

# Developing a strategy for healthcare's clouded future

(and avoiding the pitfalls)

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# Overview



- Back to Basics = Identify Healthcare Opportunities
- Defining strategy and avoiding the pitfalls
- Direction setting
- Situational analysis
- Option generation and Portfolio approach
- Execution
- Conclusion

## Contents

# Developing a strategy for healthcare's clouded future

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## Back to Basics



**What is your definition for “a strategy”?**



## Objective Health's definition of a strategy

<b>1970s</b>	An integrated set of actions designed to create a sustainable advantage over competitors
<b>Today</b>	A strategy is a portfolio of initiatives designed to achieve competitive advantage



## Implications: What makes “a strategy” so difficult to create and implement? Objective Health’s experience



- **Direction setting** is not clear: unclear objectives with unclear implications
- **Situational analysis** is difficult: fact base is incomplete and there is a poor understanding of competitive dynamics
- **Insufficient option generation and lack of a portfolio**
- **Execution risk** and lack of articulation with a strategic plan



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## Direction Setting



**In one sentence, describe the direction you have set for your organization**





# STRATEGIC POSTURE CHOICES

**Crafting a company's strategy requires making conscious choices about the company's strategic posture in each market...**

**... and deciding upon risk-adjusted supporting actions**

Strategic Posture		Actions	
Shaper	<ul style="list-style-type: none"><li>▪ Drive industries towards new structures</li><li>▪ Create opportunity by either shaking up existing industry structure or controlling direction of markets with uncertainty</li></ul>	Big bets	<ul style="list-style-type: none"><li>▪ Large commitments resulting in large payoff or loss</li><li>▪ Generally tied to shaper strategies</li></ul>
Adapter	<ul style="list-style-type: none"><li>▪ Take current industry structure and future evolution as given</li><li>▪ React to opportunities offered by the market</li></ul>	Options	<ul style="list-style-type: none"><li>▪ Secure big payoffs of best case scenario, but minimize losses in downside case</li><li>▪ May be modest initial investments allowing company to ramp up/down later</li></ul>
Reserving the right to play	<ul style="list-style-type: none"><li>▪ Make incremental investments that create advantaged position</li><li>▪ Allows wait time while uncertainty decreases</li></ul>	No regrets move	<ul style="list-style-type: none"><li>▪ Action will pay off under any scenario</li><li>▪ In uncertain environments, could mean investing in capacity or entering certain markets</li></ul>

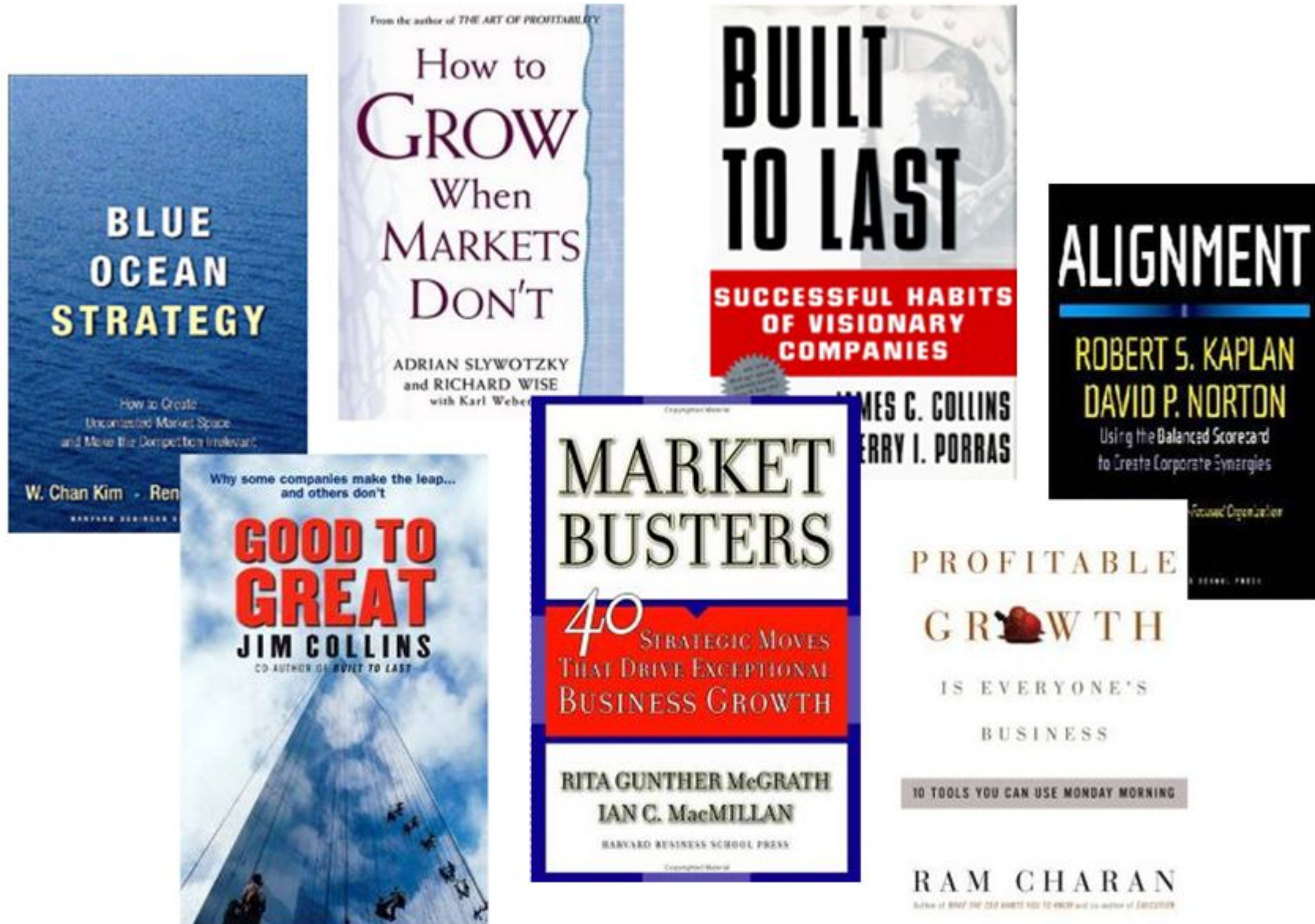
## Growth is a dominant theme for many hospitals. Why?



1. Scale
2. Protection
3. Ego
4. Integration
5. Pricing

