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VC to healthcare startups: Identify your customer very early on

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When I started in the healthcare field more than 25 years ago, the only thing that a healthcare IT startup needed was a good idea — a new technology, maybe, or a new scientific pathway. “If you build it, [they] will come.”

But 25 years later, a lot has changed, and startups need more than just a good idea if they want to secure growth capital to expand their business.

So, when I talk to prospective Safeguard partner companies, one of the first questions I typically ask tells me everything I need to know: “Who’s your customer?”

In a competitive funding environment, early- and growth-stage companies need to know who will buy their product; whether or not that customer is going to pay for their product; and why that customer would be willing to pay for it.

The paradigm shift

“Build it and [they] will come” is no longer an effective business strategy, especially in healthcare IT, where the complicated web of payment and reimbursement has blurred this formerly simple equation. Innovation and the “next big idea” have shifted from a push model to a pull model, and startups need to adapt to that.

Some companies — like Apple — aren’t affected by this paradigm shift, as they effectively control their market. An example that’s closer to home is Avid Radiopharmaceuticals. Avid creates diagnostic molecular imaging tests for neurodegenerative diseases like Alzheimer’s disease. Avid developed its imaging tests with no specific customer in mind, believing that the ability to rule out an Alzheimer’s diagnosis was valuable. Eli Lilly confirmed that value when it acquired Avid in late 2010 for \$300 million upfront, plus an additional \$500 million in contingent consideration (payable upon the achievement of future regulatory and commercial milestones).

But the push model in healthcare IT is risky and expensive. Entrepreneurs improve their chances of success if they work to understand unmet market needs, not just what they think the market wants. Unless there is a “pull” from customers, patients, providers, or payers, an entrepreneur in healthcare IT won’t be able to capitalize on just a good idea.

Identify your customer and what you can do for them

Who are these so-called customers? Big picture, they might include patients (consumers), providers (doctors, hospitals, etc.), and payers (employers, insurance companies, and government entities, including Medicaid and Medicare). The customer mix will vary for each company depending upon the specifics of the business.

A lot of IT ideas make sense, they aim to make healthcare faster, better, or cheaper. But startups need to determine who benefits economically and when. When startups seek venture capital financing, they should gear their pitch toward ROI as it relates to their customer.

Think about the following questions:

- What is it worth for employers to have a healthier workforce in terms of productivity, for example?
- What is the value of increasing compliance with therapy or keeping patients out of the hospital?
- Is that ROI calculation backed by data or does it have to be proven to a benefits administrator or payer?
- What problem are you solving for the customer?

For example, Medivo implemented a pull model around patient health management. It enables patients to order lab tests online and better understand the test results so they can be diagnosed early, appropriately treated, and monitored. Physicians and patients both benefit from this service, but neither is an ideal customer.

Instead, Medivo targets payers and biopharmaceutical and medical technology companies, all of which benefit from successful interactions between patient and physician. Those interactions help doctors correctly diagnose ailments and encourage patients show up for appointments and adhere to appropriate therapy. As a result, Medivo has had customers virtually from the start, one of the reasons why Safeguard was attracted to the company.

Understand your customer and the industry

Even after identifying the customer, healthcare IT startups face another challenge: no one really truly wants to pay. Consumers certainly don't want to pay out of pocket. Providers are dealing with shrinking reimbursements, which limit the dollars they want to part with. Private payers strive to remain financially competitive. Medicare is dealing with growing entitlements. Sales cycles are long. Customers can be monolithic, and it's important to identify an advocate within some of these large organizations.

Another issue is that technology, reimbursement, and policy change over the protracted timelines for biopharmaceutical development. And most of the solutions being proposed are incremental at best. Traditional biopharmaceutical development typically follows a push strategy. But no matter how much startups understand the problem and how good the solution, the time to market is relatively long, and the market will most likely change by the time these companies get there.

In this space, the pull model generates technologies that enable more accurate use of biopharmaceuticals or medical technology. These are potentially shorter term solutions that improve outcomes, decrease suffering, and save money. A lot of diagnostic testing as well as faster and cheaper DNA sequencing fall into this category.

Looking forward

In spite of the obvious economic and societal benefits, general adoption of health and wellness is slow. But in the not-too-distant future, much of this will truly matter. Healthcare reform and increasing costs will demand solutions. ROI will become more apparent. We will be not only personally rewarded for staying healthy, but economically rewarded as well. Physicians and

other providers will also benefit by keeping us well or managing our illnesses in a more cost-effective manner. It's just a matter of time until the ability of the tools at our disposal intersects with serious demand for better outcomes.

So bottom line for all you entrepreneurs out there in healthcare IT: Create a target product profile, and then figure out who your customer is. Identify the customer very early on in the process. If you want to improve your business's chances of success and funding from angel investors and venture capitalists, keep asking yourself, "Who's our customer?"