The Governance Institute

E-Briefings

VOLUME 22 • NO. 1 • JANUARY 2025

Friend or Foe? Private Equity as a Strategic Partner to Hospitals and Health Systems

By Hector Torres, Managing Director, Aaron Newman, Director, and Luke Hartline, Associate, Healthcare Investment Banking, *DC Advisory*

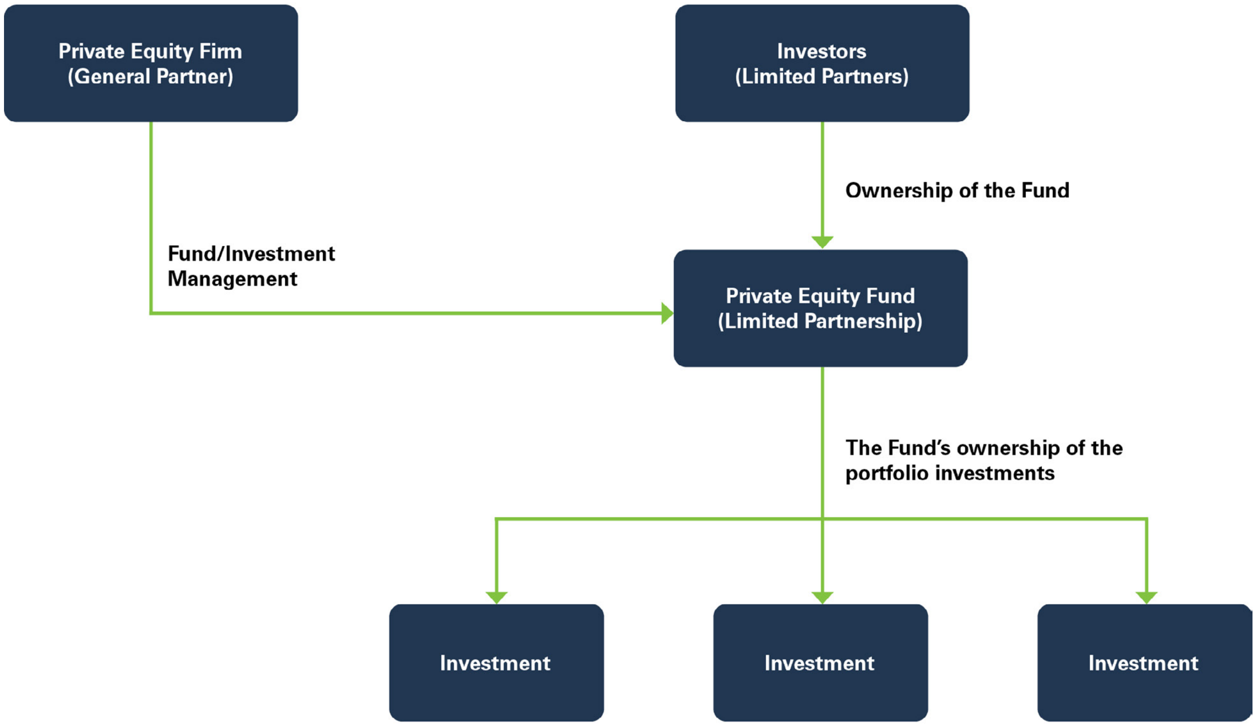
Private equity (PE) plays a significant role in the financing of healthcare in the U.S. In 2022 alone, approximately 863 healthcare-related transactions were completed by PE firms, after reaching a historical peak of 1,013 healthcare transactions in 2021.[1] PE firms have long been consolidators of the hospital, nursing home, and home health sectors, but recently, this investment activity has even extended to physician practice management sub-specialties, such as urology, orthopedics, cardiology, and beyond. PE investment activity, while scrutinized from a regulatory standpoint, has remained consistent within the hospital and health system sector, with approximately 460 acute care facilities presently under PE ownership.[2] A handful of PE firms dominate the list of private equity-owned hospitals: Apollo Global Management (LifePoint Health, ScionHealth), Equity Group Investments (Ardent Health Services), One Equity Partners (Ernest Health), GoldenTree Asset Management and Davidson Kempner (Quorum Health), Surgery Partners (Bain Capital), and Webster Equity Partners (Oceans Healthcare).[3]

In 2022 alone, approximately 863 healthcare-related transactions were completed by PE firms, after reaching a historical peak of 1,013 healthcare transactions in 2021.

