



Future of Inpatient Care in Germany

How Investors can successfully navigate Regulatory Uncertainty

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01 | Introduction

The healthcare landscape is undergoing a systematic transformation, fueled by the unification of science, data, and technology as well as regulatory and structural disruptions. The COVID-19 pandemic not only tested the resilience of the healthcare industry but also ignited rapid innovation in hospital care, digital health and telemedicine. Regulatory adaptations have further promoted more accessible healthcare models.

Amidst these challenges, a ground-breaking proposal by the Government Commission for Modern and Demand-Oriented Hospital Care is making strides in reshaping Germany's inpatient care. The commission advocates for a structural reform within the hospital sector seeking to alleviate personnel shortages and stimulate regional care concepts, to ultimately provide a high-quality, human-centric healthcare system.

Even before the formalization of the Hospital Reform Act, the sector has experienced a flux of transactions, reflecting the financial challenges faced by many hospitals, particularly smaller ones in rural areas. Within the last year, the German healthcare sector has faced significant financial challenges, as indicated by Germany's Hospital Association (in German: "Deutsche Krankenhausgesellschaft"). They report that 26 hospital owners have filed for insolvency during this period. This financial strain has catalyzed a trend of mergers and acquisitions (M&A) as a strategic response to ensure survival.

A prime example of this is the acquisition of "imland Kliniken" in Rendsburg and Eckernförde by "Schön Klinik Gruppe" in March 2023.¹ This move was largely influenced by the reduced income experienced during the COVID-19 pandemic, compounded by rising costs due to inflation and energy prices. Another significant development occurred in October 2023 with the "Regiomed Klinikverbund". Here, municipalities co-owning hospitals initially proposed to take back control of local clinics. This unified approach was aimed at managing and financing the operational deficits of these hospitals, showcasing a concerted effort to address the economic challenges in the sector.² However, ultimately also Regiomed Klinik GmbH filed for insolvency because one of the municipalities did not agree to the initial proposal.³

The anticipated hospital reform is expected to further catalyze this trend, potentially leading to additional consolidation within the German healthcare sector and spiking investor interest. While the specifics of the reform act remain uncertain, its potential implications are clear and widely discussed.

¹ <https://www.dkgev.de/dkg/presse/details/krankenhaus-insolvenzwelle-rollt-an/>; <https://www.globalpolicywatch.com/2023/08/germany-plans-significant-hospital-reform-with-broad-impact-on-life-sciences-companies/>, accessed 12.1.2024.

² <https://www.tagesschau.de/wirtschaft/krankenhaus-insolvenz-versorgung-gesundheit-100.html>, accessed 12.1.2024.

³ <https://www.regiomed-kliniken.de/20240102-Pressemitteilung-f-Eroeffnung-eines-Eigenverwaltungsverfahrens-REGIOMED.pdfx>, accessed 12.1.2024.

Likely outcomes, as envisaged by the government, include an overall reduction in the number of hospitals, leading to closures and insolvencies, a realignment of specializations towards larger, maximum care providers, and a transformation of many smaller hospitals shifting focus primarily on basic and emergency care services. Moreover, some hospitals are expected to evolve into ambulatory care providers (in German: "Primärversorgungszentren") following the economically and politically motivated trend to shift volumes towards outpatient care (in German: "Ambulantisierung").

Since the onset of the new legislative period in December 2021, there has been a noticeable decline in monthly M&A activity within the German healthcare sector (Source Deloitte M&A Sensing Tool and HealthCare Analytics Platform). This downturn coincides with the market's cautious reaction to the

anticipated policy shifts as outlined in the coalition agreement (Chapter "Krankenhausplanung und -finanzierung").⁴ The heightened activity observed during the COVID-19 pandemic has given way to a more subdued market stance, as stakeholders adopt a "wait and see" approach considering the upcoming hospital reform act. Despite this slowdown, the proposed structural reforms in hospitals are expected to reinvigorate M&A activity. The reforms are poised to incentivize mergers, highlighting an emerging opportunity for strategic investments in a consolidating hospital sector. This scenario underscores not only the market's resilience but also its dynamic potential for growth in response to legislative changes.



⁴ https://www.spd.de/fileadmin/Dokumente/Koalitionsvertrag/Koalitionsvertrag_2021-2025.pdf, accessed 18.12.2023.

