

Where Is Private Equity Investment Headed in Healthcare? Key Insights for Boards

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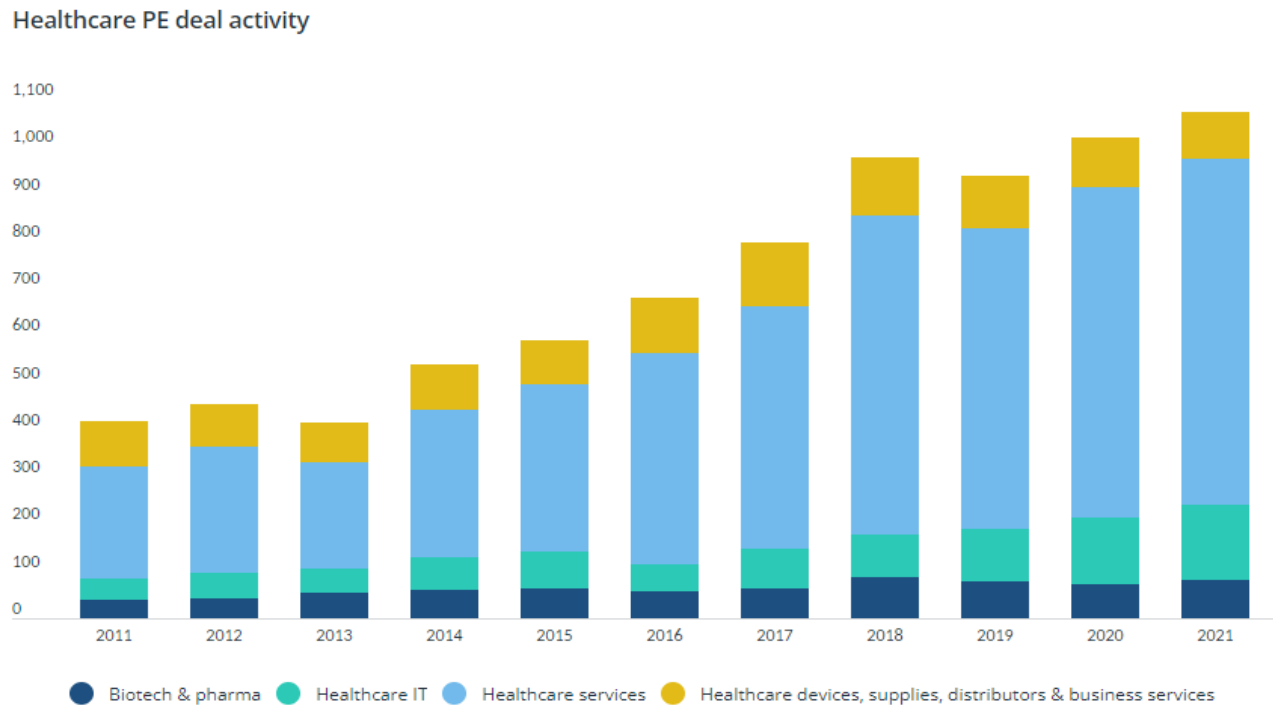
Hospitals and health systems are gradually transitioning from an intensive internal focus demanded by the operational strains of the COVID-19 pandemic toward a renewed external focus on strategic growth. Assessing where private equity firms are prioritizing their investments offers important market intelligence for health systems contemplating growth strategies and should be top of mind for boards.

Consumer engagement is one of the top challenges facing health systems today as consumers seek more personalized care, both digitally and in-person. Digital engagement accelerated rapidly during the pandemic. A recent McKinsey & Company survey found that three out of four consumers expect companies to deliver personalized encounters, and they become frustrated when they don't receive them.¹ Meanwhile, targeted, omnichannel communications for vulnerable populations demonstrate strong potential to improve outcomes and reduce care costs.²

In this environment, private equity-backed disruptors increasingly are inserting themselves between patients and health systems to deliver the care experiences consumers crave. That is especially true in primary care, a \$260 billion market that is vulnerable to disruption due to inefficiencies in care delivery and the availability of high-margin ancillary opportunities (e.g., laboratory services and diagnostics). Other specialty areas of interest for private equity in 2022 include orthopedics, cardiology, neurology, behavioral health (including autism services, substance abuse, and the therapeutics markets), and home care, according to private equity leaders at a recent

- 1 Nidhi Arora, et al., "[The Value of Getting Personalization Right—or Wrong—Is Multiplying](#)," McKinsey & Company, November 12, 2021.
- 2 Oleg Bestsenny and Jenny Cordina, "[The Role of Personalization in the Care Journey: An Example of Patient Engagement to Reduce Readmissions](#)," McKinsey & Company, August 5, 2021.

Exhibit 1: A Decade of PE Healthcare Activity



Source: Ryan Prete, *“PE Healthcare Investments Mature in an Uncertain Year for Health,”* PitchBook, January 14, 2022.

J.P. Morgan forum.³ Data from PitchBook shows that healthcare devices, supplies, and services also continue to draw significant interest from private equity firms (see **Exhibit 1**).⁴ Physician roll-up strategies are on the rise as well, including in primary care and behavioral health.

In each of these sectors, private equity investments follow a trend: they are positioned in lower-cost delivery settings, outside of the acute care hospital. Now, as the latest wave of COVID-19 abates and health systems settle into a near-term new normal, leaders and boards should consider: What does private equity investment look like in our market—and how can we strategically respond?

