

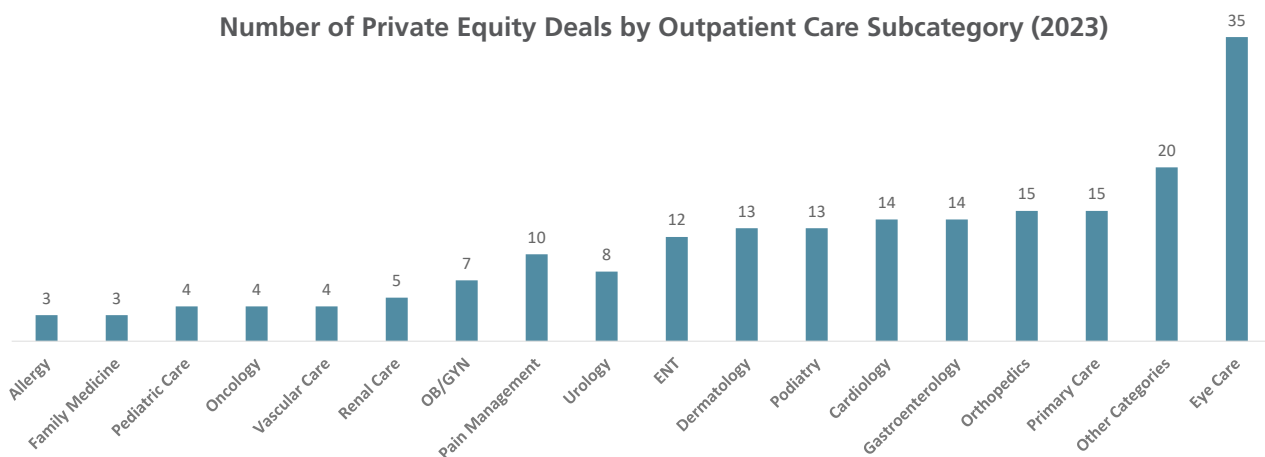
PRIVATE EQUITY IN HEALTHCARE

WHAT'S A HEALTH SYSTEM TO DO? DEFEND, PARTNER, OR BUY?

The Reality of Private Equity in Healthcare

Private Equity firms have increased their investments in the healthcare sector and health systems need a clear point of view on how to address this growth. Amidst skepticism of PE involvement in healthcare, health systems grapple with strategic choices to maintain their competitive position.

The numbers tell a convincing story of PE growth: PE investors spent more than \$200 billion on healthcare acquisitions in 2021 alone, and a staggering \$1 trillion in the past decade¹. Additionally, in 2022, PE firms closed an estimated 863 health care-related transactions, after reaching a peak of 1,013 transactions in 2021². In 2023, PE transactions in ophthalmology were the most common, followed by primary care, orthopedics, GI, and cardiology, as seen in the chart below.



Source: <https://pestakeholder.org/private-equity-healthcare-2023-trends/>

Evaluating Options

To develop a comprehensive strategy for addressing PE in the market, health systems must understand why PE is making significant investments in healthcare. PE's target sectors are those where they believe they can add value through the influx of capital and operating expertise. To accomplish their goals, PE firms implement value-add strategies such as geographic aggregation, cost structure improvement, top-line growth, infrastructure investment, and service innovation.

1. <https://www.commonwealthfund.org/publications/explainer/2023/nov/private-equity-role-health-care>

2. <https://nihcm.org/publications/the-growth-of-private-equity-in-us-health-care-impact-and-outlook>

These strategies aim to address service and access gaps so that strategic synergies, like vertical integration, can be achieved. One of the common elements of the PE investment model is that it seeks to monetize investments in a three-to-seven-year horizon, with the investment horizon culminating in selling the business, usually to a larger aggregator. This “grow and sell” dynamic presents both risks and opportunities for health systems, who may compete with these businesses but may have an interest in acquiring them at the end of the PE lifecycle.

PE’s growing influence in healthcare presents both challenges and opportunities for health systems. While encroachment from PE remains a concern, PE investments can address service gaps in a market or may enhance operational efficiency of certain businesses, but concerns persist regarding quality and appropriateness of utilization. Health systems must develop strategies that will allow them to defend against competitive PE actors in the market, consider collaborative partnerships with the right PE partners in non-core services, and acquire targeted PE-owned businesses when they inevitably come up for sale.



