach provides time to turn an idea “into an investable asset.”

In addition, Booth said, the incubator approach favors creation of a lean or even a virtual-style company. “We have some companies with no more than 10 people but they are able to address very large markets,” he said.

The venture incubator concept is not unique to Massachusetts. Matt Gardner CEO of BayBio, the South San Francisco, Cal., life sciences organization, said that in California, whether or not it is actually called incubation, both early-stage investors and venture capital funds have taken on an increasing role in helping to foster and develop new companies. “In some cases they are working on early proof of concept but some companies are also staying in that mode for longer and outsourcing things to contract research organizations,” said Gardner. Left coast venture capitalists have also made a point of partnering with hospitals and research institutions to provide more extensive incubation opportunities, he notes.

The food chain has gotten more complex on both coasts,” added Gardner, with real estate developers even offering incubation space — sometimes in increments as small as 500 square feet — in return for equity positions in life science startups.

Moreover, notes Steven Hochhauser, senior health care consultant at New York based Frost & Sullivan, while money can travel, VCs generally prefer to be close to their companies. “Under the cost pressures we will likely be seeing over the next few years they will prefer to be very close. They believe the greatest asset they can bring isn’t just funding; it is the knowledge of managing cost and people, which inexperienced entrepreneurs often lack,” he said.

Indeed, Gilman said of his funders at Atlas: “From a nuts-and-bolts perspective and in terms of providing infrastructure, support, and reference materials, they have been great. And even the fact that their office had a better printer than I had at home made a difference.”

But the ultimate advantage they conferred was the personal relationship. “Getting to know them well has been very valuable — we could jointly refine the idea for the company over time — we could kibitz and I got to understand their business perspective and what got them excited as investors,” he adds.