McGuireWoods

Episode 95: The Real Truth about PE in Healthcare, With Lauren Makhoul

Episode Summary

A principal in the financial services practice at Avalere Health, Lauren Makhoul challenges prevailing narratives about institutional capital. “Private equity investment in healthcare reduces Medicare expenditures by almost $1,000 per beneficiary,” she explains to McGuireWoods partner and host Geoff Cockrell and partner Alyssa Campbell.

Avalere does buy-side, regulatory and reimbursement due diligence for PE sponsors investing across healthcare. Tune in for insights into how capital investment enables struggling practices to survive, provides expansion opportunities without personal guarantees and creates the scale necessary for value-based care participation.

Transcript

Voice over (00:01):

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

Geoff Cockrell (00:18):

Thank you for joining another episode of The Corner Series. I'm your host Geoff Cockrell, a partner at McGuire Woods. Here at The Corner Series, we try to bring together dealmakers and thought leaders at the intersection of healthcare and private equity. Today we have an interesting discussion. I'm joined with two guests. One is my partner, Alyssa Campbell, who's a healthcare private equity partner along with me here at McGuire Woods, and we work on lots of things together. But I'm also joined by Lauren Makhoul. Lauren is with Avalere Health, and Avalere Health does a lot of interesting data analytic work, and we're going to talk some on the impact of private equity investing in healthcare. That's a topic of much debate in the press right now, and that discussion can be pretty slanted and

runs counter to my broad sense of private equity's role in healthcare. And Lauren's going to be adding some data to that general sentiment. But Lauren, if you could introduce yourself and Avalere and then, Alyssa, I'll have you give an intro as well, and then we'll jump into a discussion.

Lauren Makhoul (01:20):

Great. Well, thanks so much, Geoff for having me. I'm Lauren Makhoul. I'm a principal in the financial services practice at Avalere Health. As far as my background, I'm public policy by training. Started my career in DC with internships on the hill and lobbying shops, and then worked at a CMS contractor, really focused on quality measurement and value-based care through the CMS Innovation Center. I moved over to Avalere about eight years ago to start working on the private sector side of things and bounced around among all different sorts of healthcare groups in the ecosystem. Avalere really sits at the epicenter of all things healthcare policy, and then a couple years ago made the transition over to the financial services team.

(02:01):

So we at Avalere are a small but mighty group that serves really the entire healthcare investment community in three different ways. We do buy-side, regulatory and reimbursement due diligence for PE sponsors that are investing really across healthcare from pharma services to PPMs to post-acute care providers, health tech. We do sell-side reports as well. So again, sort of a regulatory-leaning market study approach that working with the investment banks and management teams to help proactively explain some of the complexities of different healthcare industries to prospective buyers. And we also do strategic work, so that might be in between transaction processes, companies will look to us to help them with a variety of different strategic initiatives through claims-based analytic work, payer contracting, value-based care strategy. And then we also dabble in a little bit of advocacy work, which I know we're going to talk about today.

Geoff Cockrell (02:52):

And, Alyssa, maybe a little introduction of yourself as well.

Alyssa Campbell (02:56):

Sure. Thanks so much for having me on today, Geoff. Looking forward to this discussion with you and Lauren. I'm Alyssa Campbell. I'm a partner in the private equity and corporate group at McGuire Woods. I've been focusing on M&A and investment work for about a decade, primarily in the healthcare industry, representing institutional investors of all sorts, including private equity funds, strategic investors and hospitals in both majority and minority investments in healthcare service providers or ancillary service providers to the healthcare industry. I'm definitely a proponent of institutional capital in healthcare and believe that it improves the market generally. So looking forward to this discussion today.

Geoff Cockrell (03:46):

So maybe to set the table a little bit, if the primary policy aims of healthcare generally are to improve outcomes of healthcare, improve access, and to control system cost of healthcare, the general

boogeyman that you see often in the press and sometimes coming out of the mouths of government officials is that private equity's involvement in healthcare is bad for all of those. The financial interest of capital investors over time deteriorates outcomes, deteriorates access and increases cost. And on that basis, there's a lot of discussion around kind of regulatory interventions, antitrust interventions. There's a lot of discussion around the benefits of private equity investing in healthcare.

