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## Feature Article

# Madoff Matters, But Larger Issues Loom

## Ponzi Schemer Represents Just a Piece of an Extremely Sour Financial Funding Pie

Gail Dutton

In the months since financier Bernard Madoff was charged with promoting a Ponzi scheme, the financial repercussions continue to ripple. Charitable foundations lost millions of dollars, and the recipients of their endowments are feeling the pinch.

The December collapse of the Picower Foundation, a leading benefactor for life science researchers was, perhaps, the most notable, but other funds were also hard hit. For example, the Auld Foundation, a major supporter of the Seattle Biomedical Research Center, had placed approximately 95% of its \$1.75 million in assets with Madoff.

Consequently, “a lot of endowment institutions are cutting back funds from riskier investments in an effort to balance their portfolios,” comments Paul DeRidder, Ph.D., venture partner, [Crystal Cove Capital](#).

The [Council on Foundations](#) reports that about three-quarters of foundations are maintaining their investment strategy, the remainder “generally are becoming more conservative in their investments,” and also are increasing their level of diversification.

Academic medical and bio-related research is feeling the immediate effects of the Madoff meltdown and the general economic situation, according to Nilou Arden, Ph.D., director of biotechnology, [NovoCatalysis](#). “My colleagues at Stanford have already had to tighten their belts,” adds Dr. Arden.

[Brandeis University](#) is one of those directly affected by the Madoff scheme. As to the effect on the university, Irene Abrams, executive director of the office of technology services says, “It’s a little hard to say. A lot of our donors were hit.” She points out, however, “there’s so much government funding for basic research” that it takes several years before universities’ basic research is ready for technical transfer, so any effects upon the biotech industry may not be felt for several more years.

[Howard Hughes Medical Institute \(HHMI\)](#) is looking resolutely forward. “That was long

ago and far away,” vp for communications and public affairs Avice Meehan says of the Madoff scandal. “It will have no impact at all on our operations, although it has had consequences on the institutions where our researchers work. At HHMI, we’re assessing the result of the ongoing financial challenge on our endowments and operations. At this point, despite ongoing volatility, we expect to meet our commitment to our grantees, investigators, and Janelia Farm [Research Campus], and are proceeding with new initiatives with some degree of caution.”

As Shannon Payne, Ph.D., senior scientist, [Epigenomics](#), points out, “These cutting-edge research facilities are the lifeblood of biotechnology. They are the source of the innovative translational technologies upon which biotechnology companies are founded. When they suffer, we all suffer.”

That said, she adds that Epigenomics is unaffected. That’s true of most biotech companies. They haven’t been directly affected, and any secondary effects are expected to be minor and far enough removed to make it difficult to separate them from the general economic climate.

“The Madoff situation is a very localized phenomenon, given the way Madoff worked through a network of well-known people,” notes investment advisor Dushyant Pathak, Ph.D., president of [VentureEdge](#). The ramification is that these investors, many of whom are experiencing notable declines in their net worth, are urging venture funds to slow down.

### **Larger Picture**

Abi Barrow, director of the [Massachusetts Technology Transfer Center](#), concurs. The Madoff case, she says, is “an exaggerated part of the bigger policy picture. The case won’t hit start-ups so much,” but will decrease the number of research initiatives universities can undertake. The long-term effects of the current financial contraction may be to refocus research on less risky challenges. “It will take 10 to 20 years to know the outcome,” she says.

The Madoff scandal is of minor consequence in the larger picture, representing only one challenge to a global financial environment that has been rocked by declining stock prices, additional scandals, and malaise. “Investors of all types are being hit by a liquidity crisis,” Dr. Pathak says. For example, “it’s not uncommon for me to bump into analysts coming out of retirement who are looking at accepting board positions to earn money.”

Boston attorney Jeffrey Quillen, partner with [Foley Hoag](#), reports that clients’ board members, speaking at year-end board meetings, typically advised their executives to “expect the worst.”

“The next couple of years will be hard,” predicts Fred Ledley, M.D., professor of biology and medicine, and chairman of the natural and applied sciences department at Boston’s

## [Bentley University](#).

“It’s tough to find a bright spot right now,” agrees Glen Giovannetti, partner and global biotechnology practice leader at [Ernst & Young](#). “If a pinch is being felt in the U.S., it’s almost worse in other countries.”

Globally, the number of restructurings is increasing month by month, through projects that are being either delayed or shelved. Consequently, workforces are being cut.

Raising funding is difficult. Nicholas Landekic, CEO of [PolyMedix](#), says that for early-stage microcap biotech companies, it’s virtually impossible. In the past 16 months, he has made 485 presentations and raised nearly \$20 million. “That’s enough to last until mid-2010,” he says.

Landekic is continuing to fundraise because, as he points out, “It’s easier to get financing when you have money in the bank. If you have less than six months’ capital, it’s virtually impossible to attract financing.”