Defend/Compete

In situations where PE firms present a competitive threat, health systems must first identify sectors of their markets that are vulnerable to PE competition. It is vital that systems protect themselves against PE encroachment into high margin services, and health systems must realize that competing with PE may be inevitable. Systems can take several steps to ensure that they have an adequate defensive strategy:

1. **Understand Vulnerable Markets and the Dynamics of Private Equity:** In general, health systems must look for conditions that create PE opportunities, such as disaggregated markets, service gaps and access constraints, emerging business models and services, and independent physician groups that are actively requesting affiliation or growth capital. Systems should thoroughly understand the PE business model in care delivery. For example, with outpatient facilities and physician groups, PE firms may acquire a controlling interest in the entity while the physician owners retain a minority interest. This allows physicians to receive value upfront while sharing in additional upside generated post-transaction³.
2. **Highlight Synergistic Advantages in Transactions:** Instances may arise when PE and health systems are bidding for an asset during a transaction. Oftentimes, PE can deploy more capital towards a transaction than a health system. Health systems may not be able to pay as much as PE, but there are several competitive advantages that a health system can communicate to their potential partners that can influence a transaction their way:
 - a. **Clinical Integration and Continuity of Care:** A natural advantage for health systems is their ability to integrate the entity into their broader network to improve care coordination and continuity. This integration supports better patient outcomes and long-term success for the entity.
 - b. **Physician Alignment and Engagement:** Health systems must be able to communicate and follow through on opportunities to improve collaborative relationships with physicians including improvements in shared governance, clinical pathways, and alignment of financial incentives.
 - c. **Improve Financial Performance:** Operationally, systems can leverage existing administrative and back-office functions, supply chain management, and revenue cycle expertise. These efficiencies can lead improved profitability for the potential partner. According to MGMA⁴, Medicare physician reimbursement increases by \$144,000 when integrated with a hospital system versus an independent group. Additionally, a target entity can take advantage of existing value-based reimbursement models associated with the purchasing health system assuming it demonstrates its commitment to outcomes, cost-effectiveness, and quality of care.

3. <https://www.beckershospitalreview.com/strategy/strategic-partnerships-with-private-equity-firms-what-ascs-need-to-know.html>

- d. **Consider physician integration models with long-term goals in mind:** Many physicians still yearn for entrepreneurial independence. Many employment models, like professional services agreements, allow for physicians to be aligned to the health system without being employed.
3. **Emphasize Aligned Strategic Objectives:** Health systems should clearly articulate their strategic objectives and how partnering with an ASC or physician group aligns with their long-term goals. Demonstrating a shared vision for patient care and business growth can enhance their appeal as partners. Additionally, systems can emphasize their unique strengths, such as existing patient relationships, integrated care models, and community ties. These factors can differentiate them from PE-backed entities and make them attractive partners for ASCs or physician groups.



Partner

In recent years, the healthcare industry has witnessed a shift towards partnerships between health systems and PE firms. These collaborations are particularly prominent in non-core health system services, which include areas such as urgent/emergent care, diagnostic imaging, and behavioral health.

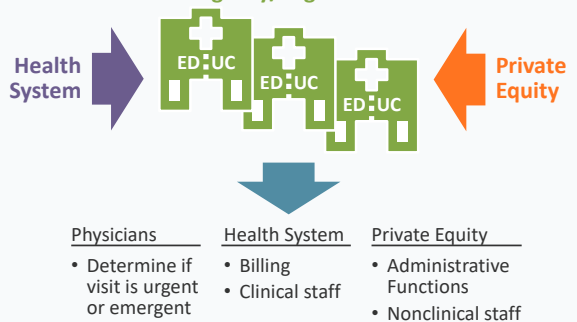
Health systems are under increasing pressure to improve efficiency, reduce costs, and enhance patient care. At the same time, PE firms are actively seeking growth opportunities in the healthcare sector. Health systems have an opportunity to partner with PE to access much-needed capital, operational expertise, and scalability to enhance their non-core services. There are three main benefits for a health system to partner with PE in pursuit of optimizing non-core services:

