

## US Election Bulletin: Implications for Healthcare

November 10, 2016

The election of a Republican president and a Republican Congress has the potential to reshape the market landscape for healthcare manufacturers, payers, providers and services. Based on Bain & Company's primary research and experience with companies and investors, we expect the impact to vary for each group and to be less disruptive overall than many anticipate.

First, it is important to separate the role of government from market forces. The incoming Republican government has promised to overhaul the Affordable Care Act (ACA), drug pricing policies and the funding of Medicare/Medicaid. At the same time, per capita healthcare costs are growing at an unsustainable pace, and that will continue to trigger new market responses—including alternative payment models, price competition, and mergers and acquisitions.

It is premature to predict how the new administration will reshape the US healthcare system. The newly elected Congress agrees on the general direction of change, but it will take time to win alignment on legislation both within Congress and with the executive branch. In the interim, uncertainty is likely to contribute to market volatility. Campaign pledges, however, provide us with a set of plausible scenarios. Based on those scenarios, we forecast implications for the largest market sectors.

### Patients

- Patients are likely to see a near-term modification of the ACA. A repeal is possible but harder given the possibility of a Senate filibuster to delay congressional action; if a full repeal is pursued, it would take time to align all of the stakeholders. In the meantime, the president can use executive orders to weaken the ACA, with significant implications for patients.

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- Consumers purchasing health plans on public exchanges may face a reduction or elimination of ACA-funded subsidies. States or the federal government may mitigate cuts, however, by increasing the scope of health savings accounts or allowing income tax credits for health premiums. If the new government eliminates public exchanges altogether or disrupts them significantly, nearly 13 million individuals would need to find alternative options for health insurance.
- The fate of ACA-sponsored Medicaid expansion is unclear. Medicaid block grants (federal lump-sum payments to the states) could rise, but eligibility levels may be either expanded or reduced.
- Medicare beneficiaries may see a wide array of changes, from vouchers to significant expansion of privately administered plans (Medicare Advantage).
- The more than 177 million Americans who purchase insurance through their employers would see little direct impact from revisions to the ACA.

## Providers

- Changes to ACA would be a net negative for most acute-care providers.
- A reduction in individually insured patients would increase bad debt expense as the uninsured would fall back on emergency care.
- Lower patient volume, especially for elective procedures, would slow revenue growth.
- Potential offsets include a slowdown of the transition to traditional Medicare Accountable Care Organizations, a reversal of ACA-directed reimbursement decreases and delays in other relevant regulation such as the Medicare Access and CHIP Reauthorization Act of 2015.
- Providers outside the acute-care sector may face reduced patient volumes in some areas but limited additional direct impact.

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## Payers

- Changes to the ACA could include the removal of community rating in the individual and small-group markets and medical loss ratio floors across segments, reducing pressure on insurers' bottom lines and increasing pricing flexibility.

- In addition, changes could also eliminate the ability of employers to cancel employer-sponsored health insurance and direct patients to the public exchanges, improving the outlook for member retention in payers' employer-sponsored businesses.
- Personal income tax credits could reduce the net cost of individual insurance. But poor payer economics—resulting mainly from the relatively poor health of many potential individual enrollees, member churn and the relatively small size of this market—may limit the ability to deliver viable individual coverage options to a broad segment of the population.
- Payers with significant exposure to Medicaid and individual exchanges will face greater uncertainty. Medicaid block grants could offset some of these declines, but lack of clarity on funding levels, eligibility limits and the timing of changes make the economics of Managed Medicaid unpredictable.
- Medicare Advantage could be poised for accelerated growth.
- It is unclear how allowing payers to compete across state lines would improve coverage or costs, other than consolidating risk pools and reducing state-to-state cost differences.

## Medical Devices

- The projected increase in pressure on provider economics would ripple through the value chain, affecting a number of medical device product categories.
- Capital equipment volumes and prices are likely to come under pressure as a result of changes in provider economics. As we have seen during recent economic downturns, providers are able to defer meaningful investments in capital

equipment, which extends from everyday products (hospital beds, patient monitors) to high-end equipment (imaging and robotics).

- Similarly, hospitals will exert additional pricing pressure on consumables as economic pressure squeezes providers.
- The medical device excise tax may be permanently repealed as part of a more comprehensive corporate tax reform agenda.
- The importance of category leadership is likely to increase as more comprehensive product and service offerings will be needed to maintain customer loyalty.

## Pharmaceuticals

- Decreased likelihood of government intervention on pricing and reimbursement should relieve near-term pressure on margins; direct pricing controls are less likely, and reimportation remains impractical.
- Underlying market forces to decrease costs remain strong, however, creating competitive pressure to bring down prices over time. Increased competitive intensity within categories will trigger price pressure earlier in the life cycle of drugs based increasingly on therapeutic substitution. In addition, patient group backlash, further consolidation among buyers (payers, employer groups and providers) and employer insistence that pharmacy benefit managers manage absolute rather than just relative costs would further amplify pricing pressure.
- It's important to note that these market forces have the most negative impact on drugs that are undifferentiated and that don't significantly advance standards of care. Breakthrough products that address significant unmet needs are less affected by these market forces.

- We expect the net impact of the election on pharma pricing to be relatively neutral for both branded and generic drug manufacturers.

- As is expected with medical devices, the importance of category leadership would increase as manufacturers seek to strengthen their access and retention of distinct physician and patient categories.

We expect existing competitive market pressures will continue to accelerate the shift toward pricing discipline, integrated and longitudinal care management, and category leadership for manufacturers. Under any scenario, the US market will continue to reward clinical innovation.

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Some leadership teams may delay mergers and acquisitions in anticipation of a new legislative agenda. However, periods of dislocation can favor the bold acquirer. Bain & Company research shows that the most significant shifts in market share occur during periods of uncertainty. Corporate buyers could find attractive opportunities to build on category leadership positions, which continues to be an increasingly powerful strategy for outperforming in healthcare.

Private investors likely will benefit from their ability to invest in secular trends and ride out near-term disruptions. In particular, assets in derivative markets

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(markets that provide services to the primary health-care sectors, such as outsourced services to pharmaceutical manufacturers) could provide a layer of insulation to the volatility and uncertainty of future policy. Given that investors generally regard health-care as a fair-weather port during times of macroeconomic uncertainty, we anticipate a continued strong interest in investing in the sector.

Bain's Healthcare practice will continue to monitor these developments over the coming months and issue further perspectives as the new legislative agenda takes shape. ↻