



Analyzing the Operational and Financial Challenges of Retailers' Entry into Primary Care

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Key Takeaways

- The entry of major retailers like CVS and Walgreens into primary care represents a significant shift in the healthcare landscape, with implications for both financial viability and care delivery for traditional primary care providers. Large retailers are leveraging their existing business lines and consumer loyalty to capitalize on ancillary services, notably pharmacy sales.
- Retailers have recently encountered obstacles in both scaling and integrating acquired primary care entities, necessitating rapidly evolving strategies to stem significant financial losses.
- The introduction of transactional business models into primary care has potentially troubling implications for the financial performance of traditional primary care providers and clinical care coordination for every health economy stakeholder.
- *Compass+ Exclusive: Comparing Financial Results with Pharmacy Growth*

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In our research, we have examined the impact of new entrants on healthcare and their long-term role within the health economy. As large retailers struggle to demonstrate the financial viability of these transactional primary care models, questions about whether primary care can be “reimagined” are emerging. The primary care business models, strategies and tactics of Amazon, CVS, Walgreens and Walmart offer valuable insights into their ability to compete effectively in this market, both in terms of financial viability and care delivery.

Background

Traditionally, primary care providers have served as the gateway into the U.S. healthcare system facilitating navigation through its uniquely complex system. However, despite its significant impact on care coordination, prevention, health promotion, and referral management, the primary care sector is not structured, positioned or incentivized to be profitable. Even the most efficient practices operate on slim margins, and recent reports revealed a median loss of over \$249,000 per physician for system-affiliated physician practices.¹

Therefore, primary care is often deemed a “loss leader,” facilitating more profitable downstream care through referrals. Nevertheless, several major retailers have acquired “value-based” primary care platforms in recent years, including:

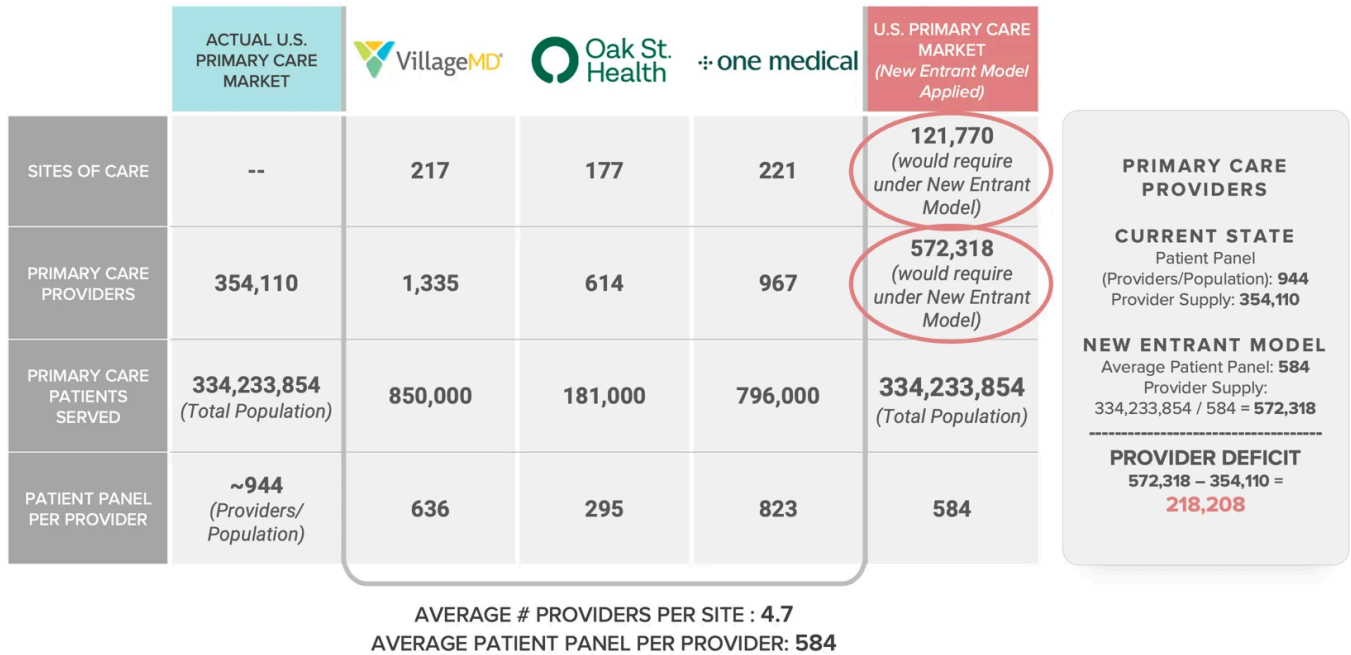
- Walgreens’ acquisition of majority ownership of VillageMD for **\$5.2B** in 2021.
- Amazon acquisition of One Medical for **\$3.9B** in 2023.
- CVS’s acquisition of Oak Street Health for **\$10.6B** in 2023.