02 | German Inpatient Care Sector

Germany's inpatient care sector, employing approximately 1 million full-time employees (FTEs) and treating close to 17 million patients annually, is the country's largest health segment.⁵ However, it faces substantial challenges, including a shortage of workforce, increasing operational costs, and a gradual shift towards ambulatory healthcare provision. Specifically, the German healthcare landscape is undergoing a historic transformation, fueled by three major government initiatives.

- **A significant push for the digitalization of the healthcare sector**

This encompasses a roll-out of digital health applications, bolstered by the KHZG investment program (in German: "Krankenhauszukunftsgesetz") aimed at hospital digitalization.

- **A shift of services towards the ambulatory sector**

The ambulatory sector will be strengthened by the "Versorgungsstärkungsgesetz", with the introduction of health kiosks and primary care centers. In addition, by introduction of hybrid-DRGs⁶, hospitals will be financially incentivized to perform more operating procedures in an ambulatory setting, thus without keeping patients overnight.

- **A structural reform of the hospital sector**

This aims to optimize resource allocation, improve patient management, transition care models, and quality of care, to effectively address a range of systemic issues and catalyze a broader transformation.

Particularly, the latter is a response to several critical issues, underlining the need for sweeping changes to address inefficiencies within Germany's healthcare system.

Main issues that need to be addressed



1) Financial strains and operational challenges

Before the COVID-19 pandemic, many German hospitals were already facing financial difficulties, mainly due to escalating operational and personnel costs that healthcare payers did not fully compensate. On top, many German states historically did not fully meet their obligation to finance hospital infrastructure, thereby adding to the financial problems as well as compromising quality of care services. The pandemic further exacerbated these challenges, and additional strains were introduced by the Ukraine conflict, which disrupted supply chains and led to increased energy costs and inflation. This series of events has significantly compounded the financial burdens on hospitals.

2) Under-utilization of hospital beds and staffing shortages

A striking issue within the system is the under-utilization of hospital beds. Germany has an unusually high number of hospital beds per capita by international standards, yet many facilities struggle to fully utilize these beds. This under-utilization is largely attributed to staffing shortages, particularly in nursing and physician roles, pointing to a critical mismatch between healthcare resources and their effective use.



3) Inefficiencies in the DRG payment system

The existing Diagnosis-Related Group (DRG) payment system has inadvertently incentivized hospitals to perform excessive procedures, sometimes beyond their specialization, for added income. This misalignment has led to operational inefficiencies and compromised the quality of care.

⁵ https://www.destatis.de/EN/Themes/Society-Environment/Health/Health-Personnel/_node.html, accessed 12.11.2023.

To tackle these issues, the German government's reform strategy encompasses several key measures:



Reducing hospital numbers

A planned reduction in the number of hospitals aims to optimize personnel and resource use, addressing the issue of underutilized facilities. This consolidation is anticipated to lead to closures and insolvencies of less critical hospitals, enhancing the financial stability of the sector.



Operational shift for smaller hospitals

The reform foresees smaller hospitals transitioning to focus primarily on basic and emergency care services, acknowledging their crucial role in providing essential healthcare, especially in rural or underserved areas.



Emphasis on specialization

The reform intends to concentrate specializations in larger hospitals, particularly those providing maximum care. The underlying expectation is, to elevate the quality of care by ensuring specialized medical services are delivered exclusively by highly skilled and experienced teams supported by best in-class infrastructure.