(04:38):

For me, having done this quite a while, it's always interesting to hear that discussion because that's not been my experience with clients at all, either from how they go about their business or what their stated strategies and investment thesis is. None of it runs contrary to those aims. But Alyssa, maybe starting with you, as a proponent of private equity investing in healthcare, what is the benefit of private equity investing from your anecdotal perspective?

Alyssa Campbell (05:07):

Thanks, Geoff. So my view is when we have this discussion, we need to acknowledge the practical realities of healthcare being part of a capitalistic market in the US. So when looking at it from that perspective, sort of the gating question is, would a more heavily government-regulated or government-provided healthcare system be the best option to improve outcomes, access and to control system costs? I think reasonable minds differ on that. I don't know that I have an opinion on that to advance on this podcast. What I will say though is, which I think is universally agreed, that's not the world in which we live. We live in a world in the US where there is a capitalistic market for healthcare. So inside of the practical realities of how healthcare is provided in the US, we need to focus on making that market the most efficient that it can be, which includes expanding the number of participants in the market, in which case competitive players will be looking to provide the best service, the best product at the lowest price for consumers.

(06:31):

So inside of our practical realities, the participation of private equity in the market generally increases competition among providers and therefore will help bring the market entirely towards its most efficient state. I'm not a proponent of deregulating private equity investment or any investment in this market. I think it's very important that as a society we invest resources in monitoring compliance, avoiding fraud, making sure that both individual as well as government payers are not being overbilled for the services provided and that patients are getting the services they need at a cost that they can pay for those services, and that there's increased access to those services. But I think that institutional capital, including from private equity sources, helps get everyone to that ideal state within our current competitive market for healthcare.

Geoff Cockrell (07:35):

Lauren, from your view, the narrative that you see in the press, where are they getting the story wrong?

Lauren Makhoul (07:41):

Yeah, thanks, Geoff. And completely agree with Alyssa here. I think that inherent to the investor community's purpose is returning profits to their investors. And I think because of that, that is why they sort of bear the brunt of some of these arguments. But I think what's not necessarily acknowledged is that all players in the industry have some level of profit that is incentivizing the activities that they take on. So hospitals make money, payers make money, providers make money. So I think to Alyssa's point, that's sort of inherent to the US healthcare system. So I think that is an important groundwork that is often missing from the conversation. And I also want to acknowledge that two things can be true. Some of these stories really are damning and we see really bad outcomes. We see institutions imploding after a transaction. We see even something not as draconian as that, but some providers who are exclusively driven by revenue and profit generation and get burned out and patients may get unnecessary care.

(08:45):

So I think that there is a lot of anecdotal evidence and there are case studies in how to do this the wrong way. I think that it's a broader story than just private coming in and doing that. But to your point earlier, Geoff, and what we see with our clients, is that's just really not the way that we're working with our clients in the private equity community. And I think there are so many investors that fly under the radar and are really doing this the right way. And part of that is the type of questions that we answer for our clients. So for example, they'll come to us and say, do we think that this PCP group is billing too many level 4 E/M codes, or do we think that these rates for ABA therapy are far too high for what the market should bear? Or do we think that this growth is sustainable and that care is being provided appropriately?

(09:37):

Those are the type of questions that our clients are bringing to us before investing in an asset. And then we also see investors who are taking a more global view to quality as well. So I think the best example of this is the InTandem Capital team, and we've been working with Elliot and Brad and their team for quite some time now, and the quintuple aim for healthcare is really just at the center of everything they do across their entire investment lifecycle. So that's everything from the types of companies that they invest in. It's also investing in putting quality reporting into their different portfolio companies as they come on board, it's their private equity for the greater good initiative where they are returning investment back to the employees of their different portfolio companies. So I highlight them because I think it's a great example of the type of work that is happening on a smaller scale that maybe isn't highlighted in some of the stories that we see in the headlines.

