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Venture Capital Funding in Healthcare Industry Remains Strong in Second Quarter 2015

Healthcare startups in the U.S. have received generous amounts of venture capital funding through the first half of 2015, totaling over $7.8 billion for the first half of 2015, which includes $3.89 billion in venture capital investment during the second quarter (2Q) of 2015.[1] Due in part to the increase in analytical tools that help predict clinical trial success,[2] as well as growing investor confidence in digital health startup companies,[3] venture capital investments in the healthcare start-up industry have steadily increased since 2010.[4] However, statistics indicate that certain sectors of healthcare startups, such as digital health and late-stage biotechnology, are obtaining more funding than other sectors, including medical devices and early-stage biotechnology ventures.[5] This Health Capital Topics article will discuss the trends associated with healthcare startup funding, what these trends seem to suggest, and best practices for investors in the current healthcare startup environment.

Funding data for 2Q 2015 indicated a significant capital infusion by investors into startups relating to healthcare technologies.[6] Among the $3.89 billion invested in 2Q 2015, investors provided over $1 billion in capital to digital health startups, an increase from the $716 million invested in the first quarter (1Q) 2015.[7] Increases in digital health funding may be attributed to multiple factors, including the growing accuracy of investors to predict the success of a startup.[8] The increase in funding may also be attributed, in part, to the 58 venture-backed healthcare start-ups that went public in 2014,[9] which is helping to attract both venture capitalists and investors with less healthcare industry experience.[10] Finally, digital health investments have increased, in part, due to a greater number of healthcare startups providing high volumes of data related to healthcare delivery and the cost of delivery. Much of this new data stems from insurance requirements in the *Patient Protection and Affordable Care Act* (ACA). In addition to the ACA's insurance coverage requirements, the law also required health insurers to publish an "*up-to-date, accurate, and complete list of covered drugs on its formulary drug list*" on an insurer's publically-available website.[11] This requirement has increased the amount of data available regarding available prescription drug benefits, allowing organizations to more easily address individualized needs rather than providing a one-size-fits-all insurance plan.

In addition to digital health startups, investments in biotechnology startups also constitute a significant portion of venture capital investments in healthcare. Healthcare biotechnology encompasses products which focus on human cells and genetics that will increase the overall health of humans.[12] Between biopharmaceuticals, healthcare services, medical devices and equipment, and medical software and information services, biopharmaceuticals constitute approximately 55% of all healthcare startup investments.[13] Of the $3.9 billion raised in 1Q 2015, biotechnology alone received $2.14 billion.[14]

Although funding for biotechnology startups has constituted a significant portion of healthcare venture funding in 2015, investors have targeted the majority of their funding toward less risky, late-stage life sciences ventures, such as mobile consumer applications.[15] Investors have shifted their focus away from creative, early-stage biotechnology startups, which frequently seek innovative ways to treat or even cure diseases like Alzheimer's, diabetes, mental health, and other common diseases.[16] Because start-ups dealing with late-stage ventures are less risky due to the increased likelihood of *U.S. Food and Drug Administration* (FDA) approval for clinical trials, investors in early-stage biotechnology ventures may not be as comfortable spending their capital in ventures requiring more research and development and overcoming regulatory hurdles.[17] For similar reasons, investments from venture capital providers are also decreasing in the medical devices sector.[18] The potential long-term effect of this trend could be continued capital infusions into investments dealing with late-stage technology, instead of early-stage startups focusing on the development of new methods of treating common ailments. If these diseases could be treated or cured by technological advances developed by an early stage start-up, the potential reward could be significant for both the investor and society at large.

Investors would be well-served to perform their requisite due diligence before investing in a healthcare startup company.[19] First, investors may want to consider investing capital in sources that help entrepreneurs determine the best way to get device prototypes on the market, in contrast to sources that inhibit the creative ideas of entrepreneurs.[20] Second, although venture capitalists should be aware that the FDA and the *U.S.*

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Department of Health and Human Services (HHS) regulates the healthcare industry, entrepreneurs who possess a thorough understanding of applicable regulations can improve the chances of successful return on investment.[21] While laws such as the *Health Insurance Portability and Accountability Act* (HIPAA) and the *Health Information Technology for Economic and Clinical Health* (HITECH) *Act* work to protect the privacy of consumers, entrepreneurs often view these laws as a form of *red tape*.[22] In contrast to this cynical outlook toward these laws and other regulatory schemes, investors may find it beneficial to review certain aspects of these regulations, including encryption, passwords, control schemes, risk assessments, audit trails, and third party reviews, as well as perform a review of the level of regulatory compliance of a potential investment target, before investing capital into the potential target.[23] Third, it may be prudent for potential investors in healthcare startup companies to confirm that the startup is establishing or has established relationships with hospital systems, regulators such as HHS or FDA, health insurers, and/or pharmaceutical companies in the proper markets.[24] For example, health systems have been investing capital into healthcare startups that develop the products used in their facilities, which may provide immediate access to innovative healthcare delivery technologies that can improve patient care while lowering operating costs.[25] These measures, along with other due diligence tasks, may help investors ensure that any future healthcare industry investments provide an adequate return in today's heavily funded healthcare startup environment.

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