Innovation Capital

An Interview with
Mary A. Tolan, co-Founder and Managing Director;
Larry Leisure, co-Founder and Managing Director; and
Vance Vanier, co-Founder and Managing Director, Chicago Pacific Founders (CPF)


Mary A. Tolan


Larry Leisure


Vance Vanier

EDITORS' NOTE *Mary Tolan is a co-Founder and Managing Director of CPF. She was the Founder, Chairman and Chief Executive Officer of Accretive Health, Inc., a leading provider of comprehensive end-to-end healthcare revenue cycle management services, which she took public in 2010 with an initial market capitalization of $1.2 billion. Previous to this, Mary was Group Chief Executive of a $2.3-billion global operations group of Accenture, and had a leadership role in taking the company public in 2001. She has received several honors and awards, including being named to Crain's Top 40 Under 40 list, the Ernst & Young Entrepreneur of the Year in Services 2010 Award, the Distinguished Alumnus University of Chicago, and the Illinois Venture Capital Company of the Year Award. She was elected trustee of the University of Chicago in 2009 and is a Trustee of Loyola University. She received a B.A. from Loyola University in 1982 and an M.B.A. from the University of Chicago in 1992.*

Larry Leisure is a co-Founder and Managing Director of CPF. Larry joined Kleiner Perkins Caufield & Byers as an operating partner in 2010 with more than 30 years of experience in the health and managed care industry. He serves as Chairman of ADVI Health, Inc. and sits on the boards of several digital health and care delivery companies including Accretive Health, Lumiata, and Recovery Ways. His consulting leadership positions include Ingenix Consulting (now Optum), where he led their Payer vertical, Accenture where he was the Global Managing Partner for the Health Vertical, and Towers Perrin where he led the Managed Care practice. From 2003 to 2007, after leaving Accenture, Leisure joined one of his clients, Kaiser Permanente, in a senior executive role. In 2010, he co-founded Healthspottr, and now convenes an annual innovation summit meeting in conjunction with The Aspen Institute. He received his A.B. in Economics from Stanford University and his M.B.A. in Finance from the University of California, Los Angeles.

Vance Vanier is a co-founder and Managing Director of CPF. Dr. Vanier was the President of Verinata, which was acquired by Illumina, Inc. in one of the largest venture-backed molecular diagnostic exits in the last decade. Verinata's product, a noninvasive blood test that can replace the need for amniocentesis in pregnant women, has revolutionized the diagnostic methods used in the field of obstetrics around the world since its launch in 2012. He managed the company's rapid revenue growth and achieved the fastest health plan coverage adoption in the history of molecular diagnostics going from inception to over 180 million covered lives within two years. Before Verinata, Dr. Vanier served as President and CEO of Navigenics, a preventative genomics company acquired by Life Technologies. Dr. Vanier received his M.D. from the Johns Hopkins School of Medicine and completed his residency training at the University of California, San Francisco, and Highland Hospital in Oakland. He received an M.B.A. from Stanford University, as well as dual bachelor's degrees with honors. He continues to serve on the clinical faculty of Stanford Medical Center as an Assistant Clinical Professor. He was named a Henry Crown Fellow of the Aspen Institute in 2011 and recognized as one of San Francisco's Top 40 Under 40 in 2012.

COMPANY BRIEF *Chicago Pacific Founders is a private equity firm specializing in innovative healthcare services and senior living investments. The firm is based in Chicago and San Francisco.*

What was the focus and vision around the creation of Chicago Pacific Founders, and what did you see in the healthcare industry that made you feel there was an opportunity for this business?

Tolan: What we all saw was a broad agreement that striving for higher quality outcomes and more affordable healthcare by taking costs out of the equation was something that had really taken hold and that provided an incredibly opportune time for this investment thesis. There was also a recognition that the role private equity and innovation capital has played in helping the competitive process unfold in other industries has been quite remarkable, and has successfully fostered innovation and competition.

Yet, we didn't see extensive participation by the private equity firms in the provider side of healthcare, which comprises 70 percent of the industry. There had been a significant focus on drugs, devices, and diagnostics, but not in the real meat and potatoes of healthcare, which is the delivery of care by the provider organizations.

We saw this as an opportune time when the stars were aligning in the industry to support a quest for higher clinical quality at lower cost, and to bring innovation capital to help that process along. Our goal is to find the provider organizations that have a higher quality and lower cost, and to partner with them to help them grow and become market leaders. We feel we can bring advantages to those founders and management teams that we partner with in terms of relationships with payers and health systems, and assistance from the ecosystem that could help them become successful entities in the long run.

Leisure: We're starting to see payers actually changing the way they interface with providers. We see payers actually buying provider practices and systems that are willing to assume that risk for cost and quality outcomes.

We're also seeing the large self-insured employers that are paying for care, moving aggressively to target providers that deliver better care at a lower price point in a way that is fundamentally different for the discounted fee-for-service approach than what they have pursued in the past.

