



Episode 115: Tracking the Fast-Growing Payor Services Market, With Patrick Keavy

Episode Summary

Payor services is an “enormous marketplace,” says [Patrick Keavy](#), managing director at Bailey & Co. In this conversation with McGuireWoods partner and host [Geoff Cockrell](#), Patrick, who focuses on payor services within healthcare, shares his insights about the market and its future. Tune in as he reviews the growth of employer-sponsored healthcare, cost-containment strategies that companies can leverage, and the results of his research into the verticals and subverticals that Bailey & Co. covers.

[Request](#) a copy of Bailey & Co.’s report “*The Rise of Cost Containment in Employer-Funded Healthcare*.”

Transcript

Voice over (00:00):

This is the Corner Series, a McGuireWoods series exploring business and legal issues prevalent in today's private equity industry. Tune in with McGuireWoods partner Geoff Cockrell as he and specialists share real-world insight to help enhance your knowledge.

Geoff Cockrell (00:20):

Thank you for joining another episode of the Corner Series. I'm your host, Geoff Cockrell, a partner at McGuireWoods. Here at the Corner Series, we try to bring together deal makers and thought leaders at the corner of healthcare and private equity.

00:34):

Today I'm joined by Patrick Keavy, a managing director at Bailey & Company, a middle market investment bank who I've had a long relationship with over the years. And we're going to delve into

some nuances of some subsegments within the payor services arena. But Patrick, if you could introduce yourself and maybe say a little bit about Bailey & Company.

Patrick Keavy (00:54):

Yeah, thanks, Geoff. I appreciate you having me on here.

(00:57):

Bailey is a middle market healthcare-only investment bank. We're about 50 employees. Right now, 40 bankers, 12 managing directors. We cover all areas of healthcare, healthcare services with a provider orientation, healthcare IT, and then payor services, which is where I spend all of my time.

(01:19):

We have become one of the most active banks from a healthcare perspective in the middle markets, closed 13 or 14 deals so far this year. We'll probably end the year with 25 plus across all segments of healthcare, and we're entirely focused on the middle markets.

(01:35):

So the enterprise values from \$50 million at the low end to \$500 million plus at the high end. I think our average deal size is somewhere in the 150 plus or minus range, firmly in the middle markets. Probably 50% of our deals are private companies, founder owner operator receiving institutional capital for the first time, and then the other half or so are key backed exits. So that's a little bit about Bailey & Co.

(02:03):

My background, I've been in banking for about 14 years. During that time, I focused on healthcare and insurance services. Started my career in the insurance industry. So I actually have a background in that as I spent the first six or so years of my career underwriting employee benefits. And then I was a consultant for a broker for a couple of years in a precursor of what became Hub International.

(02:27):

So last 14 years focused on middle-market healthcare investment banking, and now I spend all of my time within healthcare on payor services. And within payor services, there's a couple specific verticals where I spend all of my time, employer health, which will be the topic of the conversation today. We'll do a deep dive on that.

(02:47):

Insurance distribution, so think Medicare Advantage, ACA brokerage, lead generation, or services into that intermediary market. And then outsource health plan solutions. So any service or technology that can be outsourced from a health plan to a third party, cover that space as well.

(03:08):

And just given dynamics that you've probably covered on other pod paths related to healthcare, payor services has become one of the most active areas of healthcare as we've seen a lot of investors de-emphasize provider. Maybe de-weighting that, because they're pretty heavy on that, over the last decade or so. And really focusing on B2B payor services.

(03:33):

So it's become a very active area in the market and given long-term fiscal and demographic trends, it's an area that we expect to be very active in for years and years to come. So it's an exciting place to be. And happy to be joining this podcast and taking a deeper dive on employer health.

Geoff Cockrell (03:51):

Before we get directly into employer health, how big is the payor services market? For a long time, feel like all the winds were pushing direct provider services in the massive consolidation of those massive businesses. And then there was a ton of interest in pharma services, which is another vast array of only somewhat connected businesses. How big is the payor services market in comparison to some of the others?

