

# Launching a Payer Venture and Innovation Group: Options and Trade-Offs



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The past 5 years have been a time of great uncertainty for health plan executives. Continued pressure on medical loss ratios, the migration to new payment methodologies, a rapidly consolidating competitive landscape, and sweeping uncertainties surrounding the individual market have combined to form a perfect storm, rendering the status quo untenable. In this frenzied environment of dwindling margins and regulatory confusion, managed care companies have begun to find new growth opportunities by experimenting with investment and innovation programs, or accelerators.<sup>1</sup>

Continuing off of earlier work,<sup>2</sup> this article provides a high-level evaluation of the universe of model options accessible to payers who are interested in launching such programs. It draws on the perspectives of a number of nationally renowned experts in the field from several organizations at the forefront of innovation. One such organization is Horizon Blue Cross Blue Shield (BCBS) of New Jersey. Minal Patel, senior vice president and chief strategy officer of Horizon, offers the following perspective: “Given the pace of innovation spurred by the Affordable Care Act and the flow of capital, Horizon recognized the need to work closely with entrepreneurs who are building capabilities required for us to continue to fulfill our mission which is to provide access to high quality, affordable healthcare with superior member experience (the triple aim). As such, we clearly defined those capabilities that we need to succeed and then began to socialize these needs with all entities that are in the ‘deal flow.’ Clearly articulating what these needs are must be a foundational

task for any strategic investment arm so that we may efficiently source deals that fit our needs and more importantly, quickly decide upon which deals we will pass.”

## Goals of Strategic Healthcare Investing

Payers generally seek to achieve 4 principal goals when considering whether to undertake investment and innovation opportunities (Figure 1):

1. Financial returns. Many organizations establish investment initiatives to drive financial returns. By taking equity stakes in early- and growth-stage companies and growing revenue through customer relationships, payers can generate new sources of income that are not subject to the reimbursement pressures affecting the core business of reimbursing medical care.
2. Operations improvement. Innovation programs offer payers a means to identify a pipeline of promising companies that can help them upgrade operations, reduce medical costs, improve outcomes, and expand access to care.
3. Brand enhancement. Investment programs can serve as vehicles to enhance brand integrity in an increasingly competitive landscape through differentiation and expansion of market reach.
4. Foster innovation. Perhaps most significant, commercializing new ideas enables organizations to cultivate an innovation-focused culture. Rob Coppedge, president of Direct Health Solutions at Cambia, describes his organization’s

Figure 1. Benefits of Strategic Healthcare Investing



multi-pronged objectives in operating a strategic investing program: “Cambia views strategic investing as a tactic to advance its corporate mission to create an economically sustainable healthcare system organized around the consumer. We are not investing to prop up the current, broken healthcare system.... So while financial return is expected from each investment, we also look closely at the impact our companies are having on the transformation of the healthcare experience for consumers.”

### Models of Payer-Based Investment and Innovation Programs

Depending on a given health plan's risk appetite, resource commitment, and desired return, a variety of approaches are available (Figure 2):

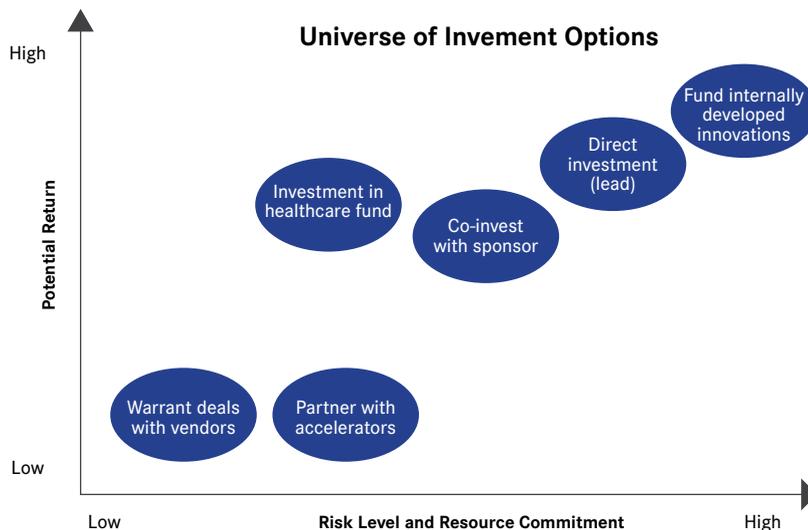
- Accelerator investments. A number of third-party accelerators offer partner organizations access to, and a small equity stake in, a multitude of early-stage companies. In addition to providing interaction with other health plans and health systems that have made similar commitments, a well-publicized investment in an internal accelerator program may confer branding benefits.
- Innovation centers. Developing an in-house innovation center enables organizations to generate revenue from internal intellectual property (IP). Such a center may take the form of an internal accelerator, whereby new products are researched, developed, and launched using a health plan's own resources. A successful center typically incorporates the following: a) mining mechanisms to identify ideas with commercial potential; b) screening processes to filter the most compelling concepts; and c) matching components to pair prospective entrepreneurs with the staffing, finan-

cial, and clinical resources needed to bring ideas to market.

