

CAPITAL INSIGHTS

HEALTHCARE TRANSFORMED



OVERVIEW

In the aftermath of the 2016 general election, there has been considerable debate regarding the public policy governing the U.S. healthcare industry, from the potential repeal and replacement of the Affordable Care Act (ACA) to Bernie Sanders' introduction of a single-payer healthcare bill.

By comparison, the industry's ongoing transformation—driven by the private sector's quest for enhanced quality and lower costs—has been largely overlooked. Indeed, the extraordinary pace of capital formation and technological innovation, as well as mergers, acquisitions, and partnerships, are driving game-changing shifts in the market.

"The private sector can't afford to wait for Washington, DC. It's working diligently to find its own solutions to the nation's healthcare challenges, which is resulting in some important innovations," said Christopher Helmraath, managing director of SC&H Capital.

"Businesses have the opportunity to deliver game-changing solutions and technologies that enable the personalization of medicine, as well as a deeper, more productive engagement of patients across the spectrum," Helmraath continued. "We're in a period of exceptional opportunity."



For their part, hospitals and physician's groups are recognizing that they have three essential options in fulfilling their missions: go it alone, acquire, or sell," said Christopher Helmraath. "For many, the status quo isn't an option, as evidenced by the atypical, but highly logical, partnerships we're helping to orchestrate."

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KEY TRENDS

The underlying need for change is inexorable. Healthcare, principally Medicare and Medicaid, represents the largest share (28 percent) of the U.S. national debt—estimated to be \$20.4 trillion, according to the FY18 Federal Budget.

“Reasonable people of all political stripes recognize not simply that the current economics of healthcare are untenable, but that the return on investment, as measured by broad-based patient outcomes, is unacceptable,” Helmrath said.

Costs are high, and getting higher

The nation’s total healthcare spending for 2016 reached nearly \$3.4 trillion—an increase of 4.8 percent from 2015—according to a recent [analysis](#) by the Centers for Medicare & Medicaid Services (CMS). The agency further estimates that total spending will reach \$5.5 trillion by 2025 due to an aging population and rising prices for healthcare services.

“Value will need to be driven with an eye towards efficiency, which will require the deeper use of technology,” said Kevin O’Sullivan, a Principal at SC&H Capital. “The development of non-regulated revenue related to the patient experience allows entrepreneurial providers to generate greater cash flow.”

Increased spending doesn’t result in better health outcomes

In an [article](#) published in March 2017 by the Harvard Business Review, researchers Yusuke Tsugawa and Anupam B. Jena argue that while the U.S. spending on healthcare accounts for 17 percent of the nation’s gross domestic product—nearly twice as much as the Organization for Economic Co-Operation and Development (OECD) average of 9 percent—the nation’s life expectancy at birth is 78.8 years, well less than the OECD average of 80.5 years.

Helmrath added: “Disease management will become critical as scientific advances enable better treatments to chronic diseases. Like HIV years ago, we now have patients that live with the condition and do not succumb to them. Evidence-based medicine will become paramount in treating these chronic conditions and thus reduce the level of ‘try everything’ approaches.”

The industry remains fragmented

Notwithstanding notable exceptions like [Kaiser Permanente](#), payers and providers have not worked together to share the economic burden of patient care—a model known as value-based care. Improving the efficiency by which quality care is delivered cannot be achieved unless and until insurance plans, charged primarily with managing costs, collaborate with hospitals and physicians, which are principally responsible for driving costs.

“[Accountable Care Organizations] and other risk-based models will become more prevalent in population-rich areas and will create synergy between the dollars spent on care and the quality of care,” O’Sullivan said. “By comparison, rural healthcare will lag behind, and this creates a real opportunity for providers who can create solutions to handle this area.”

Much of the patient population remains disengaged

Quality, cost-effective patient care is impossible without the active participation of the patient, especially among those with chronic illness and the elderly. While this may appear to be a self-evident truth, a 2016 [survey](#) of U.S. health care executives, clinician leaders, and clinicians by the NEJM Catalyst Insights Council finds that 54 percent of respondents said that less than a quarter of their patients were highly engaged.

Greg Hogan, a Director at SC&H Capital, added: “Healthcare education needs to improve to drive better quality and reduce costs. Technology alone is not the answer... Segments of the population are still not using technologies that so many believe to be essential. As an example, many segments are using the emergency room for primary care instead of an urgent care center or waiting for a doctor’s appointment when a telephone call at any time of day will suffice.”



Uncertainty surrounding ACA

Enacted in 2009, the landmark legislation established new rules for the individual health insurance market through exchanges and insurers. While Democrats and Republicans disagree on what reform should look like, few lawmakers in either party discount the need to revisit ACA, especially given that exchanges in some states no longer exist (the result of insurers no longer underwriting policies) and deductibles are cost prohibitive in other states. The uncertainty of reform, however, despite its evident need, has been highly disruptive to both payers and providers.



