Becoming a bioentrepreneur

From first idea to profitable organization, building a company requires teamwork and trust.

Hugh Young Rienhoff Jr.

As an MD who has become a venture capitalist, I often feel like I'm practicing a peculiar new branch of medicine when I meet a bioentrepreneur in search of capital. Just as the patients in the clinic are often apprehensive because they are seeking advice that could affect the rest of their lives, scientists seeking to fund their "dream" company have concerns about whether they are doing what is right for their careers. I have found that, just as in medicine, where the patient and the physician most often find a solution, so too do scientists and venture financiers find productive interactions—even if they do not always create the next Genentech (South San Francisco, CA).

The leap of faith

To the uninitiated, the world of business can be a loathsome thing. My first contact with venture capital was in the arm's length position of a consultant. Later, when I considered joining a firm, I had many of the same questions for the firm that scientists now routinely pose to me, such as, "Where do you get your money?" While some suppose that all venture capital comes from recycled Colombian drug money, most venture firms get investment capital from pension funds, university endowments, and other large pools of capital that earmark a small percentage of their funds for high-risk investment. The bioentrepreneur must make a leap of faith and accept that venture capital money is desirable.

Bioentrepreneurs often will mention alternative sources of financing, saying, "I know a bunch of cardiologists," or "Consolidated Amalgamated Incorporated has offered me \$5 million and I can do whatever I want." The question behind such declarations is always, "Why should I work with you?"

The simple answer is that venture capital is not just money. The venture capitalist helps build your company—getting financing, establishing operations, finding manage-

Venture capital is not just money. The venture capitalist helps build your company—getting financing, establishing operations, finding management, and developing strategy.

ment, developing strategy. These activities are the bread and butter of venture capital, but rarely occur when one enters into an agreement with other types of investors.

A good venture investor is an active investor: one who contributes to the company's growth rather than watching it passively from the sidelines. Some understand the technology, some have operating experience, some have financial backgrounds. Typically, venture capitalists are prepared to support the company's financial needs until other sources of capital can be obtained. In other words, any good venture capitalist has a deep commitment to the entrepreneur that a group of outside investors will not.

Establishing trust

Historically, there has been in the minds of academics a deep suspicion of, even contempt for, the businessperson. In their scenarios, the archetypal villainous venture capitalist has no appreciation for the elegance of science and would trade any number of grandmothers for an even bigger piece of the company pie. I have yet, however, to meet such a black-hearted venture capitalist.

Venture capital is a long-term business focused on establishing good relationships. The bad actors among us do not last long. The attitude of academics toward business has been changing, with the increasing recognition that accelerating the commercialization of technology benefits any number of constituencies.

The issue of trust between academics and businesspeople is underscored when the dis-

cussion turns to confidentiality agreements. As a rule, like many other venture capitalists, I eschew these agreements. My experience is that they only create liabilities in a market in which most ideas are not funded. I more or less subscribe to Marshall McLuhan's thesis that only puny ideas need protection—the really great ideas are protected by everybody's incredulity. This is not to say that intellectual property is unimportant. Rather, it is to say that a I can get interested in a project and the people without knowing all the secrets.

The fact of the matter is that the purpose of venture capital business meetings is primarily to get to know the people. From the venture capital point of view, one of the first questions a venture capitalist must answer is, "Are these people whom I can work with for the next five years?" With all due respect to Intel's (Santa Clara, CA) chairman, Andrew Grove, and his bestselling ideas about business, the paranoid don't often survive because they fret and fritter away their energy on imagined devils. But then again, when you have a \$50 billion market cap to protect, perhaps paranoia has its uses.

One other issue that often sidetracks efforts to build trust is a lack of clear understanding of the reason for starting a company. If at the outset everyone does not believe that the goal is to develop technology for the marketplace, then the enterprise is probably doomed to failure. Often the problem is that venture capitalists are seen as alternatives to the US National Institutes of Health (Bethesda, MD). "Ideally, we set up an institute that might spin-off technology," was the business plan of a well-known academic interested in starting a company. But a venture capitalist's goal is to create companies, not institutes.

