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Private Equity in Healthcare: Exploring the Challenges and Opportunities

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Private Equity's Influence: Trillions In Buyouts And Fundraising

Capitalism On Steroids

- Private markets in 2022 had approximately $12 trillion assets under management (AUM)
- North America represents the largest percentage of private market activity globally. As the rest of the world saw a contraction in PE fundraising in 2022, North America was the only region to maintain positive growth.[1]
- Even in a slow year, PE fundraising still totaled over half a trillion dollars.
- Private equity firms have steadily increased their participation in the healthcare sector over the past two decades.[2]

1 https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/mckinseys-private-markets-annual-review

2 https://uncipc.org/index.php/initiativecat/private-equity

Private Equity In Healthcare Today

An Increasing Footprint

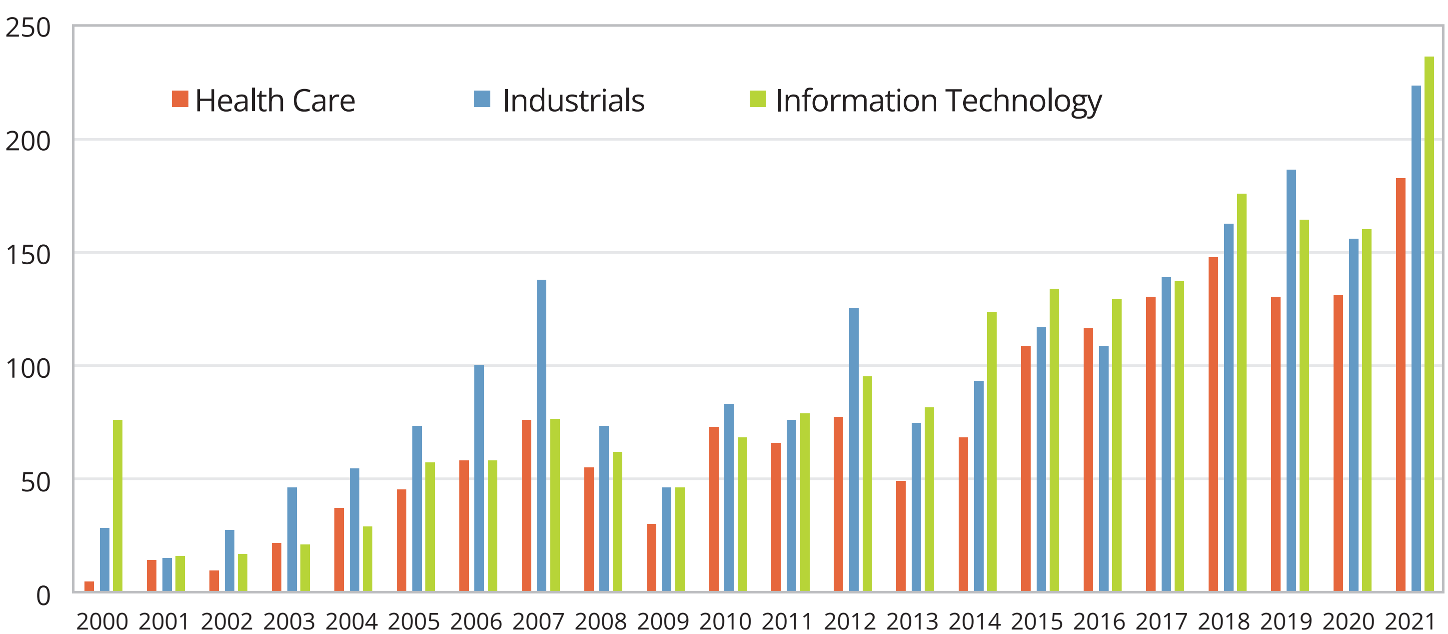
The value of private equity deals in the healthcare sector surpassed $100 billion for the first time in 2018 and reached a record year with $151 billion in deals in 2021. This is in stark contrast with the less than $2 billion total deal value in 2001.

