Strategic Investing in Healthcare Innovation

Over the past decade, a concerning pattern emerged: venture capital flooded into healthcare startups designed to pull high-margin procedures out of hospital systems. Knee surgeries shifted to ambulatory centers. Eye procedures moved to specialized outpatient clinics. Cardiovascular interventions found new, lower-cost homes.

For hospitals, the math was tough. They lost profitable cases but kept the fixed costs: the operating rooms, the staff, the infrastructure required to run a full-service facility. Margins compressed. Volume leaked to nimbler competitors.

Today, that disruption has only accelerated. For nonprofit hospitals and health systems already managing margin pressure, policy change, and rising uncompensated care, the stakes are higher than ever. The most forward-thinking organizations are no longer simply reacting. They're investing strategically in innovation reshaping their markets, improving their operations, and diversifying their revenue streams.

Healthcare innovation investing offers a path to understanding emerging care models, improving operational efficiency, and potentially developing new revenue streams aligned with mission. The challenge lies in choosing the right approach and building governance structures that endure leadership changes and market cycles.

Disruption Outside the Walls

CAPITAL FLOWING AWAY FROM HOSPITALS

Billions in capital have poured into healthcare companies built to disintermediate traditional hospital systems. The target: high-reimbursement, procedure-driven specialties where care can be delivered more efficiently outside hospital walls.

The model is fairly straightforward. If knee surgery costs less in an ambulatory surgical center than in a hospital, insurance companies push patients there. The hospital loses the case and the revenue but still carries the overhead.

The implications:

- **Volume leakage:** Profitable procedures migrate away while fixed costs remain.
- **Margin erosion:** Revenue mix shifts away from historically high-margin services.
- **Competitive disadvantage:** Organizations that engage early with new models (as investors, partners, or builders) shape their markets. Those that don't get shaped by them.

Three Drivers in Innovation Testing

Highland's conversations with CFOs, treasurers, and board members nationwide reveal three consistent drivers.

INFORMATION AND INSIGHT

Many systems start with a simple question: What's being built that could change how we deliver care?

Allocating capital (often through healthcare-focused venture or growth equity funds) provides:

- Line of sight into emerging business models, technologies, and funded companies
- Operational foresight to assess how innovations might affect volumes, referrals, or reimbursement
- Strategic optionality to engage early as a partner, customer, or co-developer

For systems without dedicated innovation staff, this "insight dividend" can be as valuable as financial returns.

OPERATIONAL EFFICIENCY

With flat or declining reimbursement and labor costs rising faster than general inflation, operational efficiency isn't optional.

Innovation targets pain points:

- **Pre-authorization and denials:** Healthcare systems regularly resubmit claims two or three times due to coding errors or incomplete data. Automating this process saves time, reduces administrative burden, and helps accelerate cash flow.
- **Workforce optimization:** Better scheduling of physicians, nurses, and operating rooms reduces overtime costs and burnout while improving capacity utilization.
- **Site-of-care optimization:** Shifting appropriate cases out of emergency departments into clinics, urgent care, or virtual settings lowers costs and improves patient experience.

These solutions directly impact sustainability in a sector where Medicare and Medicaid reimbursement rates continue declining while costs rise.

NEW REVENUE AND MARKET POWER

Many systems underestimate the influence their brand carries in local markets. When a leading regional health system endorses or participates in a new care model, adoption accelerates.

Opportunities include:

- **Owning new sites of care:** Building ambulatory surgery centers or specialty clinics under the system's brand rather than losing volume to independent operators.
- **Community-based services:** Senior day centers, chronic care programs, and offerings that generate revenue while aligning with community benefit missions.
- **Monetizing data responsibly:** Using de-identified patient data in accordance with HIPAA and applicable state privacy laws to support AI-enabled tools, population health platforms, or predictive analytics that improve care and create scalable value.

The Strategic Investing Spectrum

Health systems sit at very different points on the innovation investing spectrum. What matters is choosing a model that fits size, culture, and risk tolerance.

NO DEDICATED EFFORT

Most small and mid-sized systems operate here. Innovation investing happens informally:

- Opportunities come through individual board members, physicians, or local relationships
- Decisions are one-off, with limited documentation
- Leadership turnover often leaves "orphaned" private investments that lack strategic connection

STRATEGIC BALANCE-SHEET SLEEVE

Some systems allocate a dedicated portion of the balance sheet for innovation investments tied to operational priorities.

This might include:

- Direct investments in companies addressing known pain points
- Co-development of new sites of care or service lines with operating partners
- Later-stage investments in solutions already deployed within the system

For systems without the profitability to build full innovation infrastructure, this can be a pragmatic middle path.

GP/LP COMMITMENTS

A more structured approach: commit capital as a limited partner to healthcare-focused private equity or venture funds.

