Testimony of

Ms. Elizabeth A. Weatherman

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Good Morning. My name is Bess Weatherman and I am Vice Chair of the Medical Group of the National Venture Capital Association. I am here today on behalf of the more than 475 professional venture capital and private equity firms dedicated to stimulating the flow of equity capital to emerging growth and developing companies. Our members currently invest more than $36 billion per year in such companies and have invested nearly $210 billion in aggregate over the past 20 years, funding nearly all of the most important technological breakthroughs of that period. A substantial number of these firms invest heavily in the life sciences field that includes biotechnology, drug development, medical devices and therapeutics and health care services. In 2001, the venture capital community invested more than $4.2 billion, or more than 10% of all venture investing last year, in these medical industries.

Venture investment in the life sciences has given new hope to people who suffer maladies across virtually the entire spectrum of diseases and afflictions. In fact, without patient investment from venture capitalists, the biotechnology and medical technology industry, for example, would be virtually nonexistent. Almost every biotechnology product that has been approved for sale by the Food and Drug Administration has been financed by the venture capital community. The venture community also provided financing for many of the medical devices and therapeutics we take for granted today, including the entire interventional cardiology or stent industry. These now standard medical treatments allow patients to lead longer and healthier lives. The venture community's dedication to the medical technology industry exists despite heavy government regulation and the longer-term investing strategy required for successful development of new medical technology, even when compared to other emerging market investments.

Few can argue that what these companies do is critically important to the well being of the American public and the world at large. However, the results of the debate we are holding today on reforming group purchasing organizations to ensure a competitive and open market for all medical industry producers will directly affect the future of emerging life science companies and in turn impact the availability of the important medical products these companies are developing.

Let me be clear, companies subject to, or potentially subject to, anti-competitive practices by GPOs will not be funded by venture capital. As a result, many of these companies and their innovations will die, even if they offer a dramatic improvement over an existing solution. Permitting this innovation stifling practice is unnecessary and counter to what we believe should be a fundamental role of the government: enhancing health by making new or improved products widely available as quickly and efficiently as possible.

THE ROLE OF VENTURE CAPITAL IN IMPROVING AMERICA'S HEALTH

Venture capital plays an integral, often-unsung role in the development of medical technology. In fact, venture capital is the single most important source of early stage financing to new and emerging health-focused companies. During the past 30 years, the venture community financed 1,324 innovative medical companies with more than $20 billion in start up capital. These companies now have sales of tens of billions of dollars, employ more than 2 million people and most importantly, have revolutionized medical care for nearly all Americans. It is fair to say that virtually every U.S. citizen born during the last thirty years has benefited or will benefit, in his or her lifetime, personally and significantly from one or more of the drugs or medical devices developed with U.S. venture capital. These include MR imaging, ultrasound, angioplasty / stents, implantable defibrillators, spinal implants, pulse oximetry and drugs for cancer, heart attacks, and anemia, to name a very few. It is also important to note that the real medical impact of venture investments is also significantly greater than even these numbers would suggest, since our investments are normally focused only on ground breaking or revolutionary technology by the very nature of our investment selection process. Many of these companies' names are now synonymous with progressive medical technology including Guidant, Amgen, and Genentech.

WHY MEDICAL DEVICE AND BIOTECHNOLOGY COMPANIES NEED VENTURE CAPITAL

Medical device and biotechnology companies need venture capital because their capital needs are so large, their time to market so long - due in large part to regulatory compliance--and their risks so high. There are enormous entrepreneurial risks in bringing medical products to market--risks that include proving product safety and efficacy, securing patent protection, securing a good distribution channel, facing entrenched competition, and possibly running out of money before the product can reach a significant portion of the market - to name just a few. Such characteristics make these young companies ineligible for bank financing or other sources of private capital.

It is important to note that venture capitalists will accept these legitimate risks that traditional financial institutions and government supported programs cannot-- it's part of our function. But, VCs do not, cannot, and will not accept unnecessary and unfair risks. We need to provide our investors with justification that substantial capital investment can result in successful product development and financial gain. Thus, we have no interest in products that can be blocked from fairly competing for a share of a market, even after a long, expensive and risky product development cycle. Simply put, venture capitalists will increasingly stay away from many investments in long-term, high-risk medical breakthroughs if the government continues to allow anticompetitive business practices to artificially limit access to medical market.