Transformation into ambulatory care providers

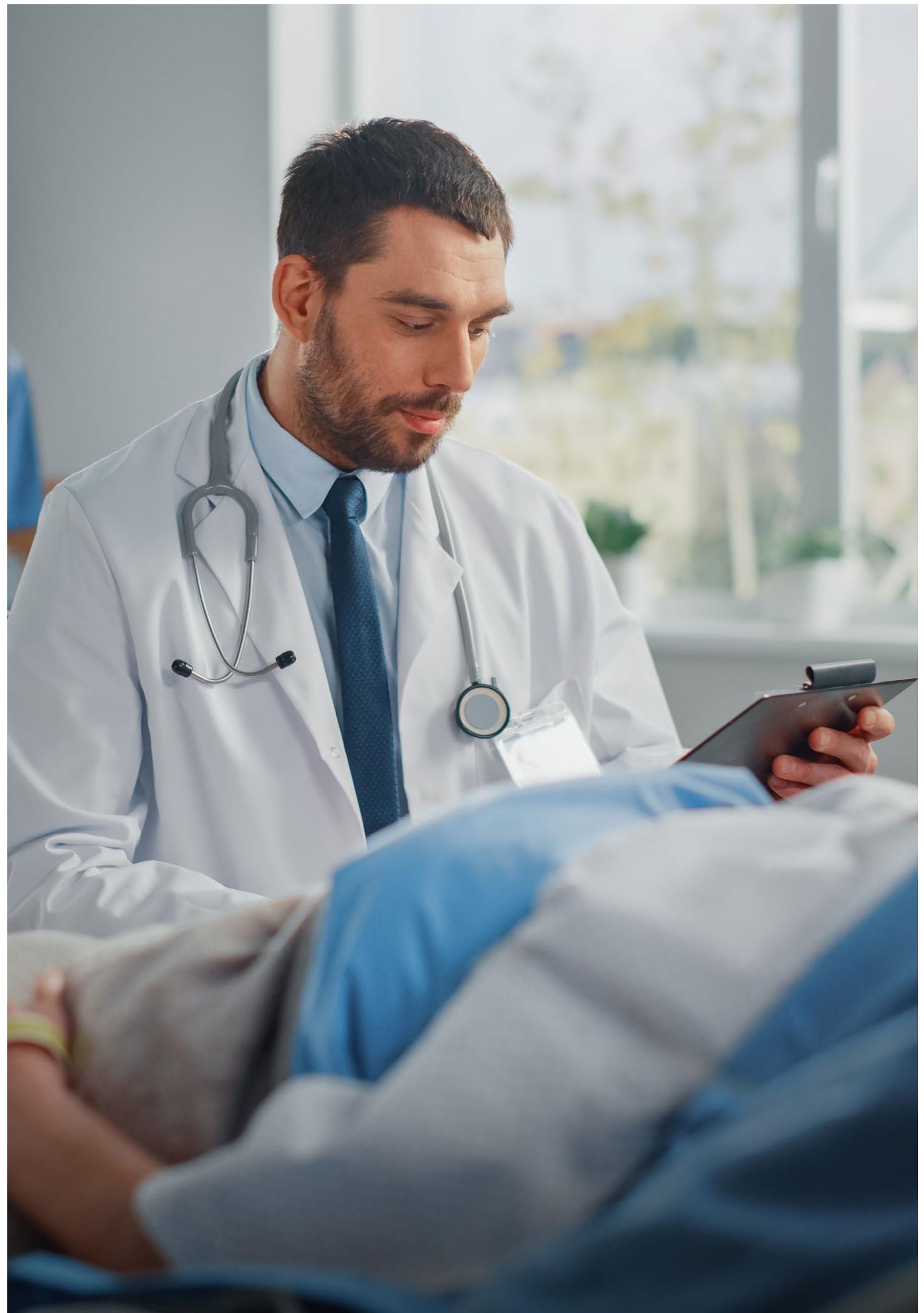
Especially MVZ and the primary care centers as proposed in the "Versorgungsstärkungsgesetz" offer interesting opportunities to repurpose hospitals into ambulatory care facilities.



Revamping the payment system

A significant change is planned in the hospital payment system, with a new model where 60% of a hospital's budget is independent of procedure numbers (in German: "Vorhaltepauschale"), and only 40% is based on DRG-related payments. This shift aims to prioritize quality over quantity of care, addressing the inefficiencies of the current DRG system.

Additionally, part of the reform involves introducing hybrid-DRGs, designed to reduce the total number of inpatient procedures and encourage a shift towards ambulatory care provision.



These far-reaching measures stand to fundamentally reshape Germany's healthcare system, boosting efficiency and care quality while aligning with the population's changing needs, thus securing long-term sustainability and a focus on patient-centered care. Additionally, this reform is driving a notable increase in M&A activity, underscoring the sector's significant potential for investment. Specifically, this momentum is driven by:

- **High degree of privatization**

Private entities manage 20% of Germany's total hospital bed capacity, about 96k out of 484k total beds.⁷ These private operators, often keen on restructuring, target financially challenged or near-insolvent hospitals, especially those under municipal ownership.

