OUR TAKE

How Covid-19 Will Impact Disruptive Market Entrants

Published - June, 2020 • 15-min read

Before the Covid-19 pandemic, health care venture funding and deal activity were approaching record highs annually. As a result, hospitals and health systems faced greater competition from start-ups each year. Now, as consumer behaviors and economic conditions change, start-ups are experiencing two diverging future outlooks. In this publication, we will explore these two outlooks—one for companies expected to thrive, and another for organizations that may falter—in light of the novel coronavirus.

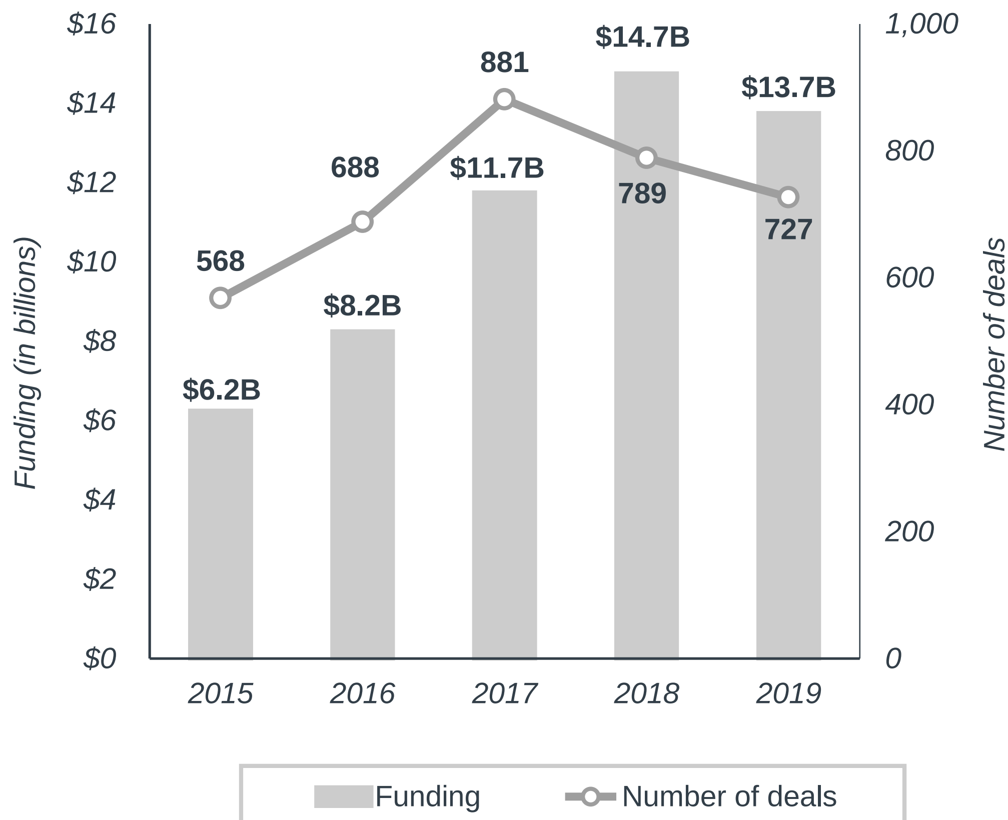
Advisory Board

Table of contents

The pre-Covid-19 reality

For the past decade, investors have poured an increasing amount of funding into health care start-ups due to the many needs that traditional players weren't meeting. From 2015 to 2019, health innovation funding more than doubled. Despite a slowdown in 2019, funding and deal activity for health care start-ups were expected to continue the momentum they had built in the years prior into 2020.

Health innovation funding and number of deals before Covid-19



Source: Startup Health Insights, "2019: The Year for Health Innovation," Startup Health, 2019.

Our take

New funding and deal activity for start-ups will experience a significant slowdown across the next 12 to 24 months, as poor economic conditions persist. In the near term, funding that has already been raised has been and will continue to be directed toward solutions that support the immediate needs associated with the Covid-19 crisis.