Building a team

I recently asked a highly celebrated academic interested in starting a company, "If you are number one in the field, who is number two?" His reply was, "There is no number two." It was difficult then to imagine who he

Hugh Young Rienhoff Jr. is a director of Abingworth Management Ltd., The World Trade Center Baltimore, 401 E. Pratt Street, Suite 1222, Baltimore, MD 21202 (hugh@abingworth.com).

MANAGEMENT

might accept on his company's scientific advisory board!

The value of teamwork is often a sticking point in transforming an idea into a company. In one sense, well-established academics are self-selected survivors in fields that place high value on individuality, competitiveness, and self-reliance. After all, these characteristics contribute to the originality, creativity, and quick wittedness that led them to try to create a company in the first place. So it is no surprise that this breed can have difficulty working on a team, sharing credit, and being charitable to those with other gifts.

Perhaps the greatest challenge at this stage is trying to convince a creative investigator to throw his or her technology into the pot with other bits. The nearly universal response is, "My technology is better" (read: worth more). This attitude asymptotes to "The other technology is worthless." Just as teamwork is essential for success, concatenating technology can also mean the difference between success and failure. It is much harder to invent around a system than around a component; it is much more powerful to control an entire integrated discovery process than a single step.

A corollary problem is the question of who is in control. Bioentrepreneurs have a gnawing fear of losing control of their companies. As a rule, small companies must work by consensus and no single stockholder holds a majority of the shares. So my favorite answer to the question is, "No one is in control here." The point of building a management team is to extract as much value from the technology as possible. To the uninitiated this sounds like an inquisitorial exercise in pain and degradation. But the issue of control revolves around trust, trust that professional management will act in the best interests of all parties in creating value.

Developing a realistic valuation

Premoney valuation—the value of the company before a capital investment has been made—includes the founder's stock and the stock necessary to secure the technology. All venture capitalists have heard the argument from bioentrepreneurs that, because their company is addressing a billion-dollar market, the premoney value of the company is some significant fraction of a billion. To some bioentrepreneurs, it sounds like horsefeathers when I tell them that all startups have roughly the same valuation. But that is the simple truth. There are limits to what an idea, some intellectual property, and a few dedicated people are worth.

There are differences between how venture funds value technology, but I am always struck by how little variation there is among the top-ranked venture funds. In trying to

explain valuation, I use the following formula: The number of founders times the number of angels in heaven squared. It works for me. Obviously, at this stage trust is a significant factor.

There are no purely objective ways to value companies, but the stock market plays a role in valuation. The market favors companies with revenue, or at least the glimmer of revenue, e.g., products in clinical trials. For this reason, the market puts a glass ceiling on the technology value of a company until such time as the technology proves itself.

Venture funds, aware of these limitations on technology values, work backward to calculate valuations, discounting for the usual setbacks that occur in a startup. Such nosebleeds include missing technical milestones, disappointments with management, and the requirement for additional capital beyond the original plan. After allowing for these factors, the venture capitalist must calculate in minimum expectations for returns for partners, as well as the limited partners who fund us. If a company is overvalued from the outset, it can be hard to get any but the most naive investor interested.

Thus, unlike life, the first million dollars into the company is often the easiest. There are many investors willing to buy cheap stock in a hot startup. The hard part comes in getting \$10 million at a price attractive to the company. The company is competing with many other promising technology-based companies. The goal at this stage of financing is the same as before: to get quality investors whose participation in the investment redounds to the company's reputation. Companies are judged by the company they keep. The market is always looking for such endorsements—who is on the board of directors, what venture firms have invested in the company, and who is the CEO.

Conclusions

Although I was brought into the venture capital business to offer insight into technology, I have learned from my experience that great people make great companies. Being a patient student of human nature and a good judge of character is much more critical to success than any technical evaluation of a company's assets. Ironically, this is what originally attracted me to medicine: It is a profession where understanding the person in the patient is essential to their recovery.

In short, there are few epiphanies in this business. Most decisions are based on common sense rather than arcane knowledge of the industry. One step follows another. For both venture capitalist and bioentrepreneur, the ability to move a company through these steps successfully—from an idea to an organization that delivers real value—is one of life's greatest satisfactions. ///