Private Equity: What Physician Leaders Need to Know

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Private equity firms continue to be major players in the ongoing consolidation of the healthcare sector, as these investors are particularly interested in physician practices. In these transactions, the firms buy controlling interest in a company and seek to optimize its profitability based on a plan to re-sell at a significant profit within a few years.

KEY WORDS: Private equity; physician practices; optimization; consolidation; platform practice; due diligence.

Although the number of private equity transactions has dropped from the record 2021 levels, private equity firms continue to be major players in the ongoing consolidation of the healthcare sector.

"There is still a tremendous amount of interest and funds available to make deals for at least the next two to three, maybe even five years," says Max Reiboldt, CPA, chairman of Coker, a physician-practice consultancy.

Private equity firms such as Bain Capital and KKR pool investment capital, form limited partnerships buy controlling interest in a company, and optimize its profitability with the goal of re-selling the company at a significant profit within a few years. For more than a decade, their sights have been set on the healthcare sector, which is known for its high degrees of fragmentation and operating inefficiency.

Private equity's penetration in healthcare is substantial or minor, depending on one's perspective. About 460 U.S. hospitals are owned by private equity firms, according to a Private Equity Stakeholder Project report in early 2024.[1] That translates to 8% of all non-government hospitals and 22% of all for-profit hospitals. In New Mexico, 38% of all hospitals are owned by private equity firms; in Idaho, 23%. Nearly 23% of all psychiatric hospitals are owned by private equity.

Private equity firms had acquired more than 5,500 physician practices by 2021, according to an analysis sponsored by the National Institute of Health Care Management Foundation.[2] In 2022, the American Medical Association reported that 4.5% of physicians were in a practice owned by a private equity firm.[3]

However, private equity's penetration into the physician-practice segment varies significantly by market and specialty. In 2021, a single private equity firm owned more than 50% market share of at least one physician specialty in 50 metropolitan areas, according to the researchers for the Antitrust Institute.[4] Their analysis revealed that between 2012 and 2021, private equity firms were most aggressive in purchasing dermatology, ophthalmology, gastroenterology, and primary care practices.

HOW WILL THE FUTURE BE FINANCED?

"Many, many physician practices around the country now are looking at their future and trying to evaluate what that will look like," says Susan Dentzer, CEO of America's Physician Groups, an association of about 360 physician practices ranging from medium-sized to very large, focused on value-based care.

Some practice owners, as they are looking to retire, want to strengthen their bargaining power in negotiations with insurers. Others want to ensure they are able to compete with deeper-pocketed entities that have entered healthcare in recent years such as Amazon and CVS.

Some need help meeting the increasing challenges of managing a practice, or they need capital to invest in new infrastructure, such as advanced information technology. Some lack confidence in their ability to adopt emerging technologies, such as artificial intelligence, quickly enough to stay relevant.

Those trends lead Dentzer to be confident that consolidation among physician practices will only pick up speed as practices are acquired by larger entities with greater resources, including public companies, or as they join

forces with private equity investors or others ready to invest capital that will enable them to survive, grow, and thrive.

"You can see this as the death throes of the cottage industry of healthcare in America, which remained a cottage industry a whole lot longer than a lot of people thought it would," Dentzer says.

One can lament this passing of the era, or one can see it as the inevitable consequence of innumerable changes in the economy and society that are reshaping almost every aspect of U.S. business. Dentzer says: "What's going to go on over the next decade-plus is a giant matchmaking operation [in healthcare] as everybody tries to decide how much growth they need or want to take on, where, to what purpose, and with whom as a partner."

A private equity deal is just one option to consider, but it checks all the boxes for some physician-practice owners. Reiboldt, author of the forthcoming book *Private Equity and Healthcare*, says private equity firms differ from one another in many ways, but as a rule, they use the same playbook. He offers this brief description:

Most private equity firms focus narrowly on certain specialties, such as dermatology or gastroenterology. Specialties that require ancillary services are most prized because of the additional revenue streams they offer.

The first acquisition, called the "platform," in a given specialty is typically well-managed, highly profitable, and a good springboard for growth. Then, the private equity firm adds other practices, often in the same geographic area, with the goal of creating a critical mass of practices within a specialty and a region.

"The subsequent acquisitions may be slightly less successful, but nonetheless very viable for growth and expansion and to fill in the overall geography," Reiboldt says. The critical mass within a region helps all involved.

The value of a physician practice — what the buyer is willing to pay — is typically a multiple, usually between 8% and 13%, of the aggregate annual compensation of all the physician owners. The investors own majority control of the practice, while the physician owners typically maintain a minority interest.

At that point, the private equity company takes responsibility for managing the business, increasing its profitability, and executing an aggressive growth plan, typically by buying other practices. Most firms want to re-sell the aggregation of practices within three to seven years at a substantial profit. This is referred to as the recapitalization process.

Thus, the physician-owners get a payout when they sell the company the first time and another when the private equity firm sells the now-larger organization a few years down the road.

The financial downside, Reiboldt believes, is that physicians' annual compensation will be reduced during the years between the original transaction and the second one, although the private equity firm will attempt to minimize the reduction. Still, the "income scrape" may be more acceptable to physician-owners who are nearing the end of their careers than younger physicians, who frequently prefer to maximize their current earnings and may be concerned about who will control the practice long-term.