Delivering better care at lower costs is healthcare's Holy Grail," O'Sullivan said. "It's crucial to understand what you can and cannot control and to develop strategies for the controllable variables. For example, one strategy may be to utilize multiple levels of clinicians, including midwives, nurse practitioners, and physician's assistants, while not being totally reliant on physicians."





WHAT WE CAN EXPECT IN 2018 AND BEYOND

The convergence of these factors has been a catalyst for increased activity in the private sector, which is spurring a significant uptick in partnerships, investment, and innovation—trends that are expected to continue for at least several years. Compounding the likely impact of these changes is the fact an estimated **\$963 billion** in private equity capital is in search of greater returns than those provided by today's historically low money market funds.

More hospitals and physician's groups working together

Reminiscent of the capitation-driven trend decades ago when hospitals purchased physician's groups, there is now greater financial incentive for both parties to share risk. Through day-to-day collaboration, if not outright acquisition, they can also enable patients to achieve positive health outcomes by helping them access outpatient and inpatient care with increased efficiency.

"The Cleveland Clinic already does this with their cardiology care programs, which are then white labeled with regional medical systems," said Helmraht. "This is reflective of the need to develop closed loops of care—building in the gaps between healthy and chronic and knowing your patient."

"The same essential need exists with nursing homes and the myriad of rehabilitation therapy providers, where a disproportionate percentage of medical spending is wasted. By establishing coordinated care with a patient's primary care physician and the multiple secondary levels of care, it would seem that quality would increase and costs could be reduced."



Water is seeking its natural level," said Helmraht. "The increasing cost constraints are such that payers and providers are working together more frequently. For example, a primary care physician no longer instructs a patient to schedule a follow-up consultation to discuss the results of his blood work—an unnecessary step that inflates the cost of care—but now engages the patient by phone or, better still, a patient-facing app or online portal."

Customized solutions through the use of medical data

Historically, healthcare providers have developed information systems for essential business functions—revenue cycle management or billing, for example—but far less frequently to enhance patient care.

While HIPAA poses barriers to sharing patient information, blockchain technology makes it conceivable that the industry might soon use integrated platforms with formidable data integrity for multiple, unaffiliated providers to compare notes in rendering care. Given the promising advancements in gene therapy, federal policy could be relaxed to allow for predictive analytics and patient modeling in ways that are currently prohibited.

“A longstanding reality about public policy is that the bigger the regulation, the greater the unanticipated consequences,” said Hogan. “HIPAA’s prime objective of safeguarding the medical information of individual Americans is unassailably virtuous, but it has also created multiple barriers to providing better care.”

“The ability to share a patient’s healthcare information across all of the disconnected providers who care for the patient would bring real efficiency and efficacy. With the advent of machine learning and artificial intelligence, how could tools like IBM’s Watson become more implanted in the system and allow for more efficient and patient focused solutions?”

Increased patient engagement through mobile health tools and solutions

There is no shortage of patient-facing apps, which hold significant promise as a means of enabling individuals of most socio-economic classes to become more active in managing their health. To realize this promise, however, developers will need to become effective in marketing their wares to patients—whose needs range from behavior change to social support—in addition to being quite different in their receptivity to using the technology. Providers will need to do their part as well in bundling, branding, and promoting apps to their patients, potentially in tandem with payers.



Communication is a critical part of the solution, but it represents a multi-stepped complement of offerings whose success is contingent on the range of users and their understanding of technology and the various means of coordinating information,” said Helmrath.

Increased investment of private equity capital

Private equity has a long history of investing in the healthcare space, and in recent years it has become active in backing rollups of specialty physician's groups. This is a trend that will continue given the increasing desire among many physicians to outsource the administrative burdens—marketing, billing, facilities maintenance, and so on—so that they can focus more intently on their practices. Private equity should also become still more active in fueling the development of the aforementioned patient-centric information systems and mobile health tools, likely having a significant impact on determining the winners and losers in a crowded field of developers.

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Health systems are now entering this fray with investments in proprietary tools and solutions,” said Hogan. “Some characterize them as ‘smart money’ versus the ‘dumb money’ originating with many of the institutional investors who are merely chasing the goal of return on investment.”





CRITICAL SUCCESS FACTORS FOR BUSINESSES IN THE HEALTHCARE INDUSTRY

Because of its vastness and general inefficiency, the healthcare industry will continue to undergo significant transformation. Some of this may well be the result of public policy, but at least as much will be driven by the private sector's quest to eliminate waste while increasing performance.

For companies looking to capitalize on these opportunities—especially those looking to buy, sell, or partner—there are several critical success factors to be weighed:

Emphasize technologies and solutions that are patient centric

As evidenced by a FDA panel's recent recommended approval for a gene-altering leukemia treatment, personalized medicine holds enormous potential. Highly secured information systems that enable physicians who otherwise have no affiliation with one another, save for the wellbeing of a shared patient. The ability to tailor complementary treatments will be of optimal value—economically to the developer, as well as the providers and payers who implement it. Most importantly—it will benefit the patient in the form of an enhanced health outcome.

