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Healthcare Investing's Strong Pulse

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Healthcare investment is on the upswing, and for good reason. Medical costs currently account for 17.6% of the U.S. economy. Projections from the Centers for Medicare & Medicaid Services show national healthcare expenditures reaching 19.6% of gross domestic product by 2019. Whether or not the president's healthcare law stays in place, consumers and providers will still lack the kind of cost accountability needed to slow the steep rise in expenditures. Healthcare spending was $2.5 trillion in 2009 even without the 30 million potential new entrants. While employers and health plans seek ways to reduce costs, results are mixed at best—costs and expenditures continue the march upward.

The health industry's players are simultaneously big business, small business, government and consumers—all influenced by the local economy. The incentives for providers, referral sources, patients and payers in the U.S. health economy are complicated and often contradictory.

For example, the use of imaging techniques such as MRI has reduced overall need for exploratory surgery, but that doesn't mean every MRI clinic is guaranteed success. New solutions can struggle to gain acceptance because providers of the older, less efficient model may dominate the distribution channel and don't have reason to give up their profitable business.

Specialized service facilities may be highly cost effective in providing certain procedures, but multiservice groups benefit from internal referrals and can offset less profitable services with others that show better returns; those with a referral base rightly want to protect their business. Such examples highlight the complexity for anyone operating in the environment, and that even with growth, success is not a given.

There are a number of opportunities investors should look for in this shifting and complex market.

Healthcare IT: This is an ongoing need that includes claims processing, practice management, medical records, and enrollment and eligibility verification. Getting people to code things similarly in the same hospital is a challenge, let alone between different hospitals. Despite the growing demand for the technology, there's a shortage of client-friendly providers who can implement new systems and effectively train people in new workflows and procedures. Health IT's biggest problem isn't in developing the technology, but in implementing and training the hard-working healthcare workforce on emerging technology.

Capitated risk and data analysis: New government initiatives are designed to share the risk of medical costs with a variety of individual providers, provider groups, facilities and other types of organizations. The competitive advantage will go to those who can accurately and quickly analyze costs and outcomes by diagnosis, treatment and patient demographics, and then market the assumption of that risk. They may also have the ability to offer attractive new products and services directly to the employer market. Even without outside mandates, providers and plans will track this data to monitor and maximize profitability.

Paraprofessionals and extenders: As price pressure grows and capitation initiatives expand, payers will want to leverage high-cost professionals (such as specialist physicians) with paraprofessionals such as nurses and physician assistants. Further leverage will come in the form of increased use of offshore and remote medical consultants.

Retailization of healthcare: New and simplified technologies and procedures will give retail outlets the opportunity to provide a broader range of medical treatments at lower cost. For example, much in the same way that optometry stores have evolved, we are starting to see more "doc in the box" operations. Existing healthcare plans and providers will have to select locations and market effectively, learning from the best practices of retail. Incumbents with strong local branding need to be proactive in their strategy, even if it means considering cannibalization.

There are also a number of risks facing any healthcare investment.

Conflicting incentives: Doctors, hospitals, insurers, employers and patients are all stakeholders in healthcare. However, their interests don't always align; indeed, they are frequently in conflict. Enterprises that don't understand these conflicts are doomed to fail. For example, if a venture proposes to link doctors and patients in a single IT system, the venture's backers must understand that those two players will not always have the same incentives. A system that reduces the need for office visits may be popular with patients but unpopular with many doctors. Referral ecosystems are well-entrenched, and without mapping these carefully, one cannot understand a major business driver. Remember, many innovations will conflict with somebody's interests.

National averages can be misleading: Our analyses confirm that healthcare needs by volume of procedure relative to total population vary greatly from one area to another, even within states. Patient demographics, types of jobs held, payer mix, employer and government benefits all vary widely by local market as does the local economy. State and municipal budget cuts will have significant local impact. An obvious result is that a chain of children's clinics may not be as profitable in South Florida as it would be in "soccer mom" suburbs, while geriatric facilities may thrive depending on competition.

Providing healthcare is capital intensive. Few market opportunities are as obvious as the previous example without intensive competition, and when you get down to the demand and supply for a procedure by market, a few points in either direction can make or break profitability.

Banking on the industry, without good old-fashioned business strategies: Many healthcare businesses will amble along just as they are, with decent numbers and good products or services that have been well-received in the marketplace. Often these good investments left alone will lag the industry growth rate. They can be made into much better investments by applying some of the business strategies used in other industries: employing market segmentation analysis; targeting and identifying the most profitable customers; allocating people and capital according to the most promising opportunities to lift profits; and developing long-range strategic plans.

Because of the high level of regulation, the barriers to competition, the lack of clarity as to future rules and regulations, and the low level of transparency, it is unlikely that individuals and organizations will become systematically more accountable for the costs of their own care in the foreseeable future. It is unlikely under these conditions that the incentives to reduce costs will be aligned, or that healthcare spending will come down on a national basis. If you can't beat 'em, might as well join 'em by investing intelligently and making a buck to save for your own healthcare costs when the time comes.


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