"Younger physicians are not as enamored, generally speaking, as older ones, who see this as an opportunity to cash out that they might not otherwise have," he says.

Some of the physician-owners may serve on the board of directors after the transaction, but their influence will be diminished. "As for the second sale — when or to whom or for how much — they are at the mercy of their majority partner," Reiboldt says. "But the [financial] incentives are aligned because the partner who has a majority ownership will want to make as good a deal as you do."

WHEN PRIVATE EQUITY WORKS WELL

Private equity's track record in healthcare is littered with challenges. Recent examples include Envision Healthcare, a multispecialty physician group and chain of ambulatory surgery centers, which filed for bankruptcy in 2023, and Steward Health Care, owner of 31 hospitals, which went bankrupt in 2024. Many deals, however, work out well.

"Private equity is looking to grow, so in general, it's a win-win situation if you are aligned," says neurologist Mark Mintz, MD. "If you're not aligned, it could be a problem."

In 2005, Mintz and his wife, Pnina Mintz, PhD, founded NeurAbilities Healthcare, a New Jersey organization devoted to evaluating, diagnosing, and treating individuals with neurodevelopmental disabilities. At the beginning, Mintz was the only physician on a six-person staff working in a 1,500-square-foot office.

During the next decade, NeurAbilities grew almost tenfold to a staff of more than 60 operating in three facilities with approximately 20,000 square feet of space. Mintz and his wife assumed all the financial risk, borrowing money to incrementally add staff to support new programs. "We couldn't expand at a very rapid pace because we would have been way behind in cash flow," he explains, "so we had to do it slowly."

The Mintzes wanted to grow the business and reduce their personal financial risk, but they were wary about partnering.

"The question was always: 'How do we get to the next level?'" Mintz says. "We had seen pitches from some groups that we could not see how we were going to be aligned. If [a potential investor] likes just a piece of the company and they want to focus on that and get rid of everything else, that could destroy your vision and mission."

When a private equity company approached the couple several years ago, the Mintzes recognized a fit. "If you're working with a group that sees what you have done and has the expertise to bring it to a higher level and the capital to provide for that, it can work very well," Mintz says.

They agreed in 2018 to bring in the private equity investors and restructure the company; since then, NeurAbilities Healthcare has grown to include more than 600 staff working in 16 facilities in New Jersey and Pennsylvania.

"They were able to recreate our management at a much higher level, and the capital that they provided upfront allowed us to rapidly grow," Mintz says. "And the board that we created, which I'm still a member of, includes a lot of healthcare expertise and other growth-company expertise."

WHO WINS, WHO LOSES

The Lown Institute, a nonpartisan think tank attempting to improve America's healthcare system, documents the industry's waste and inefficiencies, the irksome problems that make healthcare entities so attractive to private investors.

"The institutions of healthcare have been reticent to tackle those things," says cardiologist Vikas Saini, MD, the institute's president. "As a result, you have outside parties who look at this situation and say, 'Hey, there's money to be made. If they're not going to do it, we're going to do it.'"

Because the money being wasted comes at the expense of the government, employers, unions, patients, or any person or entity that is paying for healthcare services, Saini questions the appropriate role of the many for-profit investors, including start-ups and major retailers, and private equity, swooping in from outside the industry.

"There is waste to be driven out of the system, but if that money is saved, where should it go?" Saini says. "Should it go back into the healthcare delivery system to improve our emergency management services? Should it improve primary care? How could it be best spent?"

Private equity firms are of particular concern to him because their business model typically involves borrowing heavily against a healthcare entity's assets to fund operations, which can jeopardize its future.

"Exhibit A is Steward Health Care," he explains. "They saddled the operating business with tons of debt, and then the operating business had to service that debt through the care of patients."

Steward, created in 2010 when a private equity firm bought several hospitals in Massachusetts, grew to include 31 hospitals with nearly 30,000 employees in eight states before it filed for bankruptcy in May, triggering a chaotic effort to sell or close hospitals and its physician network.

Saini believes mergers and acquisitions that directly affect patient care should be subject to regulatory review akin to the review processes used for public utility rate hike proposals.

"The real tonic to make sure these deals are done right would be to require much more serious participation and engagement with the affected communities and their leaders," he says.

THINGS TO CONSIDER

Although private equity transactions can appear to be straightforward, they require extensive due diligence and negotiations.

"Really good advisors are essential to getting a deal done, and good legal counsel too," Reiboldt says. "Some groups will say, 'We can do this on our own. We will just get a lawyer to write up the final agreement,' but chances are you will get your lunch eaten."

Practice owners who are contemplating any type of ownership change, whether it be acquisition by a health system, a private-equity deal, a merger with another practice, or another suitor should prepare themselves and their organizations to accept change. The benefits of these transactions are economies of scale, centralization of services, and greater negotiating power, which are often the reasons physician-owners want to take on a financial partner.

To ensure they are making the best decision, physician-owners must engage in a thorough due-diligence process, assuring that the physician-owners and the investors have a full and mutual understanding of the transaction, the plan for the future, and the motivations of each party; they also must be patient to find the investor that is the right fit.

"The good equity groups want you to be happy," Mintz says. "They have money and could start a business from scratch, but they see what you have done, so they want you to continue doing what you are doing. That's how it becomes a win-win situation."

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