A Shifting Business Model: Becoming the Nexus of Care in Your Community

By **Dave Morlock,** Managing Director, Head of the Health Systems Practice, *Cain Brothers*

If you run a health system, the headlines, and practical ramifications creating those headlines, seem unrelenting:

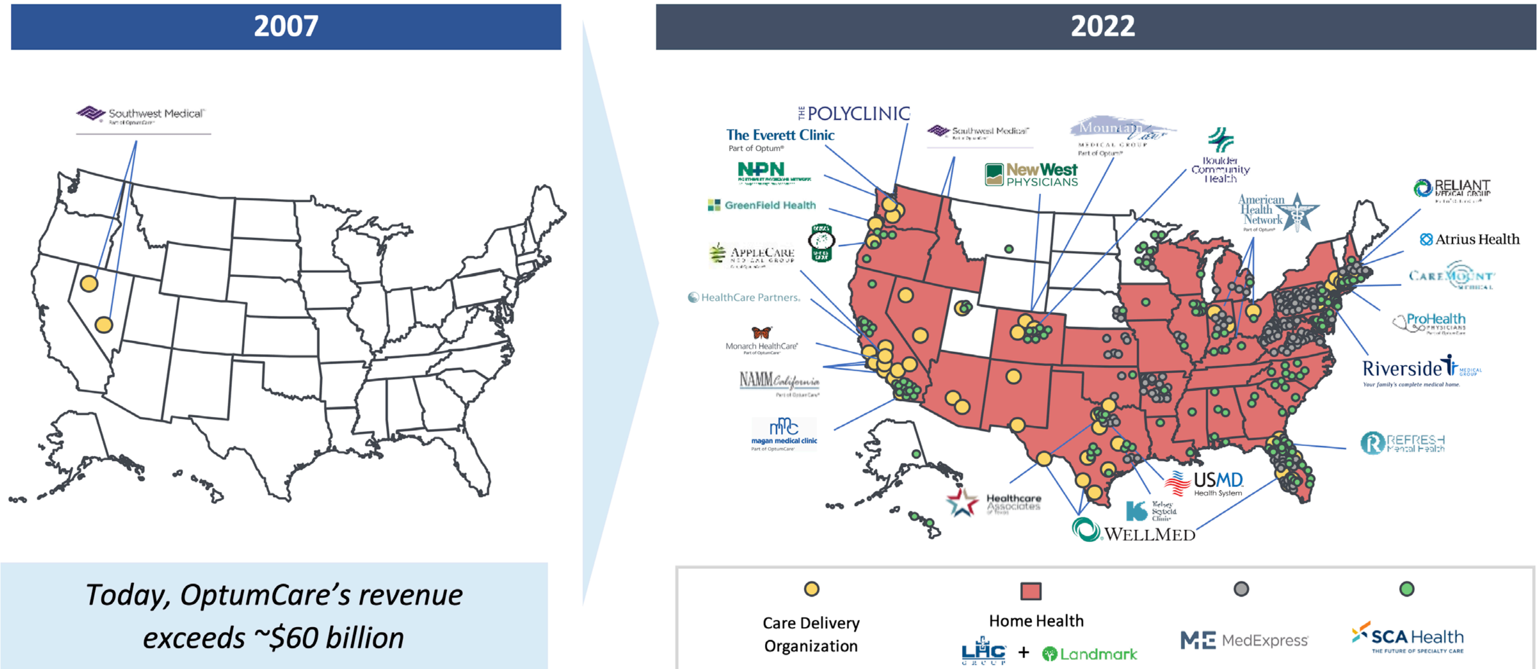
- Mounting losses in the face of higher operating expenses, softer than expected volumes, and strained reimbursement
- Deferred capital investments in the face of the new reality
- C-suite turnover and strained succession planning

Unfortunately, these issues are not the biggest strategic issue facing health system C-suites and boards. **The biggest strategic issue that you face is the reorganization of the American healthcare landscape into an ambulatory care business that emphasizes competing for covered lives at scale in lower-cost and convenient settings of care.**

This shift in the business model has significant ramifications if you own and operate acute care hospitals. And those ramifications can vary, depending on whether you are located in urban, suburban, or small-town environments.

Optum is one of the organizations driving the shift in model. They are owned by the largest health insurance company in the country (UnitedHealth Group), and they have had a string of announced major patient care acquisitions over the past few years, none of which is in the acute care space. The UHG's Optum growth has been breathtaking in the last 15 years (see **Exhibit 1** on the next page). In the last year and a half alone, they have announced deals for Change Healthcare, Kelsey-Seybold, LHC Group, Atrius Health, Oregon Medical Group, and GreenField Health.

