As discussed in the first and second installments of this three-part Health Capital Topics series on private equity (PE), investments from PE Firms experienced record growth in the healthcare industry in 2016,¹ and have realized greater returns on investment compared to other industries.² Nevertheless, concerns remain as to the similarity of this trend in PE investment to that of physician practice management companies (PPMCs) in the 1990s, which ultimately failed and left corporations such as PhyCor and MedPartners with huge losses and stock prices that plummeted under $2 per share (once above $30 per share).³ During this period, PPMCs attempted to create value in the healthcare industry by supplying physicians with management services as well as an alternative means to access capital.⁴ However, this model eventually failed because it did not yield a return on the acquisitions that exceeded the PPMC’s weighted average cost.⁵ Although PE investments do share similarities with PPMCs, PE arrangements may be able to prove more successful due to: (1) the drastic changes in the healthcare reimbursement environment under new legislation; (2) advancements in technology; and, (3) developments in data analytics.⁶

In the 1990s, PPMCs were marketed as a vehicle to accrue the necessary capital to achieve economies of scale for single and multi-specialty practices by: (1) building clinical information systems that would help manage care more efficiently; and, (2) creating bargaining power with vendors and payors for the member physician practices.⁷ With the emergence of managed care contracts, PPMCs also applied their management expertise to address the complex negotiations requisite in this managed care era, as well as, the emerging challenges stemming in part from a massive drive toward consolidation in the healthcare industry.⁸ While some physician practices were able to achieve small increases in revenues through PPMCs, most did not realize a large enough savings on practice operations to offset the costs associated with PPMCs.⁹ Generally, PPMCs struggled to manage the systems that they had created, particularly through proper utilization of technology to create a more efficient operation.¹⁰ Further, PPMCs failed to increase the bargaining power for the PPMC member physician practices because of the limited geographic proximity and the divergence of rates and expenses across state lines inherent in a given healthcare marketplace.¹¹

Since the collapse of PPMCs in the 1990s, the healthcare industry has undergone significant reform through the passage of comprehensive laws such as the 2010 Patient Protection and Affordable Care Act (ACA) and Medicare Access and CHIP Reauthorization Act of 2015 (MACRA); technological advancements, including the widespread implementation of electronic health records (EHRs); and, the emergence of big data and data analytics. The Centers for Medicare and Medicaid Services (CMS): (1) advanced the movement from volume-based to value-based reimbursement, which built upon some of the bundled payment programs first developed under the ACA; (2) replaced the sustainable growth rate (SGR) formula for determining physician reimbursement with pre-determined payment updates through MACRA; and, (3) implemented multiple value-based measures and quality-centric programs under Medicare.¹² This shift allows providers, if properly managed, to capitalize on reimbursement incentives for providing high quality care to patients at a lower cost.¹³ PE firms are capitalizing on these new reimbursement models to make physician groups more profitable and to realize an improved return on their investment.

Technological advancements have benefitted the healthcare industry in myriad ways, and PE firms have taken advantage to conquer one major shortcoming of PPMCs. PE firms are utilizing this newer technology to increase their return on investment through the use of EHRs. Over the past several years, EHRs have received governmental backing (beginning with billions of dollars in support under the American Recovery & Reinvestment Act of 2009),¹⁴ increasing significantly the number of physician practices utilizing this technology. In 2004, only 20 percent of physicians were using EHRs; as of 2015, approximately 90 percent of physicians had adopted EHRs.¹⁵ EHRs have improved practice efficiency by decreasing the wait time for laboratory results; enhancing data confidentiality; and, improving practice management through integrated scheduling systems.¹⁶

PE firms may also be more successful than PPMCs because there has been a significant development in data analytics since the 1990s.¹⁷ The healthcare industry has

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been collecting and analyzing data to identify trends and, more importantly, model and manage physician behavior and compensation based on those trends.\(^1\) PE firms are making better use of benchmarking to analyze key performance data (both internally and compared to other industry participants) to increase their quality of care\(^2\) and to take advantage of enhanced reimbursement opportunities, such as, bundled payment schemes under the ACA and MACRA. Achieving these goals is particularly difficult for smaller practices with access to fewer financial and management resources, but PE firms may assist these physician groups by providing the financial and management capital to be able to “step-up” to the next phase of growth and to facilitate the provider’s transition to value-based reimbursement.

Although the PE investment trend resembles that of PPMCs in the 1990s, it is likely that the outcome for PE firms will be quite different. Because the healthcare industry has seen: significant changes in reimbursement; technological advancements; and, the emergence of big data and data analytics, PE firms have the available tools to manage physician groups more efficiently. PE firms seem to have noted the PPMC failures of the 1990s and accounted for those shortcomings in their search for above average financial returns.\(^20\)

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4 Ibid.
7 Kraft, M.D., (March/April 2002).
8 Ibid. p. S5.
9 Ibid.
10 Ibid.
20 Abraham et al., July 2015.
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