PART 1 OF A FOUR-PART SERIES

STRATEGIC INVESTMENT IN HEALTH CARE INNOVATION

# The rise of innovation investing among health care organizations

For the past decade, health care has experienced explosive innovation, particularly in technology and tech-enabled health care services. Health care organizations have been adopting innovative technologies in response to growing demand for digital offerings from consumers as well as a critical need to limit costs, improve quality and expand access to care.

Innovation is also creating value as innovative companies scale and mature, enticing more health care organizations to get involved — not just as users of technology, but also as investors. Yet for many in the field, particularly small- and medium-sized organizations, the desire to invest in health care innovation poses challenges.

Organizations oriented toward delivering care are grappling with demands outside their core skill set, such as investment due diligence, often with mixed results. Some systems with significant scale, resources, expertise and experience may be able to pursue health care innovation on their own. However, organizations that don't fit that category can still participate by partnering with specialists, enabling them to help advance innovation in the field while also potentially benefiting their organizations.

In this four-part article series, the American Hospital Association (AHA) and Concord Health Partners, a health care-focused investment firm, delve into the fast-paced world of health care innovation investing. We discuss the channels organizations are using to invest in innovation, the roles

## About Concord Health Partners

Concord Health Partners is a health care-focused investment firm with a strategic model that seeks to optimize the alignment of interests between investors and portfolio companies. Concord is primarily focused on investing in health care companies that have the potential to enhance the value of care through products, services, technologies and solutions that achieve operational efficiencies, improve patient outcomes and/or expand access to quality care.

In late 2019, Concord and the AHA partnered to launch an investment fund to support early-stage health care companies that provide products, services and solutions that help hospitals and health systems transform care delivery, connect with entrepreneurs and spur innovation. ●

of professional investors, and what it takes to achieve success as an organization as providers work to improve outcomes and increase patient access. In this first article, we look at the factors driving innovation and the approaches organizations are taking to capitalize on the opportunity.

## What's driving the innovation imperative?

Powerful forces are driving digital innovation in health care. Pressure is coming in part from patients who demand more effective and consumer-friendly engagement, as well as the broader market, which is growing steadily due to aging demographics. Regardless of the complexities inherent in health care, consumers and businesses expect to interact with the sector in more bespoke and digital ways, as they do with airlines, financial institutions and other modern enterprises. Health care is now focused on catching up.

**Health care costs, accounting for approximately 20% of U.S. GDP, are a major force driving innovation in the field.**

Cost is another major force driving innovation. The U.S. health care system spends over twice the Organization for Economic Co-operation and Development (OECD) average. Health care costs already account for approximately 20% of U.S. GDP and appear unsustainable with added inflation pressures. Bending the cost curve while ensuring quality and increasing access is an imperative in the field, and technology offers hope.

Over the longer term, models such as value-based care may help reduce costs and improve outcomes. This, too, is driving innovation, because value-based care requires actionable data. Fortunately, over the past decade, federal mandates have fueled the creation of a comprehensive electronic health record infrastructure. This is enabling innovation in digital analytics, digital health and

**Many established health care providers and payers are feeling the pressure from a vast array of new disruptors.**

virtual health, all of which support efficiency and value-based care. Meanwhile, rapid advances in machine learning and artificial intelligence are unlocking new ways to take advantage of data.

Finally, a vast array of disruptors — ranging from startups to behemoths like Amazon, Walmart and Google — are aggressively trying to modernize health care, rein in costs, and capture a piece of the approximately $4 trillion health care field. Many established health care providers and payers are feeling the pressure from these new entrants.

## Health care incumbents respond with more than just capital

Health care organizations are pursuing a variety of approaches to invest in innovation. Many have established innovation teams and appointed chief innovation officers — a title that barely existed in these organizations a decade ago. Some are engaging in technology transfer and beta-testing new solutions. These home-grown approaches may expose an organization to innovation, but they may result in missed revenue opportunities. For instance, some early adopters of electronic health records failed to benefit financially by not seeking equity in the high-growth companies that developed the technology.

Some organizations are creating internal innovation teams, which are tasked with developing and identifying solutions to the many challenges the field faces. While ambitious, this can be difficult due to the market scale and the many internal conflicts that typically exist within large organizations. Leaders need a unique set of technical, managerial and entrepreneurial skills. To thrive in a competitive market, they must act quickly and nimbly, which may be challenging within large organizations.

## Introducing Our Series on Health Care Innovation Investing

Through this series, the AHA and Concord are seeking to provide more information to hospitals, health systems and health care organizations about innovation investing and deepen their understanding of the various private equity strategies that are involved, including venture capital, growth equity and buyout strategies. ●

### Topics in the series

PART 1 | **The Rise of Innovation Investing**

PART 2 | **Private-Equity Primer for Health Care Providers**

PART 3 | **Ingredients for Success in Health Care Innovation Investing**

PART 4 | **Growth-Equity Investing in Health Care**

Other organizations are creating system-sponsored venture funds, which identify and take a stake in up-and-coming companies, hoping to benefit from the technology being developed as well as future profits. The financial and innovation benefits may be significant, but organizations that pursue this strategy in-house may sometimes lack the specialized skills, expertise and resources needed to operate in this highly competitive area. Many are choosing instead to partner with institutional partners, including private equity firms, to pursue these opportunities.

Despite the hurdles noted above, it shouldn't be underestimated how valuable aligned investments by strategic companies can be for technology adoption within a health system. Having the investment experience and guidance of an internal champion for an emerging technology is extremely helpful for private equity partners and portfolio companies to help navigate a health system's internal ecosystem.

## The role of private equity in health care innovation

Private equity firms have been an important part of health care innovation for decades. They offer business acumen and investing professionalism that health care organizations may lack in-house.

While sometimes misunderstood, private equity is an umbrella term that includes any type of investing involving private ownership rather than public markets. It comes in a variety of forms. Venture capital is a private equity strategy focused on early-stage companies. Growth equity firms typically take minority stakes in companies that have achieved some level of market adoption and now seek the capital and expertise to scale. Buyout firms typically seek a majority stake in companies and seek to boost their value, with the goal of eventually exiting through a sale to a strategic buyer, another buyout fund or through an IPO.

It is important for health care organizations to understand how private equity works and what it takes to be successful in building out a strategic investment effort to support and adopt innovation. In the next article in this series, we offer a primer on private equity. We define what it is, how its main strategies differ from one another, and how working with a private equity firm can advance health care innovation. We also offer an overview of how companies can evaluate prospective private equity partners to avoid common pitfalls.