Start-ups that cannot play an immediate role in navigating through the crisis may face liquidity and funding issues, forcing them to lay off workers and postpone their expansion plans to stay afloat. Acquisitions or permanent closures will be a reality for some.

As the acute period of Covid-19 winds down, economic ramifications will persist and continue to shake up competitive dynamics. For the rest of the year, the new solutions introduced will be specifically designed to meet the new reality of consumer behaviors. Venture funds will deploy their capital more judiciously and with greater scrutiny to ensure that the companies they are investing in are either part of the solution or, at least, can weather the economic storm brought on by Covid-19.

Three key implications

01

IMPLICATION 1

Economic conditions will lead to fewer start-up competitors

02

IMPLICATION 2

Select disruptors will thrive in the stay-at-home lifestyle

03

IMPLICATION 3

Purchasers will seek solutions with near-term ROI

01 Economic conditions will lead to fewer start-up competitors

Care sites that cannot conduct all of their business remotely, such as urgent care centers, retail clinics, physician offices, ambulatory surgical centers, and post-acute providers, have seen dramatic reductions in patient volumes. These volumes may not recover to pre-Covid-19 levels even by year's end due to lingering consumer fears and a prolonged economic downturn. Generating sufficient cash flows and liquidity will be essential for long-term survival.

Companies that were planning to raise venture funding across Q3 and Q4 will be competing for a limited pool of funds and will have to argue for higher valuations, Most will not be successful. Start-ups that rely on cash flows from business operations and do not have venture fund backing will likely need to rely on small business grants from the federal government and low-interest loans from private creditors, if they can receive them. Finally, companies that rely on sales to cash-strapped employers or health systems will see dramatic revenue losses if they can not demonstrate how their solutions can directly assist with managing the crisis or result in immediate cost savings.

The duration and continued fallout from Covid-19 will determine the length of the slowdown and, in turn, the number of start-ups that will be forced to close their doors across the next year. While this may sound favorable to existing companies, the reality is that we will come out of the crisis with fewer start-ups, but they'll have more focused, better positioned solutions to compete with hospitals and health systems. Incumbents should continue to actively seek out mutually beneficial partnerships with well-positioned start-ups. Additionally, most hospitals and health systems will need to reconsider their own investment strategy—both venture funding and acquisitions—to ensure investments are adaptive to new purchaser needs and internal financial realities.

02 Select disruptors will thrive in the stay-at-home lifestyle

While many businesses will falter throughout 2020, we will also see companies take advantage of stay-at-home orders, relaxed regulations, and consumer anxieties to reset consumer expectations and establish a loyal customer base for the long term. This is most evident with telehealth providers and home-based care models, which have provided immediate solutions to address the challenges of the time.

Telehealth providers, including 98Point6, TytoCare, SteadyMD, and Circle Medical, are among the few start-ups that have announced new funding in the middle of the Covid-19 outbreak. Some polls have shown that the Covid-19 epidemic has led almost a quarter (23%) of Americans to try telehealth—a marked increase compared to utilization before 2020, which hovered in the low single digits. If first-time users are satisfied with their telehealth experience and payment parity stays in place and/or reimbursement is secured through other arrangements, virtual visits and remote monitoring will generate a loyal following for years to come.

The stay-at-home economy and lifestyle has also opened the door for home-based house call models and self-administered diagnostics companies. These companies offer consumers greater convenience, but they have suffered from reliance on direct-to-consumer payments and lack of public awareness. With more consumers now actively looking for alternatives to institutional settings, these companies are positioned to acquire a large swath of new customers willing to pay for the safety, ease, and convenience of these at-home care models.

Source: "National Tracking Poll #2004100," Morning Consult, April 2020; "Coverage and utilization of telemedicine services by enrollees in large employer plans", Health System Tracker, March 2020.

SELECT DISRUPTORS WILL THRIVE IN THE STAY-AT-HOME LIFESTYLE

Additional services that consumers have been exposed to in this era, including digital communications and engagement platforms such as Conversa Health and prescription delivery services such as Capsule, will likely continue to be favored by consumers.