PE is a broad term that represents private investment activity taking the form of either investments made directly in a target company or secondary transactions made by acquiring shares from existing investors. Both primary and secondary PE investments are made through a fund of committed capital that is structured as a limited partnership. PE funds involve a general partner, which raises and administers the fund, selects investment opportunities, and distributes return proceeds back to investors when investments are sold. The investors in the private equity fund are the limited partners. The standard PE fund organizational structure is outlined on the next page.

1 PitchBook Data, Inc., 2022.
2 Private Equity Stakeholder Project, Private Equity Hospital Tracker.
3 *Ibid.*

PE General Partner/Limited Partner Fund Structure



Multiple factors are driving PE's growing attraction to the healthcare sector. One was certainly the historically low-interest rate environment witnessed in the last few years.[4] A second factor has been the increasing commercialization of healthcare, which has made it more acceptable for private investors to treat healthcare—traditionally a non-profit sector—similarly to other sectors of the domestic economy.

While PE has already invested nearly $1 trillion into the U.S. healthcare market since 2006, the most recent evolution of the PE playbook includes non-traditional partnerships with hospitals and health systems,[5] due to sector-specific challenges faced by acute care operators. For example, PE can uniquely serve the role of "rescue capital" for organizations in need of funds to stabilize day-to-day operations and invest in the technology platforms and care quality improvement initiatives necessary to remain viable. PE can also be a solution to enable the attainment of operating cost reduction, while simultaneously increasing both access and quality of care. PE can provide acute care operators access to financial and operational acumen, which leads to more efficient healthcare delivery.[6] Additionally, access to the financial, technological, and operational expertise necessary to enable a thriving value-based care strategy also represents a key area of potential collaboration with PE.

4 David Blumenthal, "Private Equity's Role in Healthcare," The Commonwealth Fund, November 17, 2023.

5 *Ibid.*

6 Lukas Recio and Matthew Marconcini, "The Rise of Hospital and Health System JVs with Private Equity," VMG Health, October 19, 2023.

Key Board Takeaways

The following elements can help boards consider the viability of a PE partnership:

- **Barring a massive shift in regulatory policy, PE investment activity in healthcare is here to stay.** PE will likely remain an important constituent in the broader healthcare ecosystem. With industry drivers such as heightened levels of fragmentation, increasing life expectancy of patients, and the resulting increased demand for patient care, PE will continue to deploy an investment thesis across a wide variety of healthcare industry sectors.
- **PE partnerships can be flexible and significantly increase organizational optionality.** Hospitals and health systems typically face stronger operational challenges than most other constituents within the healthcare ecosystem. Fully understand where you are as an organization today and "stress test" if long-term independence is viable. If independence is not viable, PE may be the right strategic partner, but if independence is not a challenging element, clinical service line joint ventures may still represent a viable pathway for long-term success across lower-acuity service lines.
- **Consider PE as a potential catalyst of your broader organizational strategy.** While not a one-size-fits-all solution, PE may be a cost-effective approach to provide long-term success through enhanced clinical services, increased access to capital, implementation of technology infrastructure, and even access to higher margin value-based care programs. Whether it is a full or partial sale to PE, or whether a clinical service line joint venture with a PE-backed portfolio company, view PE as a friend and not a foe in relation to the development of a durable clinical and operating model.

For organizations not seeking an outright sale to PE, clinical service line joint ventures represent an alternative opportunity. These models include PE partnerships within specific clinical service lines in which acute care operators can partner with PE to fully leverage the institutional knowledge, financial resources, and related capabilities of a PE-backed portfolio company, while still maintaining significant service line governance, ownership, and control. These joint venture models can empower hospitals and health systems by enabling them to reap the benefits of partnership with PE-backed organizations that solely focus on a particular service line, thus resulting in increased access to higher quality, lower cost care for the patients they serve throughout the community. This model can provide the hospital and health system with a "best of both worlds" scenario in which their patients benefit from enhanced access to care across a particular clinical service line that may or may not be a core area of organizational growth and/or expertise for the acute care operator. These strategic service line joint ventures may also serve to increase access to care in rural communities not presently served by the acute care hospital or health system, thereby also growing the total addressable patient population for the acute care operator longer term.

TGI thanks Hector Torres, Managing Director, Aaron Newman, Director, and Luke Hartline, Associate, in the Healthcare Investment Banking practice of DC Advisory, for contributing this article. They can be reached at hector.torres@dcadvisory.com, aaron.newman@dcadvisory.com, and luke.hartline@dcadvisory.com.