- **Reduced hospital admissions**

The pandemic resulted in a 13% reduction in average admissions in 2020, with projections suggesting a continued decline or stagnation for 2024. This trend towards more outpatient care is likely to fuel further consolidation in the inpatient sector.

The consolidation of hospital facilities, either within hospital groups or regional networks, and in some cases the closure of hospitals that do not play a critical role in state hospital plans, is seen as an essential step in addressing the current inefficiencies. Despite current delays in the legislative process, the full roll-out of the reform is expected by the end of 2029, with initial steps commencing in the second half of 2024.

In alignment with the KHZG, the reform underscores the critical role of digitalization in healthcare, with a particular focus on telemedicine, aiming to facilitate efficient collaboration among hospitals, enrich medical education, and elevate the standard of patient care. The introduction of fixed cost allowances and service groups with specific quality criteria addresses infrastructure and staffing costs, thereby optimizing resource allocation.

Overall, the sweeping reform, coupled with dynamic market shifts and existing challenges, heralds a transformative era for Germany's inpatient care sector. This era is characterized by a drive towards a more efficient, patient-focused, and digitally cohesive healthcare system, presenting a fertile ground for future investment and growth. The impending hospital reform, interwoven with distinct market forces, underscores both the critical need and the immense potential of this crucial phase in German healthcare, signaling profound changes and opportunities for stakeholders across the sector.

Although the final details are not yet concluded, there is no question that the German hospital market will face an unprecedented transformation. Investors should closely monitor the political process but in parallel not neglect any interesting investment opportunities.

Axel Fischer, Partner Deloitte

⁷ <https://de.statista.com/statistik/daten/studie/217422/umfrage/anteil-der-krankenhaeuser-nach-traegerschaft-und-bundesland/>, accessed 12.1.2024

03 | M&A Outlook

The transformation of Germany's hospital sector – moving towards a more unified and synergistic framework – could lead to widespread consolidation. This shift is propelled by three key factors:

- **Economic strains**

Many hospitals are currently facing severe financial difficulties, challenging their operational sustainability.

- **Optimized resource allocation**

There is a concerted effort to reallocate care personnel across a reduced number of institutions, ensuring a nimbler and more efficient workforce. There is certainly a risk that some hospital workforce may leave the sector all together when the new job is remote from the current employment. Stakeholders and politics need to find ways to minimize this potential loss of workforce during the transition.

- **Political imperatives**

The government is actively working to slow the growth in healthcare costs, emphasizing the necessity of reform and smarter resource utilization. This strategy not only aims to achieve financial stability within the healthcare system but also to enhance the quality of care provided to the population.

The consolidation is expected to range from a modest reduction to 1,600 hospitals or a more aggressive drop to 1,200 hospitals, as per healthcare insurance estimates. While the market may numerically contract, the remaining hospitals are projected to expand their service portfolios, fostering a market most likely dominated by larger regional healthcare networks. These entities may encompass broader service scopes, from telemedicine to primary healthcare centers.

As a result, Deloitte anticipates the competitive landscape to undergo a transformation, characterized by the emergence of fewer, yet more dominant entities. We foresee a mix of mergers between market participants, especially when sharing the same owner e.g. municipalities, as well as acquisition opportunities for investors to contribute to the consolidation. Such consolidation could amplify care quality and trigger a momentary spike in market values as institutions coalesce. Factors such as stringent cartel regulations, a shift towards value-based reimbursement, and a cautious stance from market participants could further influence the pace and nature of this consolidation. In this context, several key considerations come to the forefront:

- **Repurposing closed hospitals**

Exploring the potential of converting shuttered hospitals into primary care centers could address healthcare accessibility, especially in underserved areas.

- **Healthcare workforce dynamics**

The reforms may lead to shifts in healthcare personnel. It is critical to understand, whether staff will relocate within the industry or leave it altogether, ensuring workforce stability.

- **Geographic consolidation effects**

Geographic consolidation effects on rural healthcare are a significant concern. It is essential to assess how these changes will affect medical services in less populated areas. However, the "Essener Model" demonstrates that consolidation impacts not only smaller clinics in rural areas but also urban centers, suggesting that strategic cooperation among hospitals in densely populated areas can offer insights into managing healthcare quality and accessibility across various geographic contexts.