Early Observations For 2023

- As PE firms look for new investments, deal volume has slowed because of valuation uncertainty.
- Given the noticeable slowdown in the first half of 2023, deal activity for the rest of the year will likely focus on consolidation and vertical integration deals.
- Capital is being deployed, however, it is being done with greater selectivity.
- Despite the pandemic, private equity had a record year in terms of deal volume in 2021. Yet, many PE firms are now debating whether they overpaid for certain companies, including overhyped pandemic-era companies and new firms whose valuations were likely inflated by temporary macro and market trends.
- Many PE growth investors "kicked the can down the road" in 2022. This was due to macroeconomic uncertainties such as persistently high inflation, rising interest rates, continued supply chain disruptions, and geopolitical conditions (e.g. Ukraine).

FIGURE 1 New Buyout Portfolio Companies by Industry

Healthcare is 3rd most represented GICS sector in US buyouts



The Healthcare Sector

Strong Returns For Investors

The healthcare sector, known for its intricate and unique challenges due to the involvement of numerous stakeholders such as patients, providers, investors, payors, and policy makers, also presents abundant and lucrative opportunities for investors. Consequently, US buyouts in the healthcare sector have consistently generated strong returns for investors.

FIGURE 2 Healthcare Buyout Performance

	15-Year Return
US Healthcare Buyout Funds (pooled IRR of 83 specialized funds)	21.1%
US Healthcare iShares	10.4%
All US Buyouts (pooled IRR of 981 funds)	16.3%
US Healthcare Buyout Deals (median gross IRR of 1320 deals)	20.5%

Source: Burgiss, buyout funds in Burgiss Manager Universe, 2007Q3 - 2022Q3

How Private Equity Operates Within Healthcare

Private equity operates with a profit motive. In healthcare, this poses unique challenges. The intertwining of public health and patient well-being within a profit-focused endeavor warrants heightened scrutiny. Because of this, some may label PE-funded companies as detrimental to healthcare. This sentiment is supported by instances in which PE has made mistakes in the healthcare sector. Reports of problematic nursing home acquisitions that resulted in worse patient outcomes or surprise billing practices revealed important risks associated with PE ownership.

Perhaps in response to public concern, PE- backed companies are displaying an increased caution in their investments and strategies with a heightened sense of awareness around the need to fully grasp the complexity of the healthcare industry. Many PE firms are partnering with strategic healthcare experts (referred to as “strategics”)—often payors, in order to better align incentives. Moreover, they are increasingly cognizant of the long-term repercussions of their actions. Private equity firms focused on making continued healthcare investments over time understand that damaging partnerships and cutting corners in patient care harm their own best interest.

Various concerns have arisen about how PE can make meaningful, long-lasting change and aid in addressing healthcare challenges. This is in part because PE investments’ are of limited term (typically 3-7 years). Health of individuals and communities requires long-term investments—both in prevention and care provision.

The Stigma Around Private Equity In Healthcare

The stigma around private equity in healthcare is shaped by several factors. The investment requirements and complex nature of private equity deals create barriers that limit entry for smaller and individual investors, reinforcing the perception that the benefits of private equity are only accessible to a select population. Private equity deals lack the inherent public visibility seen in the stock market, where individuals can become shareholders and participate. Instead, private equity deals are known for their reputation of taking place behind closed doors. Additionally, the presence of “healthcare tourists”, referring to private equity firms who venture into healthcare investments without industry knowledge or strategic partnerships, can further tarnish the reputation of private equity firms with genuine strategic partnerships and healthcare expertise.

Despite these challenges, it is important to recognize that private equity firms operating within the healthcare industry can have a positive impact and not all PE activity in healthcare is a simple “good” or “bad”. PE’s presence in healthcare presents challenges, but also creates significant opportunity. It is important to acknowledge that private equity is not the sole actor in healthcare whose behavior we should watch. Payors, health systems, pharmaceutical, and technology companies are also dominant institutions in healthcare, and their actions can have an equally or even more significant impact than PE.

