How private equity can drive innovation in the healthcare industry

Financing the future of global health

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Abstract
Private equity is a topic that has attracted significant attention in recent years. This article investigates the rising trend of private equity involvement in the healthcare industry. Examining the factors driving this surge, it delves into the implications and potential shifts in the industry landscape. Supported by two compelling business cases, this analysis provides concrete examples illustrating the impact of private equity on the healthcare sector. Conclusions reveal that such investment brings with it both challenges and opportunities.

Keywords
Investment, Innovation, Technology, Opportunities.

1. Rising Private Equity activity in the healthcare industry

Private Equity (PE) is an alternative investment class that invests in or acquires private companies that are not listed on a public stock exchange. PE investors are active investors who provide their portfolio companies with bundles of value-added activities. The benefits can include increased growth (such as capital inflow, expertise, and access to new markets), improved profitability, (through operational changes and cost cutting measures), and enhanced shareholder value (higher valuation or public listing)[1]. PE players place a heavy emphasis on both their ability to select promising companies as well as their capacity to add value through financial means and industry knowledge.

In recent decades, PE activity in healthcare has exploded with financial institutions playing an increasingly important role in the sector. The healthcare private equity (HCPE) buyout deal value reached a record year with $151 billion in 2021. Yet even with the slowdown in the

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second half, 2022 was still the second-best year so far, with around $90 billion. This is in stark contrast with the less than $2 billion total deal value in 2001[2]. PE has been rapidly acquiring healthcare operators across different medical specialties, both throughout the US and beyond. The healthcare industry, renowned for its challenges arising from the involvement of various stakeholders, like patients, providers, investors, payers, and policy makers, offers plentiful potential investment opportunities.

2. Private Equity investments to spur innovation

The long-term growth of the healthcare industry is driven by several unchanging trends, including aging populations, the rise of chronic diseases and the increased demand for healthcare services. These factors, combined with the development of new technologies are driving innovation in healthcare, by improving the quality and accessibility of medical services, enhancing patient outcomes, and making the healthcare system both more efficient, and patient centered. These advancements are continually evolving, promising a future where healthcare is not only more effective but also more personalized and accessible to people around the world. Investors with confidence in this sector who can identify highly differentiated assets and possess the expertise to craft a strategy for operational excellence will be well-positioned for success.

Healthcare has historically underspent on technology. In Europe, an average of approximately 11% of gross domestic product (GDP) is spent on healthcare. Of this figure, around 7.6% is attributed to medical technologies[3]. The pandemic, however, has accelerated the digitalization of the healthcare industry and the sector has attracted huge inflows of private and public investments. Healthcare Information Technology (HCIT) reached its second-best year in deal count[4]. According to the HIMSS Future of Healthcare Report, 80% of healthcare companies plan to increase investment in technology and digital solutions over the next five years[5].

Healthcare providers are underinvested in IT, and this suggests an upside for future technology spending. According to Bain and KLAS's 2023 Healthcare Provider IT report, most healthcare providers are now prioritizing their investments into resource optimization software, such as revenue cycle management (RCM), patient intake/flow and electronic health records (EHR). Services that let healthcare providers "do more with less" now take center stage and PE investors can help such companies expand their solutions to serve their end markets more comprehensively[6].

PE also showed enthusiasm in services and technology that allow payers (from health insurance companies to third-party payers) to automate and improve efficiency about certain administrative functions. Businesses helping payers will receive significant funding to reduce operational complexity and solve a broad range of functional needs; in 2022 ClaimsXten, a claims management technology improving payment accuracy, was acquired for $2.2 billion by TPG.

Innovation and new solutions are also changing the Biopharma sector, as new digital tools accelerate clinical trials decentralization. Investors are therefore attracted by software and services companies supporting clinical trials. Deal activity is increasing across all the pharma value chain including contract research organisations (CROs), contract development and manufacturing organisations (CDMOs), and commercialisation services. Investments in biopharmaceuticals are changing the clinical trial landscape, where further adoption of hybrid/decentralised strategies and more patient-centric approaches are expected to grow[7].

Besides the investment in IT, the development, design, and use of medical equipment to diagnose and treat medical conditions is continuously improving. The MedTech sector is receiving a lot of funding, especially towards original equipment manufacturers (OEMs), which provide best-in-class products with strong technological barriers (important deals in 2022 included 3D dental scanners and vascular intervention products). The OEM landscape is fragmented due to small and inefficient manufacturers. PE investing can bring valuable skillsets to the sector, by helping the industry to consolidate and create bigger companies that can take advantage of scale. Investors are also confident in long-term growth of medical aesthetic assets, such as injectable devices related to anti-aging, skin elasticity and fat-reduction procedures[8].

PE has also undertaken an important role in Life Science, where biomedical research and novel drug development are now relying more on genomic tools, such as next generation sequencing, and products that support faster and more accurate health assessment. With regards to the latter, artificial intelligence is accelerating therapeutic discovery, with new services emerging in patients screening through algorithm-based solutions.

