AMA Journal of Ethics®
May 2025, Volume 27, Number 5: E369-375

MEDICINE AND SOCIETY: PEER-REVIEWED ARTICLE

How Private Equity Undermines Rural Health Equity

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Abstract

Capital and staff shortages have forced many rural hospitals to close. Private equity investment in rural hospitals has been one solution to these problems. This article argues, however, that private equity firms' business practices, especially shortening acquisition-to-sale time and maximizing profit margin, generate overall health care market instability. This consequence can be particularly devastating for people living in rural areas of the United States, who report worse health outcomes, more chronic disease, and more restricted access to health services than people in urban or suburban regions.

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Rural Hospitals and Private Equity

Rural hospitals face fiscal challenges due to high levels of poverty and often a lack of state Medicaid expansion,[1] which are contributing factors in the increased rates of closure and staffing shortages that plague rural hospitals.[2] In comparison to urban populations, rural communities also generally experience worse health outcomes, including higher rates of chronic disease, serious mental illness, and all-cause mortality.[2] Rural residents also often have difficulty accessing care due to the distance to and the availability of treatment.[2]

The dire financial situation of many rural hospitals makes them an attractive investment for private equity firms seeking to make a quick return. Yet these potential profits gamble with the lives of patients and the livelihoods of their practitioners. The private equity business model aims to maximize earnings before interest, taxes, depreciation, and amortization, commonly used as a proxy for cash flow. Toward this end, private equity firms seek high returns on their investments, including hospitals, by selling them again for a profit of at least 20%, usually within 3 to 7 years of the acquisition.[1,3] This primary focus on return on investment is inherently at odds with health care's primary ethical commitment to the health and well-being of patients. Hospitals, regardless of their financial model, have responsibilities to use health care resources to provide quality care to the communities they serve and are ethically obligated to prioritize patient care above all other considerations.[4]

Investment Strategies

PE investment in health care increased over 20-fold from 2000 to 2018.[2,5] Overall, private equity firms are more likely to target hospitals located in metropolitan areas with populations of at least 1 million people compared to rural areas.[6] However, the private equity business model has not left rural hospitals untouched, with many recent acquisitions centered on for-profit hospitals in the southern region of the United States.[6] These hospitals are attractive to private equity firms because they are often financially vulnerable, with over 30% of rural hospitals estimated as being at risk of closing or losing services.[7] Private equity firms view these hospitals as cheap investments, but the risk that these firms take on is not simply financial risk—in a very real sense the risk of these investments is borne by physicians and the patients they serve who may lose their jobs and their access to care, respectively, if the hospital reduces services or ends up closing.

Private equity firms typically purchase hospitals through a leveraged buyout, whereby the hospital itself serves as the security and the purchase is financed through loans.[3] Private equity firms then aim to increase their profits dramatically or liquidate the most valuable assets of the hospital.[3] Other strategies include sale-leaseback transactions or dividend recapitalizations.[7] A sale-leaseback transaction is when a company sells its land and then leases it back to generate revenue.[8] The sale-leaseback strategy can be especially problematic for hospitals that are already struggling financially prior to takeover because it decreases the assets the hospital has while at the same time increasing monthly operating costs.[8] As a result, it can be difficult for hospitals to continue to pay their staff competitive wages and provide the necessary resources to render services to patients. Sale-leaseback was the strategy used by Lateral Investment Management, which acquired Santa Cruz Valley Regional Hospital in Green Valley, Arizona, out of bankruptcy in 2018 for $26 million.[8] After receiving millions of dollars in pandemic relief funds and selling the hospital's real estate for $60 million in 2021, Lateral Investment Management closed the hospital in 2022, leaving the rural community without its only hospital.[8] Dividend recapitalization is a type of leveraged recapitalization in which a company raises debt—and typically lowers equity—to fund increases in cash dividends to shareholders.[8] Dividend recapitalization can also lead to negative outcomes for hospitals because it often leaves them with increased debt.[8] Many rural hospitals already struggle financially, and leaving them riddled with debt after a private equity acquisition can be disastrous.

These investment strategies can lead to a reduction of funds for staffing and treatments, lower quality of care, and, ultimately, the closure of hospitals. Closures of rural hospitals have been increasing in recent years and are more likely to be of for-profit hospitals.[2,9,10,11] When rural hospitals close, many patients often lose access to care because they live in health care deserts where people lack access to adequate health care services. As underscored by this consequence, the business practices of private equity firms are fundamentally at odds with the values of health care. The risk they take on is not simply financial risk but risk that entire patient populations must bear, as private equity acquisition upsets the ethical norms and commitments of hospitals and potentially leads to greater instability within the health care system, which can have a direct impact on the health and well-being of patients.[12]

Undermined Health Service Marketplaces

Despite the concerns many physicians have regarding private equity acquisition, there are some potential benefits that may arise when private equity obtains ownership of a

hospital. Private equity firms can provide hospitals with access to needed capital and can shift the administrative burden of managing a practice away from physicians so they can focus more on clinical care.[3]

By entering into the health care market, private equity firms assume an ethical responsibility to adhere to the values of the medical field. Just as a business owner who becomes a judge is expected to adhere to the ethics and morals of the courtroom rather than to those of business when in their capacity as an arbitrator of the law, so private equity firms are ethically obligated to follow the ethical norms of the medical profession when they choose to enter the health care market. This means placing an emphasis on utilizing health care resources to prioritize quality patient care over quick returns on investments, which is in stark contrast to private equity firms' current practices.