Healthcare Needs Solutions

Can Private Equity Deliver?

PE firms are widely recognized as agents capable of removing inefficiencies in markets and optimizing company operational performance at a rapid pace, strengths the modern-day healthcare system sorely needs. Healthcare today suffers from numerous challenges, but four major categories exist:

While PE will not solve all these complex and perennial challenges alone, it can encourage innovation and serve as a catalyst for meaningful change. As PE continues to invest heavily in the healthcare sector challenges and opportunities are becoming more apparent and should be considered in order to improve upon healthcare access, affordability, equity, and overall value.

THIS INSIGHTS REPORT IS THE RESULT OF THE UNC CENTER FOR THE BUSINESS OF HEALTH AND THE UNC INSTITUTE FOR PRIVATE CAPITAL'S RECENT 2023 PRIVATE EQUITY IN HEALTHCARE RESEARCH SYMPOSIUM. THE REPORT OUTLINES THE TOP CHALLENGES AND OPPORTUNITIES EXPLORED AND DISCUSSED AMONG THE EXPERT PANELISTS AND CONTRIBUTORS FROM THE HEALTHCARE INDUSTRY, CLINICAL PRACTICE, PRIVATE EQUITY FIRMS, ACADEMIA, AND GOVERNMENT. THIS SYMPOSIUM WAS CONDUCTED UNDER CHATHAM HOUSE RULES.[3]

3 https://www.chathamhouse.org/about-us/chatham-house-rule

CHALLENGE 1

Misalignment: Does Profit-Seeking Clash With Healthcare's Goals?

Businesses, whether public or private, have an incentive to create a return on investment (ROI) for their investors. However, can this focus on profits coexist with the main goals of healthcare?

Major Goals In Healthcare:

- Prevention, treatment, and management of individual and population health
- Provision of high-quality care
- Sustained or improved quality of life
- Financial return on investment and profits

What is the Potential Misalignment with PE and Healthcare?

(Alignment)	(Misalignment)	Realignment Opportunity
Infuses needed capital into smaller, innovative, growing companies and provider practices	Emphasis on profits and outsized returns, often within a short-term period	Create measures and reporting to ensure ROI does not come at the expense of patient and health outcomes
Identifies inefficiencies, market failures, and difficult problems within the healthcare system	Leverages regulatory gaps and payment strategies that can push costs to the consumer or payor	PE's identification of gaps should provide signals for payor and regulatory updates and refinement
Optimizes workflows, increases access to health services via improved efficiency	Added burden to healthcare providers and staff via certain optimization efforts	Ensure optimization strategies include provider perspectives during the design
Partnerships with healthcare experts on strategy and investments	Entering the healthcare sector with limited familiarity. Approaching problems believing healthcare is like any other industry	Maintain long-term partnerships with strategics, not only in early-stages of investment

"FOR BETTER AND FOR WORSE, HEALTHCARE IN THE U.S. IS PARTIALLY FUNDED, MANAGED AND DELIVERED BY PRIVATE COMPANIES. INCENTIVES FOR THESE COMPANIES – WHETHER PE-FUNDED, PUBLIC OR INDEPENDENT – ARE NOT ALWAYS WELL ALIGNED WITH PUBLIC NEEDS."

"SOMETIMES, AND IN SOME WAYS, PE INVOLVEMENT BENEFITS THE PUBLIC AND OTHER TIMES IT'S HARMFUL; OFTEN, IT'S NEUTRAL."

CHALLENGE 2

System Overload: Too Many Conflicting Interests For An Equitable System

Healthcare involves numerous stakeholders with diverse interests, beyond patients and their families this includes: government, insurance companies, employers, regulators, hospital systems, pharmaceutical companies, medical device manufacturers, distributors, researchers, physicians, nurses, ancillary staff, shareholders, advocacy groups, non-profits, for-profits, entrepreneurs, politicians, and countless other entities. With each group prioritizing their own improvement, the clash of interests are so strong that it makes imagining an equitable healthcare system difficult.