Patrick Keavy (04:19):

Yeah, it's an enormous marketplace. It depends on how you define the actual PAM or SAM of the payor services marketplace, but I think at a couple hundred billion dollars, at the very least. It's such a huge component of healthcare.

(04:34):

I think healthcare is something like five or \$6 trillion of GDP right now. Payor is at least several hundred billion dollars of that, so given how large it has become. And then even these subverticals within that can be in the tens of billions or multi-billion dollars.

(04:52):

So it's an enormous industry. It's probably growing at a rate of between 10 and 15%. So making up a disproportionate share of healthcare as the years go on here. So very large, very fragmented within certain verticals. And consistently, a fairly rapidly growing segment of the healthcare marketplace.

Geoff Cockrell (05:13):

And you break the broader services sector down into the three verticals that you described of employer health, health insurance distribution, so including things like Medicare Advantage and other similar things, and then outsourced health plan solutions.

(05:29):

How would you compare the relative size of those verticals just for purposes of assessing how deep the market and activity is in the different subsector?

Patrick Keavy (05:38):

Yeah, employer health is comparable to Medicare Advantage, and we'll go through a couple of numbers here.

(05:44):

So employer health is a marketplace that covers about 150 million Americans. So around 100 million people are employed and receive insurance through their employer. By extension, over 50 million dependents, spouses, children receive their healthcare coverage through an employer as a member. So that's about 150 million people in total. It's about \$1.2 trillion in annual spending. It's been very substantial.

(06:13):

And the overall growth rate of that is somewhere in the 10% plus range. We'll talk about why inflation has been so strong in that segment over the last couple of years, and why it'll continue to be. That's one of the reasons why it's a great spot to play in, but that's an enormous marketplace.

(06:30):

Medicare Advantage covers a smaller amount of members, but has a comparable spend. I think something like 65 or 67 million people are eligible for Medicare right now. Between those 65 and older or those on long-term disability, that number is growing by around 5% every year as our population continues to age.

(06:52):

The overall spend within Medicare is something along the range of, I think it's about \$900 billion right now. That's split pretty evenly between Medicare Advantage, which is the private provision of Medicare, where CMS, the Center for Medicare and Medicaid Services, is paying the insurance carriers like a United or a Humana, a capitated rate to be responsible for the insurance of an individual.

(07:19):

Medicare Advantage is about half of Medicare. The other half is just traditional Medicare, but Medicare Advantage is growing at a disproportionately faster rate as more and more people to choose Medicare Advantage. And beyond the scope of this conversation, maybe a different podcast, Geoff, Medicare Advantage will continue to grow and make a disproportionate share.

(07:39):

ACA is something like 20 million members right now, maybe a couple hundred billion dollars of spend. So that covers that aspect of the market.

(07:49):

And then finally, outsourced health plan solutions. It really depends on how you define that, but I'd say broadly it's probably in the \$100 billion or so overall TAM. So even though that's comparatively smaller outsourced solutions to health plans, it's still an enormous marketplace, and one that is growing at probably a double-digit rate as well.

(08:12):

So you can see why all three of these segments are very well sought after areas of investment within private equity and in strategics. And again, just given long-term fiscal and demographic trends here, which could be a much longer conversation, it's going to remain that way for years and years to come.

Geoff Cockrell (08:35):

So let's zero in on employer health. From the perspective of employer health, I see lots of deals and investment theses that are surrounding employer self insurance. But I am assuming that your definition of employer health is more broad in the sense of businesses that are assisting actual payors with cost containment.

(08:57):

How would you segment or subsegment employer health?

Patrick Keavy (09:00):

Yeah, the way that we think about employer health is anything that touches an employer-sponsored healthcare plan. Now, typically that means a self-funded plan, but we also see a lot of services that are into the fully insured marketplace as well, and sometimes into both segments there.

(09:18):

It tends to be more on the self-funding side, just because the employers have more skin in the game and have more control over the overall cost. And can have more of an impact on that. But again, we see a lot of cost containment solutions, a lot of broader employer health solutions focused on the fully insured marketplace as well.