Strategies employed by private equity often negatively impact rural as well as urban hospitals. Leveraged buyouts can lead to financial instability, which can be deleterious for hospitals that are already facing financial difficulty, as is the case with many rural hospitals.[13] Private equity firms' focus on investment returns can also lead to many negative quality and cost outcomes for hospitals and for patients,[14] and it can create conflicts of interest for physician employees who may feel that the financial goals of private equity firms are at odds with their own professional and ethical duties to provide quality care to patients.[2]

There are also legal concerns that private equity firms' involvement in health care violates the Anti-Kickback Statute (AKS; formally, the Medicare and Medicaid Fraud and Abuse Statute) and the False Claims Act (FCA), which were enacted to protect patients and federal programs from fraud and abuse.[15,16] The AKS is intended to prevent exchanges of money or other valuable goods or services that influence referrals for services or items covered by federal health care programs, while the FCA is intended to penalize false claims related to billing for services reimbursed by the federal government.

Common strategies that private equity firms rely on to increase revenue include cutting staff to minimize costs and increasing the prices for services (especially high-volume services).[5,8] Increases in prices may make health care services unaffordable for some patients. This is especially problematic in rural health care settings, where patients are more likely to have low income.[17] Additionally, by reducing staff, there might not be enough personnel to provide quality patient care, which can also lead to moral distress and physician burnout.

A primary means by which private equity firms increase prices and reduce access to care is through health care consolidations. To expand market share and increase value, private equity firms often employ an add-on approach in which they acquire smaller add-ons after the initial purchase of a large, established health care entity. This practice by private equity has dramatically increased acquisitions and mergers and industry consolidation within health care over the past decade.[5]Although consolidation can lead to facility closures, it may also lead to the formation of multiple-hospital affiliations that create economic stability and prevent closures, which could be beneficial for rural hospitals already at financial risk.[18] Health care market consolidation has rapidly increased over the past 2 decades, and advocates tout the benefits of these mergers, such as increased coordination and reduced administrative costs. However, the evidence suggests that market consolidation actually leads to increased prices, reduced

quality of care, and negative impacts on innovation and competition.[19] Not only do cross-market mergers within health care lead to price increases, but there are concerns that large health systems that acquire smaller, rural hospitals may be less responsive to community needs by eliminating services, reducing spending on community benefits, and ultimately reducing access to care.[20]

Analyzing the impact of private equity acquisitions can be difficult, however, since acquisitions generally go unreported and unreviewed, as they typically do not exceed the financial threshold for mandatory reporting.[8] Furthermore, private equity firms' widespread use of nondisclosure agreements adds to the opacity of their transactions and the effects they have on the health care industry.[21] The secrecy with which private equity firms are able to operate obscures the fact that the risks that they take on through their acquisitions are directly felt by patients. Stronger oversight and new regulations to ensure greater transparency of these acquisitions and mergers are needed to better protect the populations that these hospitals serve.

Protecting Access

To protect rural hospitals from the deleterious effects of private equity investment, federal and state governments need to leverage the current tools at their disposal to increase oversight of private equity health care acquisitions to better hold the investing firms accountable. They can do so by utilizing federal antitrust laws to prevent health care acquisitions and mergers from creating monopolies and by further leveraging the FCA and AKS to deter private equity firms from engaging in illegal and unethical practices. The federal government already incentivizes whistleblowers to file FCA lawsuits by offering to award them up to 30% of the government's recovery,[22] but hospitals should also consider including formal mechanisms for medical employees to bring forward FCA claims as part of official reporting mechanisms to help establish a culture of compliance.

Aside from relying more on existing laws and regulations, federal and state governments should also consider amending current policies and creating new laws to increase regulation of private equity firms. For example, Congress could amend the FCA to target specific business practices not currently prohibited or broaden liability for corporate investors under certain circumstances. This type of policy change could also limit the use of sale-leaseback strategies and dividend recapitalization, while simultaneously offering greater protections for hospital staff. Congress could also "update federal health care laws, such as the Social Security Act, that require certain hospitals and other providers to disclose information regarding their ownership."[23]

Notably, in June 2024, Massachusetts senators Ed Markey and Elizabeth Warren introduced the Corporate Crimes Against Health Care Act, aimed specifically at private equity investors in health care. The bill includes requirements that health care providers that receive federal funding publicly report changes in ownership and financial data, provides mechanisms to financially penalize executives for "serious, avoidable, financial difficulties," and creates criminal penalties when private equity "looting" of a health care entity results in a patient's death.[16] Some state legislatures have also made recent moves to regulate private equity investment in health care, including New York, California, and Massachusetts.[16]

One of the greatest dangers of private equity investment in health care services is the lack of transparency that allows these firms to take on financial risk that is felt by

patients and practitioners as risk to their health and livelihoods, respectively—a situation that pits a commitment to shareholders against a commitment to health and well-being. It is therefore imperative that the government increase oversight of private equity acquisitions of hospitals, particularly rural hospitals. However, increased oversight alone is not enough. It is also essential that federal and state governments increase funding for rural health care institutions to ensure that private equity does not exacerbate the closure of rural hospitals and to ensure that rural populations can obtain appropriate and timely, quality health care.

As mentioned, rural hospitals tend to attract private equity interest when they are struggling financially. If these hospitals were better funded, there could be less incentive for rural hospitals to sell to private equity. More government investment could help improve rural health outcomes and help ensure that rural hospitals are able to pay their staff members fair and competitive wages while delivering quality health care.

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Citation
AMA J Ethics. 2025;27(5):E369-375.

DOI
10.1001/amajethics.2025.369.

Conflict of Interest Disclosure
Author disclosed no conflicts of interest.

The viewpoints expressed in this article are those of the author(s) and do not necessarily reflect the views and policies of the AMA.

ISSN 2376-6980