The existence, investment, and allocation of capital is one of the most important and motivating interests across stakeholder groups in the U.S. healthcare system. The substantial amount of money transacted annually within the U.S. healthcare system is an outlier in healthcare spending, surpassing every other country in the OECD by a significant margin. In 2021 alone, healthcare accounted for approximately 18% of the U.S. gross domestic product (GDP), amounting to a staggering $4.3 trillion.[4]

Considering the trillions of dollars spent each year, even a relatively small category of expenditure, such as durable medical equipment (including contact lenses, eyeglasses, hearing aids, and more), which represents only 2% of the overall spending, amounts to a significant $67 billion. When a seemingly minor spending category can attract a multitude of stakeholders all seeking their best interests, it is not surprising that the largest spending categories, like hospital care with a 31% share equivalent to $1.3 trillion, become exceedingly complex and contentious due to the involvement of numerous interested parties. Private equity needs to navigate this diverse and challenging landscape with heightened awareness of how their actions directly or indirectly impact the numerous stakeholders within the healthcare industry.

> **"THE PATH TO A WELL-FUNCTIONING AND EQUITABLE HEALTHCARE SYSTEM CURRENTLY RUNS THROUGH TOO MANY VESTED INTERESTS."**

> **"IF PE IS A BAD OWNER, WHO IS A GOOD OWNER?"**

4 https://www.cms.gov/files/document/highlights.pdf

CHALLENGE 3

Price Problems: The Need To Innovate, Reduce Costs And Increase Value

- The establishment of the right payment model and payment rates remains a critical challenge. Linking payment to outcomes is important, but this approach alone cannot resolve all the issues related to cost and pricing.
- Government regulators, and subsequently payors, need to drive appropriate incentive structures that help mitigate pricing problems.
- Despite the complexity, the role of risk adjustment must be acknowledged more by all operating within this space.
- Current prices across healthcare are too high and do not center on the patient experience.
  - Research shows that PE acquisition of physician practices results in an increase in healthcare spending. This mainly benefits PE and not society.[5]
- Cost cutting does not have to reduce care quality.
  - As optimizers, PE has not clearly proven their ability to cut costs without lowering quality of care.

TRANSPARENCY MATTERS, BUT IT DOESN'T CHANGE ANY OF THE CHALLENGES RELATED TO COST OR OVERALL ACCOUNTABILITY. PRICES MUST GO DOWN.

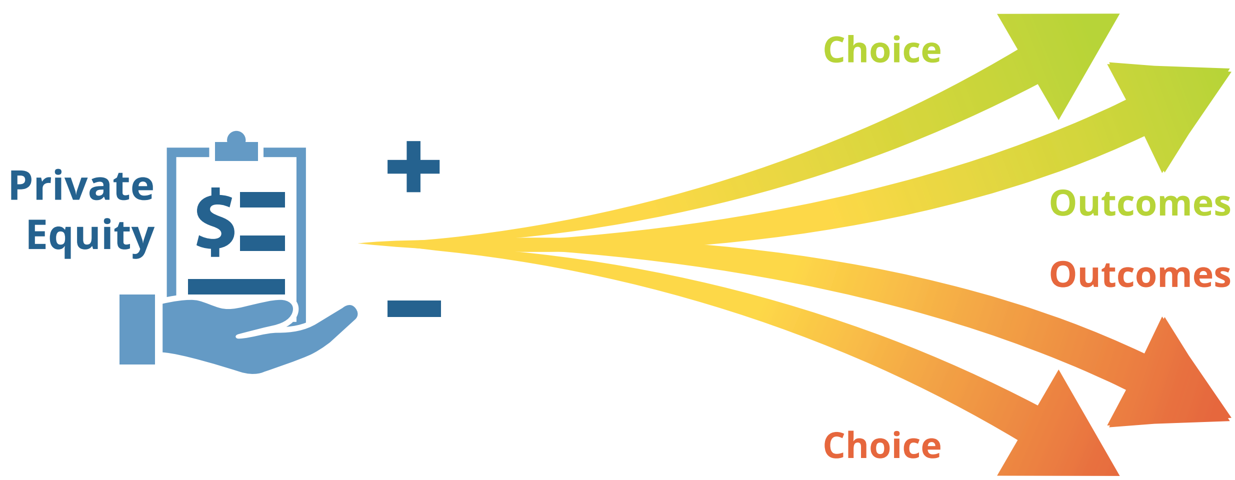
5 Singh Y, Song Z, Polsky D, Bruch JD, Zhu JM. Association of Private Equity Acquisition of Physician Practices With Changes in Health Care Spending and Utilization. JAMA Health Forum. 2022 Sep 2;3(9):e222886. doi: 10.1001/jamahealthforum.2022.2886. PMID: 36218927; PMCID: PMC9440392