3 McDermott Will & Emery, *“2022 J.P. Morgan Healthcare Conference: Healthcare Private Equity Leaders Forum,”* JD Supra, February 2, 2022.

4 Ryan Prete, *“PE Healthcare Investments Mature in an Uncertain Year for Health,”* PitchBook, January 14, 2022.

Three Considerations for Boards

1. Should your health system partner with private equity-backed organizations to bolster key service lines? Today, many health systems are exploring alternative approaches to meet certain specialty needs of the populations they serve—including in partnership with private equity-backed organizations. For instance, as health systems emerge from the pandemic, the need to devote more strategic focus to post-acute care—a market that could surpass \$578 billion by 2028⁵—is a top-of-mind concern for leaders. But it’s also an area that organizations struggle to give the attention and resources it deserves—and one that could be ripe for partnership in a post-COVID environment. Another example is behavioral health services, which present a major challenge to many health systems’ bottom lines, as very few produce EBITDA comparable to the margins of dedicated behavioral health providers. Unless your organization is spending all of its time on behavioral health services, it is difficult to keep up with best practices in clinical care and operational efficiency. As the universe of buyers for specialty services such as these significantly expands, boards of health systems may wish to consider whether their organization should continue to “go it alone” in providing these services.

It is important that boards ensure that their organization’s objectives are properly aligned with those of their private equity partners and that both parties prioritize the

→ Key Board Takeaways: The Impact of Private Equity Trends in Your Market

To determine your organization’s response to private equity investment in healthcare:

- Learn about the overarching trends driving private equity investments in healthcare—including in your market.
- Establish a governance process that prepares your organization for private equity-driven change.
- Evaluate where vulnerabilities and opportunities exist for your organization.
- Assess whether the private equity-backed companies in your market will be important partners or serious competitors.

5 “U.S. Post-Acute Care Market Revenue Worth USD 578 Billion by 2028, Says Global Market Insights Inc.,” Yahoo Sports, March 1, 2022.

expected outcomes of the proposed investment in a similar way. While a reasonable financial return is a foundational element of any investment, in healthcare, there can be many competing priorities related not only to return on investment, but also to patient satisfaction, clinical quality, patient safety, and other critical aspects of the business of providing care.

2. What should your senior care strategy look like in an evolving market? Seniors 65 and older are the fastest-growing population in the United States.⁶ Meanwhile, Medicare Advantage is the fastest-growing health insurance category, and it's highly lucrative, generating higher monthly margins per member than other health plan offerings.⁷ For health system boards, a crucial consideration in a rapidly evolving and increasingly competitive environment is whether their organization can provide all the services a Medicare Advantage population needs on their own—especially as private equity investors target profitable service lines. Increasingly, health systems are exploring partnerships with Medicare Advantage plans to attract and retain members while strengthening members' health, with recent examples including Michigan Medicine and Saint Joseph Mercy Health System⁸ as well as Cleveland Clinic.⁹ The impact of such a partnership—from better health outcomes to reduced costs of care through improved engagement, adherence, and care coordination—could run deep.

Some organizations also are ramping up investments in digital health, communications, and services to more effectively engage target populations, such as Medicare Advantage. In evaluating these opportunities, boards and senior leaders should focus on the potential to enhance competitiveness and value while creating better care and more memorable experiences for a prized population.

3. Would direct investment in early-stage firms give your organization a competitive advantage? Even amid the pandemic, healthcare venture capital investments set a record year for venture capital funding and volume. Most health systems invested in areas that were already part of their strategy, such as virtual care.¹⁰ Now, as workforce shortages and rates of burnout strain healthcare resources—including in supply chain—could direct investment in breakthrough technologies help meet

6 [“65 and Older Population Grows Rapidly as Baby Boomers Age”](#) (Press Release), U.S. Census Bureau, June 25, 2020.

7 [“Medicare Advantage Is a Fast-Growing, Lucrative Marketplace. But Is It Benefiting Patients or Insurers More?”](#) Kaiser Health News, February 21, 2020.

8 [“Health Systems Partner with PHP to Offer New Medicare Plans”](#) (Press Release), Sparrow Health Systems, September 29, 2021.

9 [“Cleveland Clinic Joins SummaCare's Medicare Advantage Network”](#) (Press Release), SummaCare, August 3, 2021.

10 Adriana Krasniansky, et al., [“2021 Year-End Digital Health Funding: Seismic Shifts Beneath the Surface,”](#) Rock Health, January 10, 2022.

health systems' needs while giving them an edge in their market? It's an interesting proposition, and one that large health systems have explored. A corporate venture investment coupled with a commercial contract relationship can bring important new capabilities to market and may also offer the potential for meaningful financial returns.

Exhibit 2: Five Factors Fueling Health System Venture Capital Investment



Improve delivery of care and the patient experience



Enable greater connectivity between patient and provider



Expand the scope and utility of health data



Reduce costs



Diversify and enhance revenue streams

Keeping a Pulse on Private Equity Trends and Investment

Capital directed by private equity fund managers continues to rise at a rapid pace, and the companies they back can be important partners or serious competitors. Understanding the trends driving private equity investment decisions in healthcare is key to determining the right response for health systems. By taking a careful view of the private equity-related activity in their market, boards can better position their organizations to make strategic decisions and develop the right relationships in a rapidly evolving environment.

The Governance Institute thanks William B. Hanlon III, Managing Director, and William E. Watts, Director, H2C Securities Inc., for contributing this article. They can be reached at bhanlon@h2c.com and bwatts@h2c.com.