- Warrant deals. Several organizations have developed warrant programs, in which the health plan picks up an equity percentage in a company in conjunction with signing a commercial agreement. This approach provides health plans with a low-risk means to share in the upside, while minimizing the downside financial risk.
- Fund investments. This option offers the opportunity to invest in a portfolio of companies while not being tied to the fate of any single business. It also allows organizations to benefit from the due diligence and investment management resources of a fund, rather than assuming this burden themselves.
- Direct investments. Increasingly, health plans are making direct equity investments in healthcare information technology (IT) and service firms to leverage commercial relationships with these vendors. Although they represent the biggest possible financial return, direct investments also carry the greatest amount of risk because financial returns are linked to a single company.

Of course, these models are not mutually exclusive. Sophisticated organizations will typically apply a multi-pronged strategy in operating an investment and innovation program—featuring, for example, internal IP commercialization alongside external investment activity. Minal Patel of Horizon describes his program's hybrid investment approach as follows: “We distinguish our direct investments from our indirect investments through funds in 1 very important way. We will only invest directly once we have decided to work with the business as a client and where the company gives us some authority to help provide input into the

**Figure 2. Trade-Offs Between Approaches**



business. We may or may not do business with a company within the portfolio of any of our investment funds.”

### Implications for Health Plan Executives

The evolving landscape of innovation and investment programs has a number of implications for healthcare leaders.

#### *A New Paradigm*

A new paradigm of health plans working with early-stage companies has emerged. Although the features of innovation and investment programs vary widely across organizations, all mandate a new mode of working with early-stage companies. The prohibitively long sales cycles these businesses customarily face when selling in a healthcare setting represent a major deterrent for entrepreneurs attempting to penetrate this segment. In many ways, the barriers to sales represent barriers to innovation. Breaking down these obstacles will require a systematic method of screening companies against organizational objectives and identifying the appropriate business unit champions to help them reach decision makers. This relationship needs to work both ways, however: health plans should be rewarded for the effort and risk associated with supporting early-stage businesses. Thomas Hawes, managing director of Sandbox Industries, elaborates on his organization’s method of working with prospective companies:

The key goal of the BCBS Venture Partners (BCBSVP) program is to find or create companies that address the strategic priorities of our LPs. This has been done by creating a 2-sided network, mapping the many active BCBS executives who are looking to collaborate with the network of entrepreneurs that come through the BCBSVP platform.

#### *An Internal Resource Commitment Is Essential*

Undertaking an investment and innovation program in earnest requires both executive sponsorship and a dedicated financial and personnel commitment. If the intention is to transform a health plan’s core business model for the future, then executives would be well served to treat the program as a priority. Maureen O’Connor, president of Mosaic Health Solutions, offers the following description of her organization’s commitment: “Mosaic Health Solutions is focused on achieving the dual goal of driving top-tier financial performance while also accelerating innovation within BCBS of North Carolina and the broader healthcare ecosystem. We strive to be a highly engaged strategic investor that adds value to our portfolio companies through deep industry knowledge, potential commercial relationships with our parent company, and a broad national network of other Blues Plans. We seek both control and minority investment positions where we can influence the future direction of the company.”

### Considerations in Launching Investment and Innovation Programs

Innovation program structure depends on goals and risk appetite. With a multitude of available options, healthcare leaders must prioritize and decide which investments are most appropriate for their organization’s risk appetite and return goals. Structuring warrant deals with companies or investing in an external accelerator presents a reasonably low risk of losing capital, but these approaches do not offer substantial upside potential. Conversely, making direct investments in companies or rolling out an internal IP commercialization effort comes with higher levels of both financial risk and return. **Figure 3** outlines a number of

**Figure 3. Key Questions Shaping Strategy Decisions**

**What are our investment goals and risk appetite?**

- How do you weigh capital appreciation versus obtaining greater access to new technologies and ideas in structuring your program?
- What is your investment horizon?
- Are you comfortable taking greater downside risk in exchange for a higher potential return?

**How are you sourcing and evaluating new opportunities?**

- Is your current pipeline sufficient?
- How do you best mine internal intellectual capital?
- Are you deploying internal resources efficiently/appropriately?

**How will the program be governed and staffed?**

- What will be the metrics to define program success and how will reporting be coordinated?
- Who will maintain ultimate oversight over the program?
- Will you repurpose existing team members or recruit and build a full internal investment team?

**How can you differentiate your program?**

- With many intelligent investors chasing the same companies, how can we provide something uniquely valuable?
- How do we drive commercial value for prospective portfolio companies internally?

factors executives should consider in launching their programs.

Revenue diversification is the name of the game. In many ways, the rise of health plan investment and innovation programs has paralleled the rollout of risk-based payment models. Healthcare reform has galvanized executives to think more critically about margin enhancement strategies. Although some payers have been laser focused on doing anything they can to maximize profitability under the fee-for-service system, others understand that surviving in a new world—one in which hospitals are assuming significant financial risk for a patient’s treatment—will require new ideas, products, and sources of revenue.

**Conclusions**

A market scan shows widespread agreement among leaders that innovation is no longer optional for health plans. The question thus becomes how to develop and implement an investment and innovation strategy that meets an organization’s distinctive finan-

cial, strategic, and marketing goals, while staying within internal resource constraints. Although few organizations have “cracked the code” on strategic investing and innovation, studying the best practices of those that have done so is an important exercise for any health plan leader who stands on the precipice of launching an internal investment and innovation program. Equipped with the insights of the experts in this article, we can identify a set of implications for other healthcare executives.

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