Geoff Cockrell (10:31):

So Lauren, maybe taking this beyond anecdotal, one area that gets a lot of scrutiny is the whole concept of provider consolidation and what's the impact of that in different markets? If we were to separate the universe into private equity backed provider groups, independent provider groups and hospital employed or health system employed providers, doctors, what does the data show of the impact on cost and outcomes of those three different groups?

Lauren Makhoul (11:01):

So just to give a little bit of background on the research we did, we were commissioned by the American Independent Medical Practice Association, which is a relatively new advocacy group that advocates on behalf of physician groups that are part of private equity backed MSOs. And we wanted to look at exactly what you said, which was using our Medicare claims data, what is the underlying impact of when a physician transitions to a private equity affiliated model to a hospital or actually to a third bucket, which was a corporate model? So think about Optum or other groups like that. And so we looked at five different specialties, cardiology, gastroenterology, medical oncology, orthopedics and neurology, which are all well-represented in the US healthcare system. Lots costs across those, particularly within the Medicare population.

(11:56):

I think it was really interesting what we found. So first and foremost, these private equity affiliated private practices in those specialties accounted for just 6% of all physicians who bill to Medicare. So again, just thinking about the relative amount that we hear about this in the press versus how significant that really is, we think about as opposed to that the hospital affiliated physicians are 45% and then the corporate physicians are about 37%. So that's kind of the different models we're talking about here.

(12:25):

When we compared physicians who moved into those three practices, I think this was where we saw a really surprising finding, which was that physicians who went to a private equity affiliated practice, a year afterwards, the Medicare expenditures for their patients went down almost $1,000 per beneficiary per year as opposed to those who transitioned to corporate or hospital went by over $1,000 per beneficiary per year. So you think about how many patients we're talking about here, that's a significant swing in terms of the dollars. You think about the private equity folks in general and you compare to a similar cohort. Again, risk-adjusted and pretty comprehensive, 10% lower overall Medicare expenditures, 8% less care received in more expensive hospital-based settings, 8% fewer ED visits and 14% fewer hospital inpatient days. So I know that's a lot of different metrics, but some of the highlights of our findings of the study, and I think, again, missing from some of the overall conversation that we see, these real underlying pieces of information that prove that it's not all bad.

Geoff Cockrell (13:30):

That's astounding and flies so contrary to so much of the narrative. Have you brought some of this data to government officials, especially in states where this has been a hotter topic, let's say some in the Northwest, for example, and how have they responded to this data?

Lauren Makhoul (13:47):

Yeah, so Avalere is generally a nonpartisan sort of analytics supporting entity. So we worked with the ANPA team to develop some of the talking points, and really it was the doctors who've gone out and been on the Hill. They actually were there again this week and really making sure that this message is explained particularly at the federal level, but also at the state level. And I think it does resonate. I think there are plenty of people in Congress who understand that supporting independent practices, perhaps through capital investment, is really important. And you may not hear people shouting from

the rooftops some of their support because, again, the current prevailing narrative is a little bit challenging to counteract. But I do think there's an underlying level of support and understanding that this type of model really can be beneficial to the healthcare system overall.

Geoff Cockrell (14:38):

Alyssa, you've talked some about the impact of capital. What have been some of the impacts that you've seen of capital in either building things or making investments? That always seems to be an element that gets lost in the discussion, but a necessary component of moving healthcare forward. What have you seen on that front?

Alyssa Campbell (14:56):

So I would say that I have seen two distinct benefits of the availability of institutional capital for investment in physician practice or physician practice management entities. The first is it creates a market for practices that are struggling, typically struggling because of issues with managing administration, vendor costs related to operating, billing, things of that nature, scheduling generally managing the practice. It brings a buyer to the market for practices that are otherwise struggling and may shut down if there's not a player in the market that can come in and provide expertise related to the business side operations of a struggling physician practice. So that's sort of one pillar.