STANDARD BUSINESS PRATICES BY GROUP PURCHASING ORGANIZATIONS AFFECT VENTURE CAPITAL INVESTMENT EMERGING MEDICAL COMPANIES, AND PATIENT CARE

GPO roadblocks have greatly diminished the attractiveness of medical device and biotechnology investments because they reduce the confidence of venture capitalists that they will have fair access to medical markets and thereby will achieve a return on very risky investments. To put this in perspective, between 1990 and 1994 at least 22% of all companies financed by venture capitalists were medical device or biotechnology companies, with medical device companies accounting for approximately 9% and biotechnology companies accounting for 13% of the 22%.

By comparison, during the period 1999 to 2001 these companies made up only 8.9% of all companies receiving venture capital financing. Of this 8.9%, device companies received 5.0% and biotechnology companies receive 3.9%.

These numbers dropped dramatically from 1999 - 2001 when 9.8%, 7.1% and 11% respectively of the companies funded were medical device or biotechnology companies. For these years, medical device companies dropped more, making up only 5.5%, 3.9% and 6.2% of the combined totals.

One of the reasons for this relative decline new investment is a lack of market access brought about by the business practices and the increasing power of GPOs. GPO practices such as contract exclusivity, substantial fee structures, and product bundling, if allowed to continue, will so constrict potential markets that product segments where these practices are widely adopted will simply not be considered for venture capital backing. This investment drain will result in a stagnation of product innovation and stymie improved patient care across these product sectors.

The arguments made by GPOs about the "administrative" savings they provide to members could be applied to every single sector of the economy and are virtually identical to the arguments made by the anticompetitive "trusts" of the early 1900s, which led to the landmark Sherman Antitrust laws. The idea that the GPOs "save" money for hospitals by extracting larger price discounts from producers than they could achieve by themselves, is unprovable and most likely wrong - unprovable because no one knows what the "real" market price would be in a truly competitive market among producers (in the absence of GPO gatekeeping). In fact, in product areas where GPOs collude with producers who already have virtual monopolies, the "discounted" price that the GPOs claim to achieve is almost certainly well above what the market price would be in an open and competitive marketplace. The impact of the GPOs in healthcare is equally anticompetitive and stifling of innovation, and there is no special reason why the healthcare system should be the only sector of the economy where such practices are tolerated.

The venture capital industry exists, in part, because the antitrust philosophy of the United States prevents entrenched, unmoveable competitors from abusing their market power to unfairly restrain competition. By their very nature, virtually every company we finance is a "revolutionary" and a threat to the established order. The technological innovations they develop, whether in computers, electronics, software, telecommunications or medicine, are inevitably threats to some existing larger competitor who will use all means at its disposal to defend itself. It is hard enough to overcome that kind of power in an open and competitive market place. It is nearly impossible when monopolistic producers collude with monopsonistic buyers such as GPO to suppress competition. This is precisely what is now happening in healthcare.

As the GPOs become more powerful and add more technologically sophisticated products to their portfolios (instead of the more commodity-like products such as rubber gloves, syringes and cotton swabs that they originally focused on) the adverse impact on innovation will increase. There will be fewer and fewer areas in which venture capital will invest. The current trend is not encouraging.

The venture capital community believes that collusion between GPOs and providers of medical products to limit market access to competitors is extremely anticompetitive and not justified by any peculiarities of the medical sector. On the contrary, while the government would not tolerate such practices in any other sector of the economy, for it to tolerate (and even encourage) this situation in medicine is disturbing, because one of the clear effects of these practices is to impede innovation. In medicine, in contrast to any other sector, reduced innovation ultimately affects patients' lives and health. There is no doubt that patients' lives have been lost and other harm done as a result of GPO's activities. In light of this, the special exemptions from the normal operation of the antitrust laws granted to the GPOs should be viewed with even greater, not less skepticism.

Conclusion

The venture capital community believes that there are enormous opportunities to continue to improve the health of the American public through the development and application of new technology. These efforts are already very time consuming, expensive and risky, particularly given recent increases and uncertainties in the U.S. regulatory environment. Despite this, the venture capital community is committed to further investment in U.S. healthcare technology. We welcome open and competitive marketplaces, and we believe that competition has served the American public well by stimulating fair prices and vast technological innovation. The increasing power of GPOs, and their collusive and anticompetitive activities with larger medical companies, threatens to undermine the open and competitive markets that have produced such obvious benefits for the American public, not only in healthcare, but also across the entire economy. We would strongly encourage the committee to consider legislation to correct these abuses and again open these markets to fair and vigorous competition. Thank you.