Key characteristics:

- **Leverage external knowledge:** General partners bring deep knowledge of what the market will fund, how to build companies, and how to manage risk across stages.
- **Dual benefit:** Systems receive both potential financial returns and strategic insight into companies relevant to operations.
- **Orientation matters:** Some GPs focus on provider solutions, others on payer solutions. Choosing the right fit is critical.

This model is often the natural starting point for organizations without the scale to build internal innovation teams.

DEDICATED TEAMS AND TECH TRANSFER OFFICES

Large academic medical centers and highly profitable regional systems build full innovation platforms:

- Dedicated internal teams that source, evaluate, and support innovation investments
- Tech transfer offices that incubate physician-developed devices, software, or clinical protocols and commercialize them externally
- Portfolio management infrastructure tracking financial performance, clinical impact, and contribution to strategy

These programs require significant scale, sustained leadership commitment, and organizational culture that supports calculated risk-taking.

Execution Risk

WHAT COULD GO WRONG

Three execution risks consistently emerge:

1. **Cultural Fit and Leadership Buy-In**
   Innovation investing often starts with a small group of champions. Without broader buy-in, programs stall when leaders turn over, leaving scattered portfolios and unclear responsibilities.

2. **Governance and Process**
   Without clear ownership and documentation, innovation portfolios devolve into collections of one-off bets that future leaders struggle to explain or support.

   Systems must answer:

   - Who owns the innovation portfolio internally?
   - How do opportunities enter the pipeline, and who evaluates them?
   - How are conflicts managed between financial return and operational priorities?

3. **Time Horizon and Stage Risk**
   Seed and early-stage investments can drive long-term transformation but involve significant uncertainty. Later-stage investments offer more visibility into product-market fit but may be less transformative. Boards need realistic expectations around timing of cash flows, possibility of write-offs, and appropriate allocation size relative to overall portfolio risk and liquidity needs.

Highland's Approach

FROM CONCEPT TO IMPLEMENTATION

Highland's role typically involves four elements:

1. **Clarifying Objectives and Readiness**
   - Helping boards and management articulate what they hope to achieve: insight, efficiency, new revenue, or some combination
   - Assessing organizational readiness in terms of culture, governance, and internal capacity

2. **Designing the Appropriate Model**
   - Determining where on the strategic investing spectrum the organization should start
   - Right-sizing allocation levels relative to overall portfolio and liquidity profile

3. **Selecting and Structuring Relationships**
   - Drawing on Highland's knowledge of the healthcare innovation manager universe to identify potential GP partners aligned with provider needs
   - Screening out strategies that are too binary (e.g., therapeutics) or misaligned with operational priorities
   - Helping systems evaluate when direct or co-investment opportunities fit their goals and risk tolerance

4. **Supporting Ongoing Governance**
   - Establishing processes for regular review of innovation investments, both financial and strategic
   - Ensuring portfolios don't become "orphaned assets" when leadership changes
   - Helping clients integrate lessons from innovation back into budgeting, capital planning, and operational

By connecting innovation investing to broader balance-sheet and mission objectives, Highland's framework helps transform these efforts from isolated bets into coherent strategies supporting long-term resilience.

So, What Does This Mean for You?

Healthcare executives considering innovation investing should keep the following priorities top of mind:

- **Reassess Strategic Footing:** Innovation investing sits at the intersection of opportunity and complexity. For nonprofit health systems facing rising costs, policy uncertainty, and shifting care models, it offers a path to better understand and shape the forces transforming their markets, improve operational efficiency, and develop new revenue streams that reinforce mission.
- **Choose the Right Model:** The organizations with the greatest chance for success will be those that treat innovation investing as a strategic capability, choose models aligned with their size and culture, and build governance structures that endure leadership changes and market cycles.
- **Partner with Specialists:** Highland provides strategic insights and tools to assist organizations in evaluating innovation opportunities, whether the organization is just beginning to explore the space or looking to formalize an existing program.

HIGHLAND

Looking Ahead

The healthcare landscape will continue evolving. New care models, technologies, and business structures will emerge. Health systems that engage strategically with innovation (rather than simply reacting to it) will be better positioned to serve their communities, strengthen their balance sheets, and advance their missions.

Three key takeaways:

1. **Healthcare innovation can improve delivery and lower costs,** but only when approached strategically with clear objectives.
2. **Building an innovation program is complex,** from governance to time horizons to cultural buy-in. There's no one-size-fits-all solution.
3. **Highland can help you navigate the landscape,** bringing together investment discipline, healthcare knowledge, and a deep understanding of nonprofit missions.

Highland Associates remains committed to helping clients manage complexity, turning innovation from a source of disruption into a source of strength.