(15:55):

In addition to providing a pathway for practices that are otherwise struggling to stay in the market, it also helps practices that maybe are doing great as a traditional in-office source of delivery of healthcare. It allows them, with access to capital, to expand their service offerings without requiring something that we typically see banks ask independent practices for, which is personal guarantees on loans that would help these practices expand, which puts physicians in a position where they may see a need for an additional service line and the availability of physicians to provide that service line within a specific market, but they don't have the hard assets, whether it be in ASC, in-office, sophisticated cutting edge in-office equipment. Capital for those investments needs to come from somewhere and frankly, banks aren't always the best option for an independent physician practice when that option means that those physicians are going to have to make a risk-based decision between subjecting their own hard-earned life savings capital to the bank in order to obtain a loan to support those independent practices.

(17:26):

Private equity fund can really help bridge that gap because they have availability of capital and they also have a different type of relationship with lending institutions where capital can be invested in the entity without an accompanying requirement for a personal guarantee of any sort from your service providers. So not only does capital allow folks to continue to stay in business, to expand the service offerings that folks are able to provide to patients, but also from, a thing that is not discussed a lot is, private equity investment is able to consolidate administrative costs and the administrative functions across multiple physician offices, which really takes the burdens and the, shall we say, stress of ownership of a practice off of physicians or other providers, allows those providers to focus on the provision of care. And there's an ability to consolidate costs across multiple physician offices, which

allows for this investment to come in without it actually increasing delivery of care. So it does fit very well with the historical synergies model of what private equity can do for a small business to help it expand.

Geoff Cockrell (18:52):

I would add that even trying to look at the impact of private equity investing on cost is the analysis can be a little slippery. So we see this a lot where a larger consolidator is coming into a market that provides capital for, let's say, to build an ASC, that larger consolidator may have advantageous payer contracting, which on the surface you might say, "Well, that's exactly what we're describing, that the private equity rolls in and they're just adding more costs."

(19:22):

But the reality is more nuanced in that higher reimbursement rate for those ASC services is often the catalyst that enables that larger practice now to build ASC in the first place. And the presence of that ASC is now creating an opportunity to move the location of care out of the hospital, which might be the most expensive place that you could have ever done a procedure. So looking at little tidbits of facts in isolation, when you have a very complex and dynamic market, you can misdiagnose where the problem is. But Lauren, coming back to you, I'd love to hear some of the reasons you think that the cost of care moved down so dramatically when someone moved into a private equity backed practice.

Lauren Makhoul (20:07):

Well, I think part of it is exactly what you were just talking about, Geoff, and part of the work we're doing as a follow-up is really looking at some of those drivers, particularly with setting of care. I think what a lot of the current narrative, and again this isn't just in the press, but a lot of studies have been done in this space, and when we were preparing our research, what we found is that many of those look at just the professional fees in terms of these surgical procedures. So just quick background for those who may not be aware, often there is both a professional fee, that's paid to the physician for the work that they do, as well as a facility fee that is paid to the institution for the space, the staff, the equipment and all those types of things.

(20:47):

And to your point, what we've started to analyze is for similar procedures that are done in a hospital setting and then that same exact procedure that is done in a lower cost setting of care, whether that the surgery center or even the office in some cases, there's a significant difference and you have to look at the total cost of the care and not just the professional fee. And there is evidence, and we saw it as well, that professional fee may actually be higher in the lower cost setting of care, but the facility fee difference is so much smaller that the actual total cost goes down. So I think this is some wonky stuff and it's pretty complicated, but I think that that level of nuance really is important.

(21:27):

When you think about private equity investor coming in, they may help a group with their payer contracting rates or they may look at the global set of services and make sure that they are being compensated appropriately, but at the same time not creating more costs for the system. And I don't want to say that that's happening across the board, I think that there's certain investors who are more aware of that than others, but I do think it's part of the conversation that lends itself to what we were saying earlier, that the private equity community is not a monolith and that there are certainly some of these success stories that are reducing the total cost of care.