3. Biomet case study: navigating a company through hard times

Once one of the most stable orthopedics companies, Biomet, a manufacturer of musculoskeletal medical products, went through hard times in 2006; the company was in turmoil, facing major issues with profitability and a public dispute. In the same year, the board announced that the company has been acquired by a group of PE investors formed by Blackstone, Goldman Sachs, KKR, and TPG. Biomet was taken private and delisted from the Nasdaq ("One of the great things about being private was that we didn't have to watch our value erode in the public market", J. Binder, the newly appointed CEO). Biomet's new investors committed to a long-term growth plan, which involved major changes in the current corporate strategy. Critical to the company's turnaround was re-establishing the long-standing culture of stability that had once defined the company. To do so, the focus was on capturing market share and developing innovative products. Biomet launched new sales force expansion programs and invested heavily in improving the functionality of its products through innovative engineering. PE investors played a crucial role in guiding the company through a very challenging period, which was further exacerbated by the 2008 global financial crisis. Notwithstanding these major strategic issues, Biomet's value increased over the seven-year PE ownership, and it was finally sold to Zimmer Holdings in 2014 for more than $13 billion. The merger created the second-largest manufacturer of orthopedics equipment and represented an important consolidation in the healthcare industry[9].

4. LifeScan case study: how its acquisition marked the "rebirth" for the company

Due to competitive pressures and price declines, in the first quarter of 2017 Johnson & Johnson (J&J) began a disinvestment of its Diabetes Care Companies: LifeScan Inc., Animas Corp. and Calibra Medical Inc. In October 2017, Animas Corporation exited the insulin pump market, while in 2018, Platinum Equity purchased LifeScan, J&J's subsidiary producing blood glucose meters, test strips and other digital health solutions, for $2.1 billion[10]. At the time of the deal, LifeScan was a leader in diabetes care, with $1.5 billion net revenue and about 20 million patients around the world using its products. Under the PE ownership, LifeScan introduced a new corporate brand identity, invested in digital solutions, and redefined its mission to provide customised health and wellness experiences to people with diabetes. LifeScan unveiled a new logo and announced partnership with Fitbit and Noom, companies with a digital focus. Val Asbury, CEO of LifeScan, said moving over to Platinum Equity was almost like the "rebirth" of the organisation. According to him, Platinum Equity brought their operational focus and helped LifeScan find where the inefficiencies were. They recognised the company's potential and committed to supporting its mission and vision[11]. LifeScan also partnered with local government to partake in community outreach, increasing awareness of diabetes and how to avoid it. On the environmental health side, it also launched strong initiatives around reducing carbon and water conservation. LifeScan also committed to becoming an environmental self-sustaining organisation by 2030.

5. Conclusion: Private Equity's controversial role

PE operates with a profit motive. This brings challenges for the healthcare industry, as concerns arise when patient welfare is combined with a business venture. Thus, there is a widespread sentiment that PE may be harmful to public health. This stigma is shaped by several factors[12]:

- Lack of transparency is a significant concern when it comes to PE investments, especially for sectors like healthcare. Limited disclosure and no public visibility on listed markets can make it difficult for stakeholders to assess the impact of PE ownership on patient outcomes and community access to services.
- The presence of players with limited knowledge in the industry. Investors that lack a deep understanding of healthcare complexities may struggle to make informed decisions that positively impact the quality of care.
- PE investments are of limited term (typically 3-7 years), as the goal is to generate return for the investors. However, the health of individuals and communities requires long-term investments, both in prevention and care provision

The arguments presented generate policy debates and new academic research. A well-renowned study published on the NBER suggests that PE acquisitions of nursing facilities lead to adverse health outcomes for some patients[13]. Notwithstanding these difficulties, it's critical to understand that PE firms that invest in the healthcare sector can have a positive influence and that not all PE activity in the industry can be labeled as "bad". It's therefore important to recognise that PE investing brings with it both opportunities and challenges.

While many PE firms lack industry expertise, some focus solely on healthcare investments. Specialized teams of industry experts, including Ph.D. holders and medical doctors, are employed by PE funds, where they can apply their knowledge to the investment process. Healthcare-focused PE firms that employ experienced professionals can spot unique opportunities to unlock value. Most of these use "operating partners," who are often former CEOs of big corporations in the medical industry, who can bring decades of knowledge and operational know-how to the portfolio companies[14].

PE activity can also be beneficial for the healthcare industry by optimizing business operations. The LifeScan case shows that private investments were crucial in restructuring the company, via improved functionality of product and the streamlining of existing processes. The influx of PE capital can help struggling companies to properly allocate their resources as PE investors usually implement strategies to ensure that such resources are utilised optimally. By reorganising workflows and supporting companies to identify inefficiencies, PE can therefore make the delivery of healthcare services more efficient.

Zimmer Holding's acquisition of Biomet is an example of PE being a source of innovation for the healthcare sector, as well as facilitating mergers and acquisitions within the industry. When a PE firm buys a small medical device manufacturer, private capital can be used to adopt innovative technologies and practices. The acquired company can then become more competitive, and the PE firm will eventually sell it to larger players. In this sense, big conglomerates are beneficiaries of PE, as its activity in improving and innovating the company was crucial in making it an attractive investment. Ultimately, this is also vital for patients because hospitals and other operators are able to buy and use products otherwise unreachable.

Careful consideration and regulation are essential to ensure that the benefits of private equity investment in healthcare is realized without compromising patient well-being.

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