- **Uniformity in medical standards**

As hospitals redefine their services, maintaining consistent medical standards across all institutions is essential for ensuring quality patient care.

- **M&A as a catalyst for specialization**

The role of M&A in developing specialized healthcare centers needs to be evaluated, as it could significantly enhance the care quality and efficiency.

The impending reshaping of the German hospital sector is poised to fundamentally alter the market dynamics. We foresee a scenario where larger, M&A-fueled healthcare networks emerge as dominant players in an increasingly competitive environment. Skillfully maneuvering through this transitional phase is imperative to uphold competitive balance, safeguard patient welfare, and guarantee widespread access to top-tier healthcare services. However, it is crucial to acknowledge that this development remains debatable and heavily dependent on the final structure of the reform, which is yet to be finalized.

04 | M&A as a Catalyst for Specialization

The current landscape in Germany's healthcare sector, marked by the anticipated hospital reform, is particularly impactful for hospital chains and smaller care providers. These groups stand at the forefront of a transformation driven by economic challenges and the need for optimized resource allocation. The reform's implications for these players are significant, as they are central to the sector's reshaping and emerging opportunities. Specifically, the implications for sector players might unfold as:

- **Infrastructure optimization and operational excellence**

The reform's initiative to reduce hospital numbers calls for a strategic approach to infrastructure investment, particularly pertinent for hospital chains looking at mergers or expansion. This shift will require an operational overhaul, integrating services and staff from various entities to create a more streamlined and efficient healthcare delivery system. Concurrently, smaller hospitals need to realign their facilities to better focus on basic and emergency care, ensuring they remain vital in providing essential health services.

- **Workforce specialization and care quality**

The reform prioritizes workforce specialization, particularly in larger hospitals, requiring significant investments in staff training for specialized medical services delivery. It calls for establishing centers of excellence in major hospitals and enhancing primary healthcare in smaller facilities. This strategic approach will not only improve patient outcomes but also elevates the reputation and competitive edge of healthcare facilities. Additionally, the reform encourages strategic partnerships with other healthcare entities, research organizations, and insurers. Such collaborations will promote knowledge sharing, operational efficiency, and cost reduction, thereby improving services sector-wide. In essence, providers are urged to focus on specialization and alliance-building to upgrade care quality, patient outcomes, and institutional standing in the healthcare sector.

- **Financial restructuring and revenue model transformation**

Shifting the focus toward service quality and readiness, the reform mandates a pivotal change in hospital financing from

a 100% volume-based model to a mixed model of volume (40%) and a fee for provision of capacity ("Vorhaltepauschale") (60%) plus an emphasis on hybrid-DRGs. This revolution in payment scheme compels hospitals to rethink their financial strategies, seeking diverse revenue streams and innovative business models. Furthermore, the reform's push for quality-focused financing necessitates rigorous financial restructuring, continuous cost monitoring, and thorough review processes, fostering an environment that encourages hospitals to innovate and adapt their revenue models to the changing dynamics.

These criteria (both in terms of "status quo" and "most likely status after reform act enacted") apply in the assessment of the attractiveness of assets in the expected market consolidation. In addition, some stakeholders have very specific criteria regarding potential hospital acquisitions, which are important to understand when evaluating upcoming M&A opportunities.



05 | The Role of Different Stakeholders in the Expected Market Consolidation

A variety of stakeholders will play a role in the expected market consolidation. The following paragraphs describe the different motivations and drivers for each of the stakeholders involved.

Private hospital chains

Private hospital chains, traditionally growing through the acquisition of municipally owned hospitals, are skilled in due diligence and the integration of acquired assets. They are expected to play a significant role in the upcoming market consolidation driven by the hospital reform act.

Investment activities will likely focus on enhancing service portfolios by adding new specialties, achieving market leadership in specific German regions, and targeting assets with clear turnaround potential, such as those offering synergies or cost improvements through scale effects in procurement.