(22:02):

I think the other piece is the types of investments that are being made. So we've seen a lot of growing interest in value-based care entities and those that are focused on post-acute care and some of the really high complexity patient populations. And I think that part of the reason for that is that there are now incentives when it comes to value-based care of reducing the overall cost, but those savings going back to the provider entity. And the higher the cost of a patient, and we're talking $40,000 a year in Medicare, in some cases, the more opportunity there is to generate savings. So those types of models, they're a little bit smaller, but we've seen quite a bit of interest in several transactions actually at the end of last year in these post-acute or SNF-based provider groups that are able to really invest in their communities and in post-acute care, but also reduce the overall cost to the system.

Geoff Cockrell (22:56):

And another way of thinking about that is if value-based contracting is the vehicle through which we're going to change the trajectory of system cost, participating in value-based contracting has some table stakes. One of the table stakes is if you're going to be absorbing risk, you need a certain amount of scale to diffuse that risk. A smaller practice can't absorb the risk of value-based contracting because the population is not big enough to absorb it. Another table stake is that you're going to have to make material investments and data analytics. Risk-based contracting is exactly like it sounds. Risk can cut different directions and to fly blind into that is not prudent, which means that to be a legitimate participant in value-based contracting, you need scale. And I find it ironic that regulators and the dialogue about private equity investing is bemoaning the scale of some of these practices when that scale is, on the face of it, part of the table stakes of even entering into value-based contracting in the first place. So I think you got to keep all of these pieces in mind when you're thinking about what is the role of private equity.

Alyssa Campbell (24:06):

Lauren, I have a question I would like to put on the table for you to weigh in on. What are your views on some of these successes that you've seen following from private equity investment in healthcare, and what can private equity investors do to help hold each other accountable related to increasing access, improving outcomes, and controlling system costs?

Lauren Makhoul (24:33):

Yeah, thanks, Alyssa. I think there's a few things. Again, going back to some of the strategy work that we do with our clients, we're in kind an interesting time where we all thought the market would come back at the beginning of 2025, and then just based on the state of the world, there may be more of a

slowdown. And if you look at that glass half full, I think it's an opportunity to really look across the portfolio and in places where typically we think of adding value around adding ancillary services or building out De Novos, I think there's other pieces that you can really focus on this return on value to the system. So whether that's embedding quality into your portfolio companies, helping round out a value-based care strategy or doing some of this data analytics work that we've done on behalf of other clients to prove what they already know, which is that they are returning quality back to the patients and the system.

(25:28):

So I think there's some of that sort of internal work that investors can do over the next 12 to 18 months ahead of a sale that I think could be really interesting. I think also just generally highlighting some of these positive stories and holding the entire investment community to a higher standard. Maybe that's through stricter guardrails around some of these anti-quality practices. I think it's incumbent upon us and serving our clients and making sure we're highlighting some of the quality and value-related risks along with other financial associated risks. But just investing in the types of functions and the types of portfolio companies that we talk about an A+ asset, that doesn't just mean a really solid management team and a good balance sheet, but it also means a high-quality patient-centered entity as well. So I'm excited about seeing more of that in the coming year and talking to more of our clients about what it means to return value to the healthcare system.

Geoff Cockrell (26:25):

Yeah, and when I'm talking to clients, I'm always giving them a few pieces of advice that is consistent with that, and one is to know your own story. Every private equity investor should know what the impact of their presence is and know it in detail and be able to track it and monitor it. Because ultimately, if you're not advancing those aims of healthcare, you're going to be on shaky grounds either regulatorily or just business-wise. So know your own story, test your own impact, and then be... And I think this is general advice for the overall private equity back to healthcare universe is do a better job of having your story be out in the world. I know it's an intimidating venue when there's some loud, angry, maybe smaller voices, but do a better job of getting the beneficial impact of private equity investing out into the world. And hopefully this podcast helps in that as well. Lauren, we could go on for quite a bit, but let's call it a wrap there. Alyssa, same. Thank you both for joining. This was a lot of fun.

Alyssa Campbell (27:25):

Thank you both so much.

Lauren Makhoul (27:26):

Thanks, Geoff and Alyssa. It's been a fun one. Appreciate it.

Voice over (27:33):

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.

(27:46):

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