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# Investment Strategies: Healthcare Product and Service Providers

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Although public debate rages regarding evolving national health policy and how it will change the healthcare industry, private equity firms continue to invest billions of dollars in healthcare product and service providers every year.  Organizations that offer health information technology (HIT) or medical device products or clinical, revenue cycle management or other support services coupled with attractive earnings and growth potential are attracting intense interest within the PE community.  In many cases, these targets have provided exceptional value to their investors. Those who consistently succeed in this complex, rapidly changing market combine practical portfolio strategies, careful pre-sale target diligence and seasoned post-close execution.

## Effective Healthcare Portfolio Strategies

Choosing the best portfolio strategy requires analysis of the rapidly changing healthcare landscape and careful consideration of national, state and local market and regulatory conditions.  Based on this analysis, private equity firms typically pursue a strategy that either vertically integrates complementary offerings to serve the needs of a specialty market, or one that concentrates providers of similar services and products to build market share.

### Vertical Integration within a Specialty Market

Due to the high level of specialization and fragmentation among healthcare product and service providers, significant opportunities exist to vertically integrate firms across all or a portion of a specialty market's value chain (e.g. vendors to orthopedics providers).  Successful PE investors reduce complexity, decrease costs and increase customer value. By establishing more comprehensive and effective business arrangements with customers, resources can be allocated to pursuing growth within existing and adjacent markets. As a result, operating expenditures are cut from each organization's budget, new sources of revenue are introduced, and EBITDA and free cash flow increase.

### Market Share Accumulation

Private equity investors that choose to develop a scalable and focused platform are able to resolve many of the inefficiencies and "growing pains" that may have previously plagued their portfolio firms. By generating a robust set of codified policies and procedures and implementing them across a platform, aggregate overhead costs shrink dramatically. This process entails normalizing software and vendor selections, sales and marketing processes, training and management procedures, and integrations between systems. These standardizations have been shown to generate significant economies of scale that contribute to the overall profitability and sustainability of the platform's constituents.

## Due Diligence Considerations

Regardless of portfolio strategy, PE firms considering a healthcare investment must thoroughly evaluate a number of strategic, operational and regulatory components of each target prior to acquisition. Careful due diligence of the following factors helps investors expose issues that may influence the decision to proceed, the terms of purchase, or post-close activities required to realize the investment thesis.

### IT Maturity.

Is the target's IT organization aligned with the business? Can the current IT staff handle the demands placed on it by the business? Are the correct applications (e.g. enterprise resource planning, customer relationship management, business intelligence, human resources, document / content management) in use throughout the organization, and are they deployed correctly? Is the target's platform (including procedures, processes, technology, and strategy), able to support growth? Can the platform scale to adjacent or complementary markets without significant enhancements?

### Operational Efficiency.

Do the target's day-to-day operations run smoothly and efficiently? Is management able to maintain a high level of visibility into the overall performance of the organization? Do capabilities exist that enable identification and remediation of underperformance? Has the target effectively automated its core business processes? Interoperability. Are the target's systems integrated and interoperable with external entities' (e.g. customers, regulatory bodies, and vendors) systems? Are those integrations compliant with industry standards and customer or market demands?

### Revenue Cycle Management.

Does the target maintain a comprehensive understanding of its revenue cycle? Can the target produce accurate forecasts and models to estimate financial key performance indicators (KPIs)?

### Leadership.

Does the target's leadership team have a vision of growth and strategic expansion? Are the current leaders capable of providing adequate guidance to the organization as it grows?

### Regulatory Compliance.

Does the target have capabilities to comply with the numerous healthcare specific rules and regulations? Depending on the organization, these could include: the HIPAA privacy rule, ICD-10 and HIPAA 5010 compliance, Meaningful Use of health IT (HITECH Act and ARRA), quasi-governmental accreditations (e.g. The Joint Commission), Patient Protection and Affordable Care Act regulations, and numerous other laws and guidelines.

Obtaining accurate and complete answers to these and other questions ensures an informed investment. Furthermore, many of the concerns revealed by this level of analysis have plausible and proven fixes that can drive improvement—given the right focus and investment.

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