(09:39):

And then within that, there's a whole host of different verticals that focus on employer health. You have everything, and I think we'll talk a bit more in detail on this. You have hard-dollar cost containment, so I feel like reducing the cost of an incurred claim. You have more population health-focused services such as care management, care navigation, member steerage.

(10:05):

And then you have a host of services and technology that just helps support these plans and allow cost containment to take place. It may not have a direct hard value dollar [inaudible 00:10:17], but it is allowing employers to participate in a self-funded arrangement. And therefore, is a very valuable service because it allows this full operation to take place there.

Geoff Cockrell (10:27):

One of the evolutions that has made employer health, and especially self-funded programs, expand has been the lowering of the number of employees that you need to have to effectively enter that idea.

(10:43):

How has that evolution changed the market and what services do those companies need?

Patrick Keavy (10:50):

And maybe I'll take a step back here. Maybe I'll just spend a minute on what's driving this, because I think it'll be a good foundational background in these various services. Why the small mid-size employers are increasingly embracing self-funding and where things go from here.

(11:06):

So if you think about commercial health insurance, and may use those terms interchangeably, commercial health, group health insurance, employer-sponsored healthcare, those are all going to mean the same thing here. Commercial insurance or employer-sponsored insurance has grown at a much more rapid rate than Medicare, Medicaid, ACA, particularly Medicare and Medicaid.

(11:29):

The reason for that is because Medicare and Medicaid, the government sets the reimbursement rate. It's by fiat. This is the rate, you're going to take it no matter what. Commercial insurance has always been negotiated between payors and providers. And up until recent years, there's been a high degree of opaqueness or opacity, so lack of transparency into what reimbursement is across the payors.

(11:57):

There's really been no quality metrics tied to the overall cost of reimbursement. And because providers have had to just take Medicare or Medicaid rates and have not been able to negotiate that, they have looked to commercial insurance to effectively cross-subsidize Medicare and Medicaid.

(12:17):

And because the overall industry has been so opaque, there has been no transparency to employers or to members of what actually reimbursement is, to know what you're going to pay until you receive

the bill in the mail. The providers have been able to negotiate rates that are two times, three times, five times Medicare. So a huge disparity in pricing overall.

(12:41):

Now in the last couple of years, the annual costing freeze for employer-sponsored healthcare has been in this consistent 10% plus range. So if you think about the overall cost or the overall wage increases, maybe a nominal rate of three to 5%, you can quickly see how a 10% increase in the cost of healthcare compared to a three or 4% increase in overall wage increases. That's totally unsustainable situation.

(13:11):

And then if you look in the hard dollar amounts, the average cost of a PPO plan for a family of four, something like \$25,000, the average cost to cover a single employee is something like eight or \$9,000. You're talking real dollars here. A huge portion of the overall compensation for an employee. And if you have a sustained 10% rate increase every year, that's going to continue to chew up a disproportionate share of overall income.

(13:44):

So I give you that backdrop in why this is becoming such an issue. And why even these small employers, 50 lives, 75 lives who have traditionally always sought a fully insured product because it's much more simple. And the responsibility of paying claims is entirely on the payor. The costs are very predictable. You just pay your premium. Why even those smaller companies are aggressively seeking self-funded alternatives now as opposed to just a traditionally fully insured product.

(14:14):

So that's a big driver of the overall market growth here. I'll take a pause there and then I'll get to your question on what modalities of cost containment they're choosing right now. And what's allowing them to actually effectively and sustainably choose a self-funded alternative.

Geoff Cockrell (14:32):

What's the delta in what a company can save versus just traditional employer sponsored health plans? If they go the route of self-insurance and cost containment, how much savings is actually in play?

Patrick Keavy (14:50):

So the answer is of course, it depends on how aggressive of a cost containment approach you would take. So if you just go plain vanilla and you stay within a PPO plan, you're not making any changes. You're just basically moving from a fully insured plan to a self-funded plan. You get on an appropriate level of stop-loss insurance to protect, if you're a small employer, protect against a large flame hitting your insurance and just blowing up your plan.