In parallel, private hospital chains will strategically manage their assets in line with the reform's focus by consolidating procedures and specialties within their networks and repurposing some assets to ambulatory care centers, like MVZs (e.g., the Helios-Klinikum Dippoldiswalde).⁸

Non-profit hospitals

Non-profit hospitals, often church-run, have a distinct investment approach that emphasizes social aspects such as shared beliefs, ethics, employee welfare, and community responsibility. The merger of Marienhospital Aachen GmbH with Alexianer GmbH in 2022 and the acquisition of Valeo-Kliniken GmbH and St.-Marien Hospital GmbH by Johanniter GmbH in 2023 are examples of this approach.⁹ These mergers reflect a commitment to community welfare over purely economic goals. Non-profit hospitals are likely to focus on other non-profit hospitals needing investment for transitioning post-reform, while also considering publicly-owned hospitals for regional synergies and market positioning. However, not all non-profit hospitals may survive the transition, as evidenced by the insolvency of the K-Plus Group under Catholic Church ownership.¹⁰

University hospitals

University hospitals, known for their broad service portfolios and innovation in medical and care organization, are not expected to drive market consolidation actively. Instead, they will likely play a crucial role in care coordination at the regional level, aligning with the concept of strengthened health regions as outlined in the "Versorgungsstärkungsgesetz".

Municipalities

Municipalities, with a vested interest in local healthcare provision, face a dilemma between the economic sustainability of hospitals and the need for local access to healthcare services. They have several options: Finding investors to restructure and maintain hospitals, repurposing hospitals for ambulatory care services¹¹, using restructuring procedures like "Schutzzschirmverfahren" or "Insolvenz in Eigenverwaltung" to manage deficits¹², or closing and selling off hospital infrastructure as a last resort. Many municipalities are expected to prefer investor-led restructuring over insolvency, but some assets may not attract investor interest and might need to be repurposed or closed.

Private Equity investors

Private equity investors have historically focused on acquiring and operating Medical Care Centers (MVZs) in Germany. Given the current pressures on this business model¹³ and the even more challenging profitability in stationary care, private equity is not expected to lead the awaited hospital market consolidation. Interest might be limited to hospital assets with a profitable MVZ business, but competition from private hospital chains could drive up acquisition costs for only a handful of highly critical assets in the German states hospital plans.

⁸ <https://www.mdr.de/nachrichten/sachsen/dresden/dippoldiswalde-sebnitz/krankenhaus-klinik-helios-schliesst-patientenversorgung-100.html>, accessed 19.12.2023.

⁹ <https://www.johanniter.de/presse/nachricht/valeo-kliniken-und-st-marien-hospital-hamm-unter-dem-dach-der-johanniter-8414/>; <https://www.alexianer.de/aktuelles/aktuell/strategische-partnerschaft-fuer-die-zukunft-marienhospital-aachen-wird-teil-des-alexianer-verbundes>, accessed 19.12.2023.

¹⁰ <https://www.marburger-bund.de/nrw-rlp/meldungen/insolvente-k-plus-gruppe-schliesst-drei-krankenhaeuser>, accessed 19.12.2023.

¹¹ <https://www.kma-online.de/aktuelles/klinik-news/detail/krankenhaus-bad-waldsee-schliesst-frueher-50264>, accessed 19.12.2023.

¹² <https://www.echo-online.de/lokales/kreis-gross-gerau/landkreis-gross-gerau/die-kreisklinik-gross-gerau-ist-raus-aus-der-insolvenz-1911608>, accessed 19.12.2023.

06 | Conclusion

In summary we at Deloitte strongly believe that the German hospital sector offers numerous opportunities but also poses challenges in financial and personnel management, requiring adept navigation. Influenced by political consensus and healthcare needs, this reform has wide-reaching implications across numerous federal states.

In this era of profound change, Deloitte stands at the forefront, dedicated to guiding healthcare providers through uncertainty and empowering them to emerge as leaders in the ever-evolving healthcare landscape. Our suite of services, encompassing strategic M&A, operational restructuring, and financial advisory, is underpinned by deep industry insights, ensuring seamless transitions and strategic superiority. Through our expertise, we aim not just to navigate but to actively shape the future of healthcare excellence in Germany's dynamic sector.

Whereas uncertainty in general often leads to more conservative decision making, investors with the right strategic framework and market insights will likely be able to capitalize on investment opportunities during the transition period.

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Acknowledgment:

A very special thanks to Leana Christine Diekmann and Lea Kasper for all their valuable contributions from idea to final publication.

In addition we would like to thank: Udo Janßen, Sandra Musa and Frank Bressau for their continued support throughout the journey.

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