CHALLENGE 4

Promoting Health Equity: Ensuring Private Equity Addresses The Needs Of Diverse Populations Where It Operates

- PE raises the quality of care and quality of services in markets where there is a wide range of choice and less so in spaces that serve vulnerable populations with limited market choices.
  - This connection between market choice and outcomes exacerbates inequities in access, affordability, and value.

- Consumer choice is key to making PE align with better patient outcomes, PE then has a strong incentive to provide better outcomes when they are competing with other firms.



> "WHERE THERE IS VULNERABILITY, SOMETIMES POPULATION OUTCOMES ARE NOT AS GOOD. (E.G. NURSING HOMES)"

OPPORTUNITY 1

Pointing Out Regulatory Gaps And System Inefficiencies

In the rapidly evolving healthcare sector, regulators face an ongoing challenge to ensure compliance. However, they often find themselves lagging behind due to the time-consuming process of updating payment models and closing policy loopholes. This time gap inadvertently allows exploitation of system inefficiencies, in many instances for financial gain. Although not all market situations are subject to such exploitation, examples exist within the hospice provider industry, where approximately one-third of providers are currently under investigation. It is important to note that private equity (PE) is not uniquely responsible for these circumstances. Nonetheless, the presence of bad actors in the hospice market presents an example of an opportunity for ethical players to enter and make a positive impact. If PE takes on the responsibility of identifying and highlighting regulatory failures, it can benefit both regulators and the industry, while also addressing negative perceptions and stigmas associated with PE involvement in healthcare.

- Government regulators actively seek innovation from all sources, and private equity has an opportunity to be the prime example of rapid, compliant innovation in the healthcare sector.
- Regulators provide ethical access to comprehensive and robust datasets. The Centers for Medicare & Medicaid Services (CMS) have made significant strides in improving the timeliness of data availability, reducing multi-year lags.

> "REGULATORS SHOULD OBSERVE PE ACTIVITY AS SIGNALS FOR WHERE TO CHANGE POLICY."

> "REGULATORS ARE NOT USUALLY THE INNOVATORS, SOMEONE HAS TO DO IT, SO WHY NOT PE?"

> "REGULATION IS OFTEN CHASING THEIR TAILS AND CANNOT KEEP UP WITH THE RAPID SPEED AT WHICH PE OPERATES."

OPPORTUNITY 2

Private Equity As An Optimizer And Risk Reducer

Private equity firms play a crucial role as effective deriskers in the healthcare sector. Leveraging their expertise in assessing investment opportunities that offer substantial value, they are able to accurately evaluate the risks associated with these ventures. PE needs to continue to make it known that it excels at optimization, mitigates financial risks for growing innovative firms seeking to scale, and tackles gaps in quality of care that the government and public companies have failed to address.