(15:20):

So let's say it's about as plain vanilla as you can get. On average, you can expect probably a five to 10% decrease and maybe a few hundred basis points off of the overall trend. So maybe on average, because there's more variability and volatility within a self-funded plan, but on average over a five-year time period, you're probably taking five to 10% off the cost of the plan.

(15:45):

Some of that is insurance profits, some of that is premium taxes. Some of that is just more traditional cost containment of care management that comes with a plain of vanilla plan. And then you may reduce the trend from say 10% down to 8%. So you can see, Geoff, that an initial five or 10% reduction reducing trend by 200 basis points over a five-year period, and that's meaningful. And that's plain vanilla.

(16:15):

Now, you can take much more aggressive strategies. We'll talk about some of those. We can talk about some of those here.

(16:22):

Say for example, reference-based pricing or some flavor of reference-based pricing where you are decoupling from a traditional network, a traditional PPO network. And the claims administrator is paying claims based off a percentage of Medicare. So say for a traditional PPO plan, the negotiated rate, and there's a high degree of variability in that, but say the negotiated rate is something like three to four times Medicare.

(16:54):

Well, you choose an RBP strategy where you effectively do not have a network and claims are paid based on referencing Medicare. Maybe at 150%, maybe at 175%, and that can reduce the cost of the plan by 20 to 30% out of the gate. So very, very meaningful in doing that. But the cost of that is everything in life is a trade-off, and everything in fully responsive health care is a trade-off, is you tend to have higher member abrasion if it's not done the right way.

(17:26):

So every bill by definition is out of network. And oftentimes, providers will say, "Well, this is not a negotiated rate." My out of network rate is fairly higher than one of being reimbursed right now. I'm going to go after the member who received the care and provide that person with a balanced bill.

(17:47):

And then the RBP provider has to go fight that. That's how we think about member abrasion. And it just all comes down to how much of that you can accept relative to the cost decreases you get. Again, because everything's trade-off there.

(18:04):

So that's a very aggressive form of cost containment and can save 20 or 30%. And you could see how for \$25,000 for a family four and a PPO plan, if you can knock 20 or 30% off of that, it's \$5,000 \$7,000. That is very, very meaningful. And you may accept a certain amount of abrasion to go forward with that approach.

Geoff Cockrell (18:29):

So I can see the benefits to the employers and that there might be degrees of how aggressive you might be on the cost savings side. From an investor perspective, what are the different flavors of types of companies that you can invest in in this arena?

Patrick Keavy (18:45):

And Geoff, perhaps we can link to this in the podcast notes here, but one of the things that we do at Bailey is we publish fairly detailed research within the verticals and subverticals that we cover.

(18:59):

I recently worked with Rebecca Springer, our director of research at Bailey & Co., to produce a fairly detailed report on cost containment within employer health. So relevant and timely for this conversation here today.

(19:13):

And we had around 30 interviews with different executives in the space across a whole host of cost containment strategies, but also to executives that allow cost containment. Maybe they're not doing an outright themselves, but allow cost containment to take place within employer-responsive healthcare.

(19:32):

And we bucketed this into maybe six or seven different categories within cost containment, all focused on hard dollar ROI. So I'll take it through a few of them here.

(19:45):

One is we were just talking about reference-based pricing and repricing the two that go hand in hand. So typically, reference-based pricing, I think historically, has been focused on just a percentage of Medicare.

(20:00):

I think what's interesting, Geoff, is that what we have seen is that it's gotten increasingly more specific. Where it's probably less RBP in the sense that it just references Medicare and it goes and fights the provider and accepts abrasion.

(20:17):

And it is more a five-powered network where because of the transparency legislation that's passed in the last couple of years, there's much more information based on what actual reimbursement is and what providers are accepting. We've seen these RBP or repricing providers out there reference a rate that providers have accepted in the past and know that they will accept, maybe a little grudgingly, but will accept nonetheless with no member abrasion. So it's morphing away from traditional RBP into a much more specific technology or algorithm-driven pricing strategy.

