

Start-ups assess new hurdle

Bay State's smaller medical device firms see excise tax draining money needed for growth

By Robert Gavin, Globe Staff | April 14, 2010

WESTFORD — BioBehavioral Diagnostics Co. raised millions of dollars in venture capital and invested heavily in its technology to get its medical device to market. Now, with revenues just beginning to roll in, the six-year-old start-up faces another hurdle as it reaches for success: a new federal tax that will take a cut of every sale it makes.

“It’s going to take even more cash to break even,” said Byron Hewett, the company’s executive chairman. “We’re not even profitable, and we’re already getting hit with a tax.”

BioBehavioral, which developed a system that tests for attention deficit and hyperactivity disorder, is an example of why Massachusetts business and political leaders worry about the medical device tax, recently enacted as part of federal health care reform. The 2.3 percent excise tax, which takes effect in 2013 to help finance the expansion of coverage, will be levied on sales, not profits, draining away revenue that emerging companies need to invest in technologies, not to mention survive, industry officials said.

In Massachusetts, small, innovative firms drive the medical device industry, which directly and indirectly provides some 50,000 jobs and generates \$7.5 billion in economic activity, according to 2007 study by the University of Massachusetts. Three of four medical device firms in the state have 50 employees or fewer, and their ability to compete in the global market depends on whether they can develop better technology, industry officials said.

For example, BioBehavioral, which earlier this year raised \$10 million in venture capital to quadruple its sales force to eight, is already looking to reinvest growing revenues into new applications to diagnose other behavioral disorders.

“Companies in this industry have to innovate or perish,” said Thomas J. Sommer, president of MassMEDIC, the state association of medical device firms. “Our concern is that they are going to have to absorb this tax and make reductions in research and development, expansion, and head counts.”

BioBehavioral’s system was spun from technology developed at McLean Hospital in

Belmont to provide a missing element in the diagnosis of attention deficit and hyperactivity disorder: objective measurement. The company's device, designed as a kiosk where patients respond to blinking geometric shapes, assesses attention spans by combining motion detectors, tracking software, and powerful analytical programs to provide empirical data to help doctors make diagnoses.

The company licensed the technology from McLean and launched in 2004. It raised an initial \$16.5 million in venture capital in 2006 and brought out the first commercial version of the system in 2008. BioBehavioral, which employs about 20, including eight in its Westford headquarters, has sold about 75 systems at under \$20,000 each.

The medical device sector is considered by economic development specialists as vital to Massachusetts, which has the nation's third-largest industry cluster, behind California and Minnesota. With demand for health care products expected to grow as the population ages, the sector draws on skills, industries, and brain power that are well established in Massachusetts, including electronics, software, advanced materials, medicine, and precision manufacturing.

The medical device industry also provides jobs across a variety of occupations, from engineers to computer programmers to assemblers, said Carlos Martinez-Vela, director of innovation policy at the John Adams Innovation Institute, part of the quasi-public economic development agency Massachusetts Technology Collaborative. The industry not only relies on universities and hospitals, but also machine shops, plastics makers, and contract manufacturers.

"Medical devices have a broad reach across the value chain and provide jobs across a wide range of skills," said Martinez-Vela. "It's not just PhDs."

BioBehavioral's kiosk, for example, is built in West Boylston at Cogmedix, where production workers assemble an array of devices, from home health care monitors to cellulite removal systems. Launched at the end of 2008 by its parent, Worcester contract manufacturer Coghlin Cos., Cogmedix's revenue is expected to quintuple this year to about \$10 million from \$2 million, and employment to increase to about 18 from 10, said Chris Coghlin, chief executive of Coghlin Cos.

Still, Coghlin said he is worried about the device tax, since Cogmedix's business relies on small to mid-size firms introducing or improving technologies every few years.

"China doesn't keep me up at night as long as we're working on the next generation of the product," said Coghlin. "But any tax that our customers have to pay inhibits their ability to innovate, to invest in better technology, and create jobs."

Massachusetts political leaders have also raised concerns about the impact of the tax on the industry and state economy. Senator Scott Brown, a Republican, has called for a repeal, although that appears unlikely. Greg Bialecki, state secretary of Housing and Economic Development, said the Patrick administration is committed to working with

Massachusetts device makers to ensure that the industry continues to grow jobs.

Senator John F. Kerry, a Democrat, and other members of the state's congressional delegation worked to reduce the tax, which was cut during legislative negotiations to 2.3 percent from 2.9 percent. Despite the tax, Kerry said in a statement, health care reform "will help the bottom line of most medical device companies by giving them access to 32 million new customers" after insurance coverage expands significantly in 2014.

That may well turn out to be true, said BioBehavioral's Hewett. But it is a promise that emerging firms must buy with precious cash.

"If you are a start-up company, by the time those people are covered, it could be too late," he said. "What differentiates us from the rest of the world is innovation, entrepreneurs, and venture capital, and this tax is a further burden on entrepreneurial companies."

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