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ACOS: GETTING BEYOND WAIT-AND-SEE

As the rules that will one day govern Accountable Care Organizations (ACOs) are being shaped by contentious voices on all sides, what was once eager anticipation has given way to a more circumspect, wait-and-see attitude. Uncertainties abound, as a dense tangle of interconnected problems—financial, legal, technological, political—continue to defy easy resolution. Consequently, private equity firms seeking opportunity in the otherwise vibrant healthcare environment can as yet find little comfort in the ACO, an entity type that does not, after all, officially exist.

And yet, even as the industry expresses both confusion and pique over the ongoing formulation of the ACO rules, there seems to be no shortage of activity in the M&A markets, most of it involving healthcare providers who may—or may not—be well-positioned to turn the eventual ACO model to their advantage.

Major acquisitions—of Caritas by Cerberus, of Detroit Metro Center by Vanguard Health, even the failed takeover attempt of Tenet by CHS—all point to a serious interest in ACOs, whatever form they ultimately take. Accordingly, the private equity community has to wonder at what point "wait-and-see" becomes "too-little-too-late."

What follows is a birds-eye view of the ACO landscape from the private equity perspective. It takes as given the panoply of complexities and challenges that have already been widely chronicled, seeking instead to arrive at a few common-sense approaches that might help an investor new to the field get beyond simply waiting and seeing.

32 million new patients

Even given the daunting uncertainties surrounding the ACO initiative, there is nonetheless cause for optimism. Over 32 million Americans are about to become insured, and while there will surely be problems absorbing them all, there will also be plenty of success stories, many of them dazzling. Massive government funding of a number of inter-related initiatives is aimed at nurturing these success stories, and in this context, ACOs will have significant influence on future direction, whether they ultimately succeed or not.

A longstanding vision

While the goals being pursued—higher care levels, lower delivery costs, and shared savings—are no doubt worthwhile, there are simply too many variables inherent in the ACO initiative to predict, with any confidence, its ultimate success.

That said, these goals are not new. The huge questions facing healthcare delivery have long been known, and most of its main players have long understood their role in finding the answers. The best-positioned companies are the ones who have made serious investments, both financial and emotional, in process improvement programs—in the evolving technologies of infrastructure, collaboration, back-office, and compliance that will drive the new realities. These companies have been eager participants in pilot programs, both public and private. Not coincidentally, the learning from those programs has had no small influence on the emerging ACO model.

These are the companies, in other words, that will be well placed to take advantage of the ACO initiative, regardless of how it pans out.

Look for the effective players

Any acquisition strategy should, therefore, focus on the companies that "get it." They should be easy enough to identify. They will already have formed powerful collaborative alliances—IDSs, PHOs, and other entities—aligning hospitals, physician groups, and business systems. Their prospectuses will show that they've anticipated the future, identified the promising directions, and embraced the changes needed to get them there. They will already be delivering better care more efficiently—and making money in the process. Happy to spearhead the nascent ACO movement, they will have long since acquired the skills and resources to survive even its total failure.

Look for the picks and shovels

In a gold rush, it's said, the real money is made not by the miners themselves, but by the people who sell them the picks and shovels. Similarly, in today's healthcare "rush," an endless parade of suppliers is lining up to sell providers the vast array of tools they need to exploit this new environment. HIT vendors are only the most obvious examples. Process improvement systems of every stripe—infrastructure, workflow, project management, claims management, etc.—are aggressively being sold to every department in the healthcare universe.

Substantial investor attention has already been lavished on the HIT sector, and while the importance of IT in transforming healthcare cannot be overstated, the early bargains have largely been identified and claimed. Still, the sector bears close watching as a bellwether of developing trends and opportunities. The best of these companies will surely be in the forefront of the ACO movement, helping to define it, implement it, drive the desired efficiencies, and point out future directions.

Look for scale

With so many new patients entering the system at the same time, it makes sense to think big. Most of the serious players will be seeking capital, many in large amounts. Cerberus and Vanguard Health are clearly feeling that size matters. Both have recently acquired major hospital systems whose price tags represent only a portion of the capital investment being committed.

That a big private equity firm like Cerberus should be making such a hefty commitment in what is, for them, an unfamiliar category is, in itself, instructive. Looking, no doubt, for opportunities where large infusions of capital can make a difference, it was perhaps inevitable that the major healthcare providers would command their attention. That Cerberus has publicly affirmed their intention to form an ACO is telling, as well, in that it assures them a place at the table in the ongoing rules debate. The sheer size of the acquisition, in other words, carries considerable weight in the ACO world. It may even help insulate them from any future disruptions in the ACO program.

Look for payers who get it

Payers and payment schemes vary wildly from market to market. While the "shared savings" model currently enshrined in the ACO initiative is clearly the government's favorite, it will not be the only scheme out there. For the foreseeable future, a number of public and private payment models—fee-for-service, episode-of-care, bundled payment, capitation— will surely co-exist and compete for supremacy.

Since the overall success of the new system will depend as much on enlightened insurers as it will on enlightened providers, it follows that the more promising opportunities may well be in the markets—both geographic and demographic—that are served by those insurers who "get it."

Take the long view

The nation's healthcare system will not be transformed quickly or quietly. As with every major social reform, all manner of false starts, dead ends, and do-overs will attend the process. For private equity firms, patience will be required. Whether healthcare acquisitions ultimately lend themselves to easy, straightforward exit strategies is anybody's guess, but it seems clear that the kinds of smooth exits so common in the last decade will be difficult to replicate in this one.

Still, the dust has to settle somewhere. Those 32 million newly-insured Americans will create a huge demand that cannot be met by the current system. Huge capital infusions will be channelled, in large part, to the people who, again, "get it." For these forward-thinking providers, ACOs are simply one more step on a long road they've been traveling for decades. They will neither be deterred by the ACO model's failure, nor over-awed by its success.

They have learned their patience the hard way, and will continue to take the long view. The investors who follow them will need to do the same.

Additional Information

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