Exhibit 1: Optum's Growth (2007 vs. 2022)



The future of American healthcare will likely be dominated by large well-organized and well-run multi-specialty physician groups with a very strong primary care component. Optum, VillageMD, Summit, and Duly are well on the way. These physician service companies will be payer agnostic and focused on value-based care, though will still be prepared to operate in markets where fee-for-service remains. They will deliver highly coordinated care in lower-cost settings than hospital outpatient departments. And these companies will be armed with tools and analytics that permit them to manage the care for populations of patients in order to deliver both better health outcomes and lower costs.

At the same time that this is happening, we are experiencing a steady growth in Medicare Advantage. Along with this growth is a stream of primary care groups that operate purpose-built clinics for the Medicare Advantage population. These companies include ChenMed, Cano Health, and Oak Street Health, among others. These organizations use strong culture, training, and analytics to better manage care, significantly reduce utilization, and produce better health outcomes and lower costs.

Public equity capital and private equity capital are pouring into the physician services sector, fueling this growth. As of the start of 2022, nearly three-quarters of all physicians in the U.S. were employed by either corporate entities (such as private equity, insurance companies, and pharmacy companies) or health systems. This employment trend has accelerated since the start of the pandemic, and the corporate entities, rather than health systems, are driving this increasing trend. Corporate purchases of physician practices increased by 86 percent from 2019 to 2021.[1]

To succeed in the future, you must be the nexus of care for the covered lives in your community. Across all of these physician service companies, they tend to position themselves in major metropolitan markets (urban and suburban areas). In markets large enough for multi-specialty and primary care groups to have scale, these physician groups are quickly becoming the nexus of care. Health systems in these markets risk being commoditized as inpatient beds and an emergency department.

In smaller markets, health systems may be better positioned to serve as that nexus of care, because the large private and public equity backed physician service companies do not tend to locate in these smaller markets due to a lack of local scale. Unfortunately, that same lack of scale can prove to be problematic for those health systems as they try to navigate the choppy healthcare waters.

➜ Key Board Takeaways

- Despite the immediate operational and financial challenges facing health systems, the biggest strategic issue that you face is the reorganization of the American healthcare landscape into an ambulatory care business that emphasizes competing for covered lives at scale in lower-cost and convenient settings of care.
- The future will likely be dominated by large well-organized and well-run multi-specialty physician groups with a very strong primary care component. Public equity capital and private equity capital are pouring into the physician services sector, fueling this growth.
- To succeed in the future, your organization must be the nexus of care for the covered lives in your community. You must be a relevant player in a relevant market.

1 Primary Care Collaborative, "Report: Supermajority of U.S. Physicians Are Employed by Health Systems or Corporate Entities," April 25, 2022.

Next Steps for Health Systems

So, what can health systems do? They need to engage in growing their own multi-specialty physician groups, if they can do so at scale. This will also require the health system to think about how it does "internal accounting" around various business units. Many hospitals treat the ancillary revenue and margins driven by the physician group as "hospital" revenue, rather than attributable to the physician group. This often leads to a misleading picture of how well (or poorly) the physician group is doing. Your health system needs enough analytic horsepower to understand the true economic value of your physician group.

Another potential solution for health systems is to establish a physician services MSO entity that is capitalized by the health system. This entity could provide equity ownership opportunities to local physician groups. In that scenario, the physicians remain a part of a physician-led group, as opposed to becoming employees of the health system. And the health system established MSO that provides equity ownership to the physicians serves as an alternative to the doctors selling their practices to private equity or publicly traded insurance companies.

Whether health systems seek to employ a multi-specialty physician group or choose to stand up a physician service MSO, it is critical that they get into the physician group business in order to be the nexus of care in the local community. This is necessary as the future of American healthcare becomes more and more about reorganizing into an ambulatory care business that emphasizes competing for covered lives at scale in lower-cost and convenient settings of care. And this will best be accomplished by large well-organized and well-run multi-specialty physician groups with a very strong primary care component.

What will you choose to do?

The Governance Institute thanks Dave Morlock, Managing Director, Head of the Health Systems Practice, Cain Brothers, for contributing this article. He can be reached at dmorlock@cainbrothers.com. Cain Brothers, a division of KeyBanc Capital Markets is a trade name of KeyBanc Capital Markets Inc. Member FINRA/SIPC. This article is for general information purposes only and does not consider the specific investment objectives, financial situation, and particular needs of any individual person or entity.