- As active investors, PE firms willingly assume the necessary cost risks associated with healthcare investments that other entities often choose not to assume, this should be better communicated to the general public.
- PE plays a crucial role in transforming healthcare by providing a valuable source of capital.
- Significant investment is necessary to push unproven firms to scale.
- The government is not providing the funding to address all of the gaps in quality of care. This creates an opportunity for private equity to step in and address these needs.

" PE FIRMS IMPROVE THE OPERATIONAL EFFICIENCY OF THEIR TARGETS. "

" WHEN PE MAKES A FIRM MORE EFFICIENT THAT OFTEN TRANSLATES TO MORE ACCESS TO SERVICES. "

" PE BEARS THE NECESSARY FINANCIAL RISKS INNOVATIVE FIRMS AND STARTUPS NEED IN ORDER TO SCALE AND TO DELIVER QUALITY AND ACCESSIBLE CARE TO POPULATIONS. "

OPPORTUNITY 3

Aligning With Healthcare Experts And Industry Insiders

- Strategic alignment with healthcare companies mitigates risks (uninformed market entry and misunderstanding population needs) and improves the odds that private equity firms do not engage in activities that could be detrimental to a specific healthcare sector.
- By actively seeking collaborations and deepening their understanding of the intricate healthcare landscape, firms can shed the "tourist" label and build a positive reputation rooted in long-term growth and comprehensive industry knowledge. Embracing this opportunity allows them to align their goals with the goals of the broader healthcare ecosystem.
- Strategics contribute their expertise to drive scalability and foster a comprehensive understanding of the ecosystem a PE firm is entering.
- Strategics now play a crucial role in driving valuations within the industry.
- It is common for financial investors to invest alongside strategic investors who possess deep market knowledge and a nuanced understanding of patient or partner needs.

"THE RIGOR OF KNOWING THE HEALTHCARE SPACE IS REALLY IMPORTANT."

"THE MARKET RIGHT NOW, IN 2023, IS MUCH MORE RATIONAL THAN THE COVID ERA. HEALTHCARE EXPERTISE IS VALUED MORE THAN EVER IN THIS CURRENT MARKET."

"WHEN PE FIRMS TREAT HEALTHCARE LIKE ANY OTHER INDUSTRY, SUCH AS FAST FOOD AND RETAIL, WITHOUT MAINTAINING A COMMITMENT TO IMPROVING HEALTH, IT GIVE PE FIRMS A POOR REPUTATION."

OPPORTUNITY 4

Adjusting The Narrative; Showing The Value Of Private Equity To The Healthcare Industry

PE has a unique opportunity to reshape the narrative surrounding its actions. Building upon the aforementioned opportunities, PE can effectively alter the prevailing negative perception and narrative associated with it. This can be achieved by establishing a mutually beneficial alignment with regulators, excelling at optimization, derisking, and providing crucial capital to innovative companies. Moreover, PE should maintain collaboration with strategic partners to ensure investment strategies are not detrimental and possess accurate, in-depth market knowledge.

CURRENT PERCEPTIONS OF PE IN HEALTHCARE

- Focused on healthcare staffing investments. Consolidated and disrupted labor in a negative fashion
- Surprise billing practices
- Nursing home acquisitions resulting in increased mortality rates
- Enter into markets without the necessary expertise
- Short-term investment strategies