The other issue coming up that is going to have a material impact is called the Cadillac tax, where employers are going to be limited on how much care they can provide or pay for on behalf of their employees without paying an excise tax, and they're taking it very seriously.

It's very real this time, and the system is ready.

Vanier: This area accounts for a trillion dollars or more of the U.S. economy, and we see a real underrepresentation of private equity.

We also see a real opportunity for the fund to invest in three different themes: the aging population, value-based care delivery, and the migration from inpatient to outpatient services.

We are one of the only private equity teams that are formed by three former healthcare CEOs and executives. Consequently, as we looked at how to create value in each of our investment themes, we felt that we would have a distinct advantage in partnering with entrepreneurs and businesses that need to commercially scale to make value-based health delivery a reality.

How hard is it to find the opportunities you're looking for, especially with the high bar you have set for the type of companies you want to invest in?

Vanier: The great thing about the market is that there is an ocean-sized opportunity. For instance, in senior living, there are thousands upon thousands of senior communities. In the behavioral health and addiction/recovery space, there are over 6,000 businesses.

The trick is to find the ones that have higher clinical quality at lower cost. The three of us have a unique blend of health plan, payer, provider, and technology industry networks. Our industry relationships create an important advantage for recruiting first-class executive talent, attracting business owners, and creating advantageous partnerships for our companies.

Tolan: Even though it's a really big market, many of these companies are small and the market is very fragmented, and without a lot of big dominant leaders.

We've known for a long time that there is a great deal of variation in quality, so we start our search by looking for high clinical quality. We use our friends in the industry and our relationships to discover who the clinicians really respect, where a provider stands in a given part of the landscape, and whether a provider organization is renowned for high clinical quality.

Then we want to get to know that management team, what their vision is, and whether they have an appetite to try to scale and make their company a market leader. This is when we discover if the right ingredients are starting to come together.

You all have a deep knowledge of the industry and the transformation taking place. When you're looking to make investments, will you be hands-on and engaged with the management of these companies?

Leisure: When we look at an opportunity, our intent is to buy successful businesses that have the chance to scale. Through our cumulative experience, we can help them grow the business faster than they might otherwise be able to.

In the case of our addiction/recovery business in Salt Lake, Recovery Ways, I'm working actively with the CEO and COO on securing in-network contracts with the major payers. Today, we've already accomplished that with one major payer and are well on our way to doing that with several others.

I'm working actively with the team, leveraging the relationships I have. I'm out there at least every other week working shoulder to shoulder with the management team. I would assume we will have that same kind of ongoing role with our other portfolio companies.

Do you foresee consolidation with just a handful of winners that become larger players?

Tolan: It's not likely to consolidate quickly. There is consolidation at the level of the large hospital systems, but the rest of the provider landscape beyond hospitals is still in the early days of aggregation.

When we first invested in our behavioral health business treating addiction, they had 50 beds and were full all year. That meant they treated 600 patients. We're going to grow this business very robustly and get it up to 300 beds, which will allow us to treat more than 4,000 patients per year.

Even though there are 2.5 million patients receiving treatment in this market each year, it's not likely that we will see big dominant winners emerge that have the preponderance of a national market. This type of healthcare is very local or regional at most. That is good news for our investors. It means that we can have great investment returns with reasonable scaling in our companies without having to assume they need to be nationally dominant. Hopefully, we're going to build entities that are renowned for higher quality, that are much more efficient on the cost side, and that are very effective in the communities they serve.

Vanier: As Mary mentioned, we are in the early days of consolidation. For instance, there has been some private equity consolidation

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in the dental space over the past 5 to 10 years. However, the most dominant player in this space has over $800 million in revenue and yet has probably only consolidated less than 1 percent of the market because there are 170,000 dental practices in the U.S. making it an over $100-billion market.

It's clear that these are enormous, heavily fragmented markets, and that we're still in the early days of that consolidation.

When considering an investment, is your primary concern a great product and culture or is it more about having the right management team in place?

Tolan: We first really want to see that there is good clinical quality and, from there, we can deduce that they've got some really good clinical leadership.

As we grow the company, we're going to have to add more bench strength to it. We may need to step up some of the personnel in order to open up some new markets. Strengthening and adding to the management team is something we expect will be required in most cases. It's part of the growth journey that companies will be on.

Vanier: Typically it requires expanding the commercial team, adding capabilities to the finance and revenue cycle parts of the organization, all of which are basic infrastructure for scaling.

How great are the opportunities within senior living and how much of a priority is this area for you?

Tolan: Senior living is about one-third of our fund's focus, and it's a very important part of the landscape.

Every single year since 2000, the number of people who are of the age at which it would be typical to want to live in these communities, has gone up.

Societal attitudes are changing greatly. As they reach an advanced age, many people don't want to live at home alone or with family members who are busy all day. They are increasingly determining that living in a vibrant community where they can have friends of their own age and interests, and activities and programming that are appealing to them, is an attractive option. This gives them independence because they're in their own unit and, if they're not at dinner, someone is there to check on them.