1. **Access to Capital:** One of the primary benefits of partnering with PE is access to substantial capital reserves. Health systems often face financial constraints that limit their ability to invest in new technologies, infrastructure, and expansion. PE firms provide the necessary funds to support these investments, enabling health systems to improve and expand their non-core services without straining their own resources.
2. **Operational Expertise:** Certain PE-backed businesses bring specialized management and operational expertise to the table. They have a track record of optimizing operations, reducing costs, and improving efficiency. By leveraging expertise of the right PE partner, health systems can streamline their non-core services, leading to better patient outcomes and increased profitability.
3. **Scalability and Expansion:** Partnerships with PE can facilitate the scalability and expansion of non-core services. PE firms have the resources and experience to identify growth opportunities, acquire new facilities, and expand service offerings.

Health System/PE Partnership Case: Urgent Care/Emergency Combo Centers

University of Florida Health (UF Health) and a PE-backed company, Intuitive Health, opened three centers that offer both emergency and urgent care services co-located in the same building⁵. Upon patient entry, physicians determine whether the case is urgent or emergent, for which the health system bills accordingly. Under the JV agreement, UF Health manages medical staff, clinical care, and billing while Intuitive manages administrative functions. This partnership shows that PE can provide operating expertise and growth capital for health systems in non-core services with the intent to make care delivery more efficient and cost-effective for the patient.

Innovative Freestanding ED/Urgent Care JV
Three Emergency/Urgent Care Centers



4. <https://www.mgma.com/articles/carving-out-space-between-employed-and-independent-professional-service-agreements-in-today-s-physician-market>

To maximize the benefits that PE could bring to a partnership with a health system, it is important that the health system picks the right PE partner. Health systems must first ensure that the PE firm has shared objectives and aligned strategic goals. Next, systems must align physician leadership to proposed partnerships to align economic and clinical interests. Physicians will become more than just providers; they become stakeholders in the success of the venture. Finally, systems must evaluate the ownership position that they will be taking in the venture.



Buy

The PE lifecycle culminates in the sale of a business entity. If that business entity is of strategic value (or presents a strategic risk), health systems should be prepared to engage as a potential buyer—despite reservations about dealing with PE firms as the seller. If bidding for a PE-backed business, health systems must understand that likely competitive bidders will be highly capitalized firms ready to move quickly in a transaction. Therefore, to compete effectively in a fast-paced bidding environment, health systems should anticipate and prepare for potential acquisitions. Such preparation would include the following:

- 1. Anticipate potential asset sales:** Identify and maintain awareness of PE-backed businesses of interest; anticipate when they are “ripe” for sale (e.g., >3 years ownership, plateaued pricing/efficiency/scale gains, market chatter, etc.); and keep lines of communication open with the provider base and/or management.
- 2. Understand and quantify the unique strategic value to the health system:** The business for sale will represent a unique strategic value for each potential purchaser. This strategic value may justify a higher acquisition price than that for the general market. For example, the ability for a health system to convert services to HOPD-based payment or its ability to leverage its physician network to integrate care within the system may justify a higher valuation.
- 3. Prepare organizational leadership in advance:** The senior executive team should understand the underlying organizational fit, strategic value proposition, and other key risks/benefits of a potential transaction in its core market well before the bidding begins.

By anticipating and being prepared for a potential transaction, health systems can move more nimbly and competitively in the fast-paced world of PE transactions.

Conclusion

With PE deeply in the healthcare space, it’s clear that health systems need to devote time and energy to addressing this reality and planning for scenarios where PE may be involved. Depending on the circumstance, health systems must be prepared to defend against, partner with, or buy from PE firms who operate in their markets.

If you have any questions about market strategy related to PE or potential partnerships, please contact Scott Clay or Keith Loukas.



Scott Clay

Principal
scott.clay@theinnovagroup.com
678.772.6628



Keith Loukas

Consultant
keith.loukas@theinnovagroup.com
651.270.5114

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The Innova Group is a national healthcare consultancy that specializes in strategic, operational, financial, and facility planning. Since 1995, health systems and medical groups have sought our advice on their most difficult strategic and facility planning challenges. More information about our team of professionals and consulting services can be found at www.theinnovagroup.com.

5. <https://kffhealthnews-org.cdn.ampproject.org/c/s/kffhealthnews.org/news/article/urgent-emergency-care-combo-centers-intuitive-health-jacksonville-florida/amp/>