(20:58):

I think that's very interesting. They can move the needle a lot. You can have various flavors of RBP, say for example, you can do a primary care network where it's in network. And then everything else is out of network and aggressively repriced. Seen a lot of folks do that, have a lot of success. Or you can do an entire plan is carved out and everything is effectively out of network and everything is aggressively repriced.

(21:24):

So there are many different companies out there providing that type of strategy and solution. And we've seen a significant amount of private equity investment within the space. It's been very high growing, tends to be very high margins. Very successful investments, very successful exits. That's a very active area of this ecosystem.

Geoff Cockrell (21:46):

So Patrick, in a lot of areas of investment, things open up with a lot of innovation, a lot of smallish companies solving a whole array of problems. And then over time that sector will consolidate and they'll grow, and you'll get private equity investment. And then you end up with bigger players. What inning is this process in for employer health?

Patrick Keavy (22:12):

Yeah, I would say we're in the third or fourth inning right now. It's not early stages, but there's a long way to go here. It is an industry that I think started off more as a focus on point solutions. I think there's also a much more nifty industry where only a few folks much more focused on insurance specialization, we're investing within this space.

(22:35):

In the last few years, just given successful investments, very successful exits, continued growth in this industry, cost pressure on employers. It really has blown up in a positive way.

(22:48):

And you have very aggressive investments from not just the insurance specialist, private equity firms, but also a whole host of healthcare-focused private equity has aggressively pursued this industry.

And then just more general business services focused private equity has also pursued this too, so heavy degree of investment. We are at the mid-innings as far as consolidation goes.

(23:15):

So still a lot of interesting point solutions that are growing very rapidly, but you are seeing, I don't know, something maybe like a dozen or so platforms within the space that become fairly large, scaled, diversified. Have rolled up a whole bunch of point solutions underneath their umbrella.

(23:33):

And that's become very creative given that these point solutions have a common distribution network typically like brokers and/or the TPAs, the third party administrators, to which they are distributing their product and ultimately accessing the employer, which is the end clients. The end consumer of these services.

(23:53):

So we've seen a pretty healthy degree of consolidation, leveraging that distribution, and being able to consolidate a bunch of disparate point solutions within one umbrella. That's been a very successful strategy over the last couple of years here.

Geoff Cockrell (24:09):

So Patrick, looking forward as this sector, which was a little bit backwaterish, has now gotten more mainline, what can we expect in the next finishing up 2025 and into 2026 by way of market activity and participants?

Patrick Keavy (24:25):

Yeah, so I think for the remainder of 2025, there are a couple deals in market right now. You will see those come to close. I think they'll be very successful deals in market too.

(24:36):

And then I think in 2026, you will see an actual acceleration of deals coming to market. It's been active, probably not as active as some folks would've liked it to be, but I think you'll see probably an acceleration of platforms coming out to market in '26.

(24:54):

And then from there on out, I think you'll see a very healthy degree of overall M&A activity. There's dozens and dozens of privately backed platforms within the space. Maybe there's 100 in total at this point.

(25:08):

But also too, there's a multiple of that on the privately held side, both scaled but also interesting point solutions. It'll either make their own platforms or acquisition targets for these larger scale players.

(25:21):

So I would expect a continued amount of very healthy M&A into '26 and beyond. This will be an area for years to come. It's going to be a very active side of healthcare. And I don't see any disruptions in the economy or any other existential factors really disrupting that in any meaningful way. I think it's relatively immune from that.

Geoff Cockrell (25:43):

Patrick, we've only scratched the surface on this exciting subsector, but I think we'll have to end it there. Thanks a ton for joining me. This has been a lot of fun.

Patrick Keavy (25:52):

Well, thanks, Geoff. Appreciate you hosting me and looking forward to continuing the conversation.

Voice over (25:58):

Thank you for joining us on this installment of the Corner Series. To learn more about today's discussion, please email host Geoff Cockrell at gcockrell@mcguirewoods.com. We look forward to hearing from you.

(26:11):

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