This demand will only grow as a function of living longer, so we think it's a huge opportunity to do well.

Like the other parts of healthcare, this is still a bit of a cottage industry – 60 percent of the communities are owned by small operators who have fewer than 10 communities. John Rijos, the CEO of our senior living, is one of the best operators in the history of the industry who has built the largest single platform, Brookdale. He started there when there were 22 communities and by the time he retired, there were 650. He brings a passion for understanding how to blend excellence in hospitality, healthcare, and real estate to meet the needs of our aging population.

Seeing firsthand how well he does this and how well the market responds to it, gives us tremendous conviction to continue investing in what he's doing.

Vanier: The core business model for the senior living industry today revolves around increasing occupancy through better programs, dining, and living experiences for seniors.

However, a large senior citizen membership among our communities also means a pool of extraordinarily valuable members for Medicare advantage plans, hospital systems, and for all of the innovators looking to add clinical services to increase the quality of care and life for seniors, especially in primary care. This is an area that is relatively untapped in the industry.

The senior living industry is still in the early days of thinking about how to increase value-based delivery care from a clinical perspective for that population, and that is enormously exciting for our fund as well.

Do you believe that we are properly preparing for the challenges facing healthcare?

Leisure: I see all those things we call challenges as interesting opportunities. In the senior healthcare space, there are a large number of digital health offerings for monitoring, for finding a caregiver online, and for identifying the best retirement community. Each provides an opportunity to make money, and innovation rushes to where the opportunities are.

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I'm quite heartened by the pace of innovation and the flow of dollars to opportunities.

I think we have tremendous opportunity around end of life. Even as we're talking about how much care is consumed end of life, we're looking at innovations around hospice and the increasing recognition that hospice is a viable option.

I'm quite optimistic and all I see are opportunities for us to address these challenges and bring capital into areas where it has been scarce before.

Tolan: The reality is that there is some really good news here, which is that people are going to live much longer and more productively. However, people are going to have to work longer for that to become affordable.

There are changes that need to take place in terms of the way people think about education and careers. They need to think about it as different chapters and plan to remain productive longer in life. We know that is actually helpful to mental and physical health, as well, and it will allow them to collect resources that can sustain them over a much longer lifespan.

The fundamental issue is affordability. It's probably not going to be the case that people can work for 40 years and then be retired for 30. This adjustment is already happening subtly but more quickly than people realize, and everyone will have to start adjusting in terms of expectations.

Even though it's a really big market, many of these companies are small and the market is very fragmented and without a lot of big dominant leaders.

Vanier: While people have been talking for a long time about the need for affordable healthcare, for the past several years, we've been seeing very specific important microeconomic decisions being made by the purchasers of healthcare in a way that shows that change is real.

For instance, it used to be that if a company invented a better medical device or drug, they could go to a health plan with clinical data, get them to cover it, and automatically charge a premium for that new standard of care.

Today, when a company pitches a health plan, they not only have to demonstrate clinical efficacy for the new innovation, but they also need to have a wealth of health economic data that shows their innovation costs the same or less than the previous standard of care.

It used to be that the employers were willing to simply sign up for a plan and expect that they would be paying more year after year. Now, the large innovative employers are going out of their way to explore ways to reduce costs, such as adopting narrow provider networks. They are willing to take risks on start-up companies that come in showing them how they can save money on their membership base, for instance, through cost transparency.

The more examples we see of that, the more we know this trend is real and that this shift to value-based healthcare is actually happening. This, again, spells opportunity for our fund and, therefore, we can take heart that we are living through momentous times of change.

When you look at coming together to lead Chicago Pacific Founders, what made you feel it would work?

Vanier: Most importantly, all of us were at stages of our careers where we had our pick of who we wanted to work with. The fact that we knew each other, liked each other, and respected each other's backgrounds formed a special chemistry. That is why we wanted to create the partnership and why it works.

Leisure: I had worked with Mary for a long time at Accenture and really respected her passion and vision. She is truly a force of nature and truly inspiring as a leader. I felt I learned a lot from her.

Vance is a superb clinician, incredibly steeped in knowledge in the personalized medicine space. This is going to be increasingly important, particularly as we move more towards precision diagnostics, and the application of technology to drive that. I would argue there are going to be demonstrable improvements in patient outcomes here. He also has tremendous experience as a CEO scaling revenue inside small and large companies.

I bring in expertise from having been around the space a very long period of time and having developed many very strong relationships with self-insured employers, with payers, and the great delivery systems that are going to be ever more powerful in this new world. I thought that bringing those various qualities and experiences together would create something of extraordinary value. We all like each other and this is the opportunity to both make a difference and have fun. ●

Hopefully, we're going to build entities that are renowned for higher quality, that are much more efficient on the cost side, and that are very effective in the communities they serve.