Hospitals and health systems will need to track consumer preferences over time to determine which solutions remain important to consumers, even when stay-at-home habits fade. Most hospitals and health systems will find that partnerships with start-ups will be the best path for quickly instituting solutions that adjusts to new consumer behaviors.

03 Purchasers will seek solutions with near-term ROI

Economic conditions brought on by Covid-19 will lead to employers and consumers taking a more activist approach to managing health care costs. Start-ups that can demonstrate a positive and immediate ROI to these purchasers have a better chance of garnering funding. Examples include digital therapeutics companies, value-based primary care companies, and direct-pay primary care models.

With growing evidence of cost savings and efficacy of digital therapeutics in managing chronic diseases such as diabetes, hypertension, and depression, digital therapeutic companies were already gaining favor among employers before the outbreak. Since these chronic conditions are likely to worsen in the aftermath of Covid-19—one survey found 11% of adults saying that postponing or skipping medical care due to Covid-19 has caused their or a family member's condition to get worse—digital therapeutics are likely to see more funding and prominence.

Additionally, employers will likely accelerate adoption of value-based primary care models that share financial risk with providers for total cost of care. Companies that are set up to manage risk, such as VillageMD and Cityblock Health, are poised to expand their market presence and lives under management.

Rising unemployment, loss of insurance, and less expendable income will also increase cost-sensitivity among consumers. A segment of consumers will seek out low-cost membership models or self-pay options to receive essential primary and urgent care. This will threaten medical group finances if cost-cutting measures and low-cost alternatives, such as telehealth, are not embraced.

Source: Hamel L, et al., "KFF Health Tracking Poll," Kaiser Family Foundation, May 2020.

PURCHASERS WILL SEEK SOLUTIONS WITH NEAR-TERM ROI

Hospitals and health systems will need to closely monitor cost sensitivity among employers and consumers. They’ll also need to assess the businesses where they can offer a competitive value proposition. Partnerships may be an appealing option for some hospitals and health systems. Others may determine that the size of their market does not warrant investment in new areas that aren’t part of their core business.

Parting thoughts

Even through a crisis, incumbents should monitor the start-up landscape to maintain their competitive position and keep pace with emerging market innovations.

Questions for health care providers:

1. What new expectations will consumers have for your organization coming out of the crisis?
2. What new opportunities might open up in the market given the business realities facing many companies?
3. What businesses should health system-sponsored venture funds be investing in given the problems exposed through the Covid-19 crisis?
4. How will you compete digitally against start-ups?
5. How will health care benefits change among local employers?
6. How will your organization adapt to a more cost-conscious consumer?
7. Are there partnerships you can secure now that will benefit your organization in the long term?

More takes on the post-Covid-19 world

For more takes on how Covid-19 is reshaping the future of the U.S. health care industry, please visit www.advisory.com/covid-19impact

How will Covid-19 impact…

DEMAND

+ …the health status of the U.S.?
+ …telehealth?
+ …behavioral health?
+ …senior care?

PURCHASER LANDSCAPE

+ …payer enrollment mix?
+ …employers' health benefits strategies?
+ …the government's role in health care?
+ …the future of value-based care?

COMPETITION & INNOVATION

+ …disruptive market entrants?
+ …public perception of the industry?
+ …health system philanthropy?
+ …the health care innovation pipeline?

OPERATING MODELS

+ …"systemness" efforts?
+ …capacity expectations?
+ …the structure of the U.S. supply chain?
+ …the future of the clinical workforce?

Related content

RESOURCE
Innovative players shaping care delivery competition
Read now

RESOURCE
Innovative disruptors in care delivery
Read now

RESOURCE
Vertical integration: preparing for new competition
Read now

RESOURCE
How Covid-19 will impact telehealth
Read now

Project director

Colin Gelbaugh
gelbaugc@advisory.com

Program leadership

Anna Yakovenko

655 New York Avenue NW, Washington DC 20001
202-266-5600 | **advisory.com**