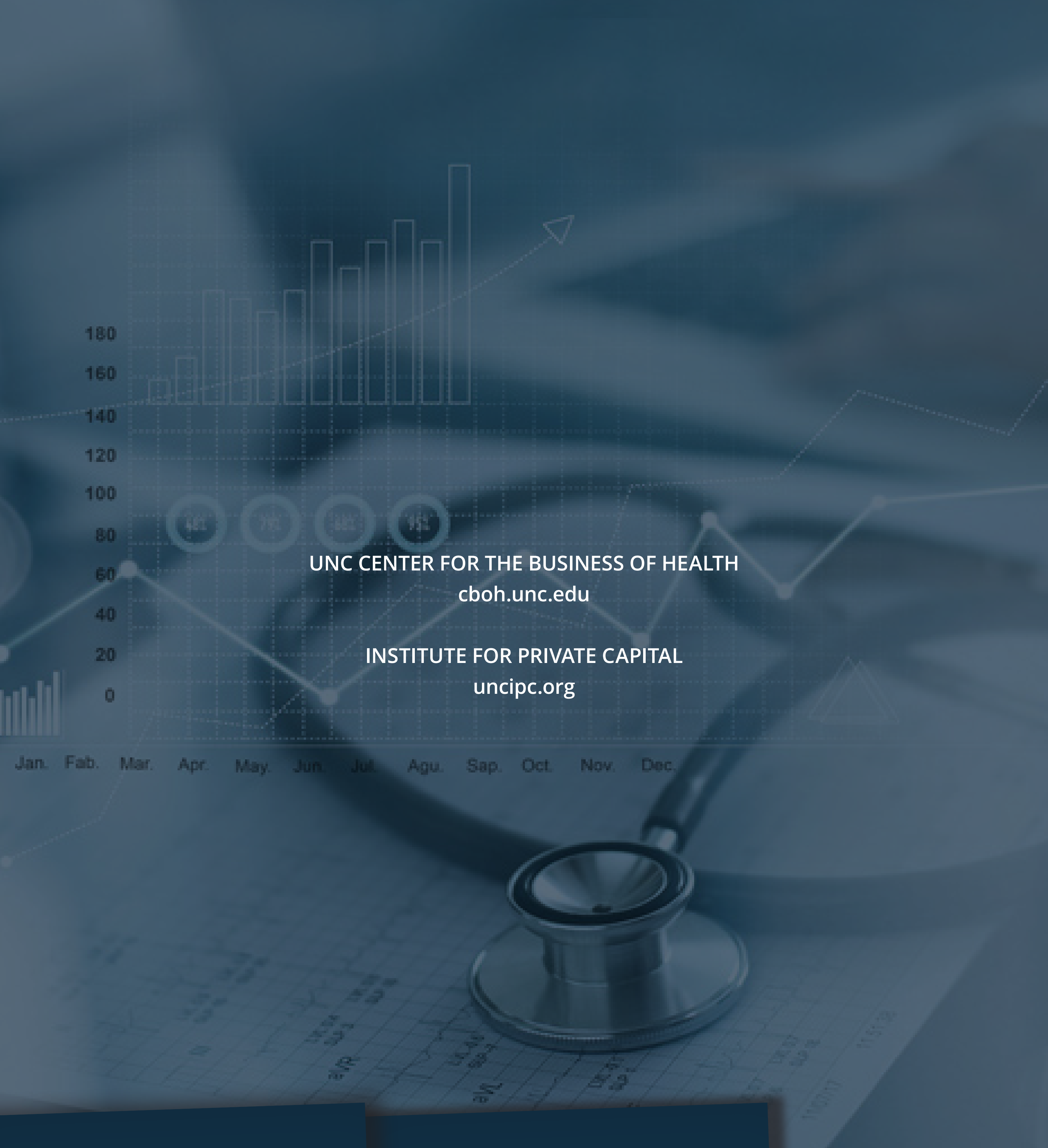
REIMAGINED VALUE OF PE IN HEALTHCARE

- Innovate in staffing to reduce provider workloads and burnout
- Improve transparency and increase value for consumers
- Avoid entry into markets with minimal expertise where vulnerable populations are present
- Align with strategics and experts to make informed decisions
- Long-term growth strategies

"IF PE IS TRULY CAPITALISM ON STEROIDS, THEN IT'S NOT IN PE'S BEST INTEREST TO HARM THEIR CUSTOMERS FOR SHORT-TERM GAINS, AND PE KNOWS THIS."


€ + 1.56%
€ + 0.45 %
95 € - 2.17 %
43 %
63 € + 1.43%
92 %
12 € - 0.92 %
56 %
28 %


Market
PARIS - LONDON
84,95 € - 2.17 %
27,86 €
SEP



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