Companies “need to be flexible and opportunistic in raising financing,” Landekic emphasizes. NIH grants can help with basic research, and SBIR funding is slow with low initial outlays, although secondary levels of funding can be meaningful. Research contracts are another opportunity, but success depends heavily on who you know, he says.

### **Venture Capital**

Baiju Shah, CEO at [BioEnterprise](#), a Cleveland, Ohio-based biotech accelerator, reports that venture capitalists are less interested in early-stage development, favoring projects that are ready for Phase I or Phase II trials. Shah says he sees an investment trend toward medical devices and healthcare, which are “less risky and less capital intensive.”

Venture funds are also making smaller investments in second-round financings, seeking to leverage their own cash flows. “That means early-stage companies must become more aggressive about financing,” Shah adds.

“Venture capital is being more selective,” Giovannetti agrees, “but the VC companies I’ve talked to lately are still excited about ideas that aren’t yet into the clinic. They’re not moving away from breakthrough ideas. They are, however, looking at different strategies.”

For example, Giovannetti says, exit strategies have shifted from IPOs to mergers and acquisitions, and to transactions that “effectively lock a company up with one suitor.”

[Cephalon](#), for example, has an option for the right to buy [Ception Therapeutics](#). “Investors have some money, but there’s no guarantee of an exit. This is indicative of the

marketplace,” adds Giovannetti. “The focus is on near-term value to get a deal.”

Strategic partnerships offer another financing option, although some, Quillen says, consider this mortgaging their future. “These deals have slowed down,” he says.

All options are being considered. [Unigene](#) is a case in point. Last autumn, Unigene arranged financing through a nonconvertible debt structure with one of its institutional partners.

“We tried to pursue different alternatives but, given the climate, the deals couldn’t be consummated,” CEO Warren Levy, Ph.D., says. “The alternatives are either gone or, if they’re still available, the terms are pretty Draconian.”

That situation is spurring a lot of talk about mergers and acquisitions or creative financing to remain afloat. “If companies aren’t creative, they won’t be around anymore,” Dr. Levy predicts. The expected sell-offs could prove a boon to companies that still have ample cash. “Big pharma and big biotech are seeing an opportunity to pick up technology and programs at better terms,” Dr. Pathak says.

Some companies still have the money for acquisitions, Quillen assures. “Pfizer, for example, laid off 8,000 employees, but still has a lot of cash.” Other companies are in similar positions. “Some big pharma or big biotechs are waiting a bit longer, anticipating fire sales,” he says.

Shah also advises companies to seek out disease-specific funds. [Copernicus Therapeutics](#) and [Vertex](#), for example, each have received funding from the Cystic Fibrosis Foundation. That foundation, along with several others, has modulated its grant policies to direct funds to those scientists best able to bring therapies or diagnostics to market.

### **Federal and State Funding**

Some have suggested companies turn to federal, state, or regional financing options, including SBIR grants. The prevailing notion is that such grants are too low to be worth the investment of time and effort. That may be true for the initial grant, but subsequent funding is often worth a few million dollars.

Shah cites [Arteriocyte](#), which received a \$6 million grant over a 3.5-year period and frequently receives grants of \$500,000 or more. He insists grant writing is not wasted effort. “You can fund a good chunk of research from development to early clinical work this way,” Shah explains.

States, also, may still have some life science funds. Massachusetts, for example, launched a \$1 billion life sciences initiative last June and just made a \$7 million grant to [Organogenesis](#).

Colorado is another bright spot. It has built its biosciences industry from scratch in this

decade, thanks in great part to a state commitment that funded start-ups and built the necessary infrastructure.

“A lot of positive things are happening in Colorado,” according to John Collar, executive director, [Colorado Biosciences Association](#).

Although the state is facing a budget shortfall of some \$604 million, “the legislative groups are doing a good job crafting a budget to go forward with the commitment to biosciences,” including making funds available for proof-of-concept and early-stage companies, he says.

The final option, Quillen adds, is bankruptcy. “Bankruptcy isn’t exactly a survival strategy,” yet some companies that have reorganized under Chapter 11 have returned stronger.

### **Advice**

Despite the overall environment, “there’s opportunity for entrepreneurship,” Dr. Ledley comments.

Shah advises start-up companies to form around a portfolio of ideas. “That means having more than one inventor at the table,” he says. Another trend, he says, is for funds to finance companies because of the team rather than their technology. [Ovation Pharmaceuticals](#) is a case in point. Its management team licensed-in the technology it needed to develop a viable product, which helped it win funding.

“Fundamentals are important,” Landekic continues. “In the past, you could raise financing based upon stories. Today, the focus is on quality, clinical data, business prospects, and the management team.”

Experience, not just in the industry, but in raising capital and taking a compound through development to commercialization is vital. “This is the most adverse financing environment in the history of biotech. Investors want seasoned people,” notes Landekic. His advice? “Be tenacious. Be indefatigable.”

The overarching survival strategy, Quillen says, may be simply to hibernate. Leverage strengths and maximize opportunities, but most of all, cut costs. Sublease office space. Reduce headcount. Shelve all but key projects. Do what it takes to survive.