These investments in primary care represent a significant shift in the healthcare landscape, with implications for both financial viability and care delivery for traditional primary care providers.

Large retailers are leveraging their existing business lines and consumer loyalty to capitalize on ancillary services, notably pharmacy sales. Retailers have recently encountered obstacles in both scaling and integrating acquired primary care entities, necessitating rapidly evolving strategies to stem significant financial losses. For instance, in a move to withdraw from "nonstrategic" markets as part of a \$1B cost-cutting plan, VillageMD has already announced the closure of all clinics in Florida, Illinois, Massachusetts and Indiana, along with clinics in New Hampshire.^{2,3,4} With the goal of acquiring fully at-risk lives, many observers are surprised that Florida – where over one in five residents are Medicare-eligible – was deemed a nonstrategic market exit for 2024.⁵

In terms of scale, it is unlikely that retail and direct-to-consumer (DTC) primary care models can scale to meet the needs of every American. Under a traditional primary care model, the typical panel is 944 patients per primary care provider (i.e., MD/DO physician, nurse practitioner, physician assistant specialized in primary care). In contrast, the patient panel for new primary care entrants is much lower, averaging 584 patients per provider. Scaled nationally to the U.S. population (334M), the new entrant primary care model would require a total of 572,318 primary care providers (Figure 1). Relative to the current state, this suggests that the U.S. would need an additional 218,000 primary care providers to meet the needs of every American under these "next generation" models. Additionally, the 8.4% decline in primary care utilization volumes from 2019 to 2022 creates additional uncertainty about the financial viability of these "next-generation" business models.⁶

FIGURE 1. REPORTED INFORMATION FOR NEW PRIMARY CARE ENTRANTS COMPARED TO U.S. PRIMARY CARE MARKET



Note: Primary care providers are inclusive of MD/DO physicians, nurse practitioners and physician assistants specialized in primary care. Source: Company financial filings; Health Resources & Services Administration Primary Care Workforce Projections. • PNG



Analytic Approach

To assess the performance of CVS and Walgreens following their acquisitions of Oak Street Health and VillageMD, we conducted a qualitative analysis of quarterly financial reports, analyst call transcripts, investor presentations and regulatory filings submitted to federal regulators.

Findings

CVS Health finalized its acquisition of Oak Street Health for \$10.6B in May 2023 despite Oak Street's reported net loss of \$509.7M in 2022.^{7,8} Throughout 2023, CVS executives outlined their strategies for integrating Oak Street Health into the broader CVS enterprise, which already encompassed consumer goods, retail pharmacy, specialty pharmacy, pharmacy benefit management (Caremark), home health (Signify), low-acuity care delivery (MinuteClinic) and health benefits (Aetna). In Q1 2023, CEO Karen Lynch emphasized the importance of leveraging CVS's assets, particularly its pharmacy and retail clinics, to scale and integrate Oak Street, an implicit acknowledgment of primary

care's loss leader characteristics (Figure 2). In announcing the closing of the acquisition, CVS executives expressed confidence in Oak Street's "differentiated model," foreseeing high demand and announcing plans to open up to 60 new clinics in 2024, despite a ratio of less than 1,000 at-risk lives per clinic. Moreover, executives highlighted the strategic imperative of enrolling fully at-risk Aetna members, particularly those in Medicare Advantage (MA), into Oak Street to drive primary care growth.