“As currently practiced in academic medicine, clinicians allow themselves to review patient cases with other clinicians to be sure that they are using all the possible protocols available in their care plan,” said

O’Sullivan.” Efficient modes of communication would be particularly valuable in coordinating data amongst non-affiliated channels such as ambulatory surgical centers, urgent care centers, and therapeutic care.”



There’s a reason why we’re seeing so much private capital being invested in the industry,” said Helmraht. “The general lack of connectivity between healthcare’s essential participants—patients, providers, and payers—and the economic opportunity of eliminating costs that aren’t required for quality care. That’s what business does best.”

Understand the adoption curve

As is the case when a wave of new innovations are introduced to a marketplace, the sellers of new healthcare technologies need to be savvy in targeting both the early adopters and early majority, not simply the innovators, so as to hasten the adoption of their products. While payers and providers are becoming less averse in their decision making, many are still reluctant, at least initially, to depart from conventional behavior. They too need to recognize that patient-facing technologies will likely take longer to be embraced by the general population—and not everyone will do so.



Develop a patient engagement platform that can expand with the patient's needs

Catalyzing the participation of patients in their health and incentivizing wellbeing remains a stubborn challenge for providers and payers, especially among the poor and elderly. “This will require not only enhanced functionality, ranging from adherence to biometrics, but also synthesized patient data to better understand patient outcomes and anticipate emerging patient needs.”

For example, providers need to consider the fast-approaching era of personalized medicine and the various data sets it requires. However, since these data will often come from different sources—a primary care physician in one network, a specialist in another—and can be used not simply to provide better care, but to do so more efficiently, data management and confidentiality are essential.

Conceivably, a patient's data will be stored in a lockbox-like repository where they can be accessed not only by his physician, but also the health system in which he is being treated to streamline the delivery process.

O'Sullivan added: “This does not have to require sophisticated technology. We're talking about the use of call centers to coordinate care, for example, while providing telephone access to clinicians to answer questions. The net result is ready access to the provider without always having to visit an office.”

Recognize that the dynamics of many deals have changed

By definition, the transformative change in healthcare means that mergers and acquisitions (M&A) as well as working partnerships, no longer adhere to conventional standards. The shifting, end-to-end complexity of an increasing number of deals requires not simply an astute strategic consultant, or a deft investment banker, but a partner possessing all of these skills. Think of it as a synapse connecting these two traditional functions; both are essential, yes, but they now require an overarching expertise that determines the right balance between the two.

“The ability to ascertain the real objectives of a deal that will determine success is paramount,” said Helmraath. “Given the large number of not-for-profit healthcare entities, simply saying that money is the be-all and end-all is not true.”

“Deals can be structured to form alliances and joint ventures and maintain the mission and charisma of an organization, while honing accretive solutions via another’s competency,” he concluded.



Clients often ask us when healthcare reform will occur—and what it will look like,” said Helmraath. “While recognizing that national healthcare policy can have a highly significant impact on the entire industry, we’re quick to point out that reform is happening every day in the private sector, and will continue to, especially as payers and providers further align the needs of their patients and economic interests.”

With the change in healthcare comes [change](#) among professional services firms. Increasingly, business don’t need a “how to” consultancy or an investment banker, but an amalgam of the two that is equally adept at both disciplines and possesses a depth of knowledge regarding public policy.



About Capital Insights

Capital Insights converts SC&H Capital's in-depth knowledge of key industries, as well as our expertise in M&A, into actionable insights that businesses can use to their competitive advantage.

About Healthcare Transformed

Few industries in the U.S. are as large and complex as healthcare. Fewer still are as ripe to be transformed—an inevitability given healthcare's size, inefficiencies, and uneven performance. The transformation will result in sweeping changes, potentially displacing established market-leading firms, products, and alliances.

The first installment of SC&H Capital Insights, Healthcare Transformed is a series of eBooks written to help payers, providers, suppliers, and funders successfully navigate sweeping changes in the industry—transformation that is only now beginning, but will play out over many years to come and contribute to the ebb and flow of the healthcare M&A market. Our healthcare authorities identify the emerging trends, while examining the opportunities and threats they pose to business, in addition to making sense of public policy and its potential impact on the private sector.

About SC&H Capital

SC&H Capital, an affiliate of SC&H Group, is an investment banking and advisory firm providing M&A, employee stock ownership plan (ESOP), capital raising, and business valuation solutions to middle market and growth companies nationwide. SC&H Capital delivers investment banking and advisory services across numerous industries, including technology, healthcare, manufacturing, and government contracting to help owners achieve their exit planning goals and liquidity objectives. To learn more, visit www.schcapital.com.

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