Walgreens, on the other hand, acquired a majority ownership stake in VillageMD in 2021.⁹ Since then, VillageMD expanded its portfolio by acquiring Summit Health-CityMD for \$8.9B, thereby broadening Walgreens' exposure to both value-based primary care (VillageMD) and fee-for-service (FFS) primary, specialty and urgent care models (Summit Health-CityMD).¹⁰ As we have extensively discussed, commercially insured Americans are the lifeblood of the U.S. healthcare system, a sentiment echoed by Walgreens leadership when discussing their aim to grow both fully at-risk and FFS patient populations: ***"it's really, really, really important to have commercial patients. They pay the bills, right?"*** And, as we predicted, Rosalind Brewer's resignation as Walgreens' CEO and President on September 1, 2023, foreshadowed the challenges and shifts within the organization's healthcare strategy.¹¹

Addressing growing operating losses, Walgreens executives emphasized the significant contribution of the VillageMD clinic count and highlighted the prescription-driving effect of co-located clinics and Walgreens pharmacies, indicative of the disintermediated, closed-loop system cultivated by retailers.¹² Although the profitability of Walgreens' other business units, such as pharmacy, could offset operating losses from its primary care business, ongoing losses in its U.S. Healthcare segment recently prompted Walgreens to pause VillageMD growth and exit at least five nonstrategic markets, resulting in the closure of at least 60 clinics in 2024.

FIGURE 2. SELECT QUOTES FROM 2023 WALGREENS AND CVS QUARTERLY EARNINGS CALLS



Walgreens Boots Alliance

"...there are a lot of other assets that we can connect the dots for these members, including kind of **our retail health clinics, including our pharmacy.** You can think about pharmacy adherence, pharmacy reconciliation, **so there's lots of touchpoints that will create additional value for us** across the entire enterprise as we connect all these assets"

-Karen Lynch, CEO, on how CVS plans to develop Oak Street

"And we **continue to believe that there's high demand for more access to the differentiated Oak Street care model.** Our analysis has consistently shown that accelerated clinic growth is the right thing to do in terms of optimizing the long-term returns on this investment and expanding access for at-risk populations."

-Shawn Guertin, CFO, on plans to build 50-60 Oak Street clinics

"Oak Street ended the quarter with **192 centers and 191,000 at-risk lives.** They've grown by 31 centers versus the prior-year quarter and are on track to open a total of 35 new centers this year, ramping to 50 to 60 centers in 2024. Oak Street also significantly increased revenue in the quarter, growing 44% compared to the same quarter last year."

-Thomas F. Cowhey Interim CFO

"So one of the key parts of the partnership we have with Aetna [...] is we have additional levers we can pull at HCB to positively impact patient care quality, positively impact outcomes and then lower medical costs [...] that can be on **Oak Street Health having more leverage as a PCP to further lower MLR [...]** when our payer partners are growing and taking share, right, **a lot of that growth trickles down to us and becomes a tailwind for us.**

-Michael T. Pykosz, EVP & President, Health Care Delivery

Q1

"So Village's stand-alone is, they want to grow the 125 [fully at-risk lives] and they want to grow the 440 [non-risk lives] as a percentage of the total 1.6 [million total patients] but bear in mind here, **it's really, really, really, really important to have commercial patients. They pay the bills, right?**

-James Kehoe, EVP and Global CFO, on having both at-risk and FFS lives across Walgreens assets

Q2

"Adjusted EBITDA was a loss of \$109 million compared to a loss of \$62 million in the prior year. **This largely reflects the increased VillageMD clinic count** and higher Walgreens Health organic investments..."

"We are seeing benefits on the Walgreens side from our partnership with VillageMD. **Roughly 50% of patients had co-located VillageMD clinics opt to get their prescriptions filled at Walgreens.**"

-James Kehoe, EVP and Global CFO

Q3

"...while we're confident in the range and scale of our healthcare business, **we are disappointed with the pace of our path to profitability.** US Healthcare missed targets due to **VillageMD and CityMD underperformance,** directly related to reduced COVID, cold and flu season and **softer market demand [...]** Over the last few months, we've **slowed the pace of [VillageMD] clinic openings in new markets.**"

-John Patrick Driscoll, EVP & President U.S. Healthcare

Q4

"As we grow, we are constantly evaluating our footprint. With that, we plan to **exit approximately five markets and approximately 60 clinics** in fiscal 2024 [...]. As we exit these nonstrategic markets, our long-term focus will be on achieving density in those regions with the greatest potential to drive future profitability growth and where we can best serve patients with our consolidated set of assets [...]. We are also **launching new virtual and less capital-intensive models.**"

-John Patrick Driscoll, EVP & President U.S. Healthcare

Source: Quarterly Earnings Call Transcripts, CVS Health and Walgreens Boots Alliance, 2023. • PNG



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FIGURE 3. REPORTED FINANCIAL METRICS, CVS HEALTH SERVICES SEGMENT AND WALGREENS U.S. HEALTHCARE, 2023 QUARTERLY EARNINGS CALLS



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Conclusion

With CVS's planned addition of up to 60 Oak Street this year, it will be informative to measure their success in scaling their value-based primary care operation as compared to Walgreens' initial investments in VillageMD expansion. The projected impact of rising MA medical costs for CVS raises significant questions about the company's resilience and strategic positioning as both a MA payor and risk-based primary care provider.¹³ Similarly, it will be informative to monitor the impact of the closure of VillageMD clinics across "nonstrategic" markets on Walgreens' financial performance for 2024. The profitability of emerging "next generation" retail-operated primary care models is contingent upon the sale of ancillary services, notably pharmacy sales. While adding a fully scaled primary care operation is critical to creating the "closed loop" systems that these retailers seek, it appears they are facing the same challenges that traditional primary care operators have for years.

Additionally, whether retailers can – or even want to – integrate comprehensive services into transactional models is an open question. Amazon, CVS, Walgreens, and Walmart

excel in consumer-facing transactional models but lack incentives and expertise to coordinate care. Furthermore, the transactional nature of most consumer-centric primary care models threatens to commoditize traditional relationship-driven healthcare practices. In contrast, Amazon's One Medical subscription model has the potential to generate substantial returns by a lack of utilization by its members. The more success that large retailers realize from creating closed-loop systems like Apple's app store, the more detrimental to the business models for traditional primary care providers and overall care coordination for Americans.

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TIMELINE OF SELECT SUPPLIERS OFFERING RETAIL-BASED CARE

2000 - 2003 2004 - 2007 2008 - 2011 2012 - 2015 2016 - 2019 2020 - 2023

PREDICTION ARTICLE SYSTEMATIC REVIEW (n=200)

- Telehealth and remote services will experience significant growth.
- Wearable devices will advance to monitor intricate health parameters.
- Smart hospitals and healthcare organizations equipped with AI will revolutionize patient care and operations.
- The health tech startup ecosystem will flourish.
- Access to digital mental health platforms will increase, especially in underserved areas.
- Patient advocacy and healthcare consumerism will rise.
- Hybrid care delivery models will become mainstream.
- The shift towards value-based care models will persist.
- Patients will increasingly receive care at outpatient settings.
- Established healthcare organizations will acquire or partner with new entrants.
- Hospitals will focus on streamlining, and automating where possible, operations.
- Healthcare operations will continue to struggle with staffing shortages and frequent turnover.
- There will be advancements in precision medicine.
- As use of diabetes drugs for weight loss continues, advances will be made in delivering these medications sustainably.
- Drug pricing and access issues will persist.
- Unique prediction not repeated across at least two articles

Gain a comprehensive understanding of new entrants, including their operations, advantages and disadvantages.

Maintain a pulse on what senior healthcare leaders are focused on, worried about, excelling at and struggling with is critical to succeed in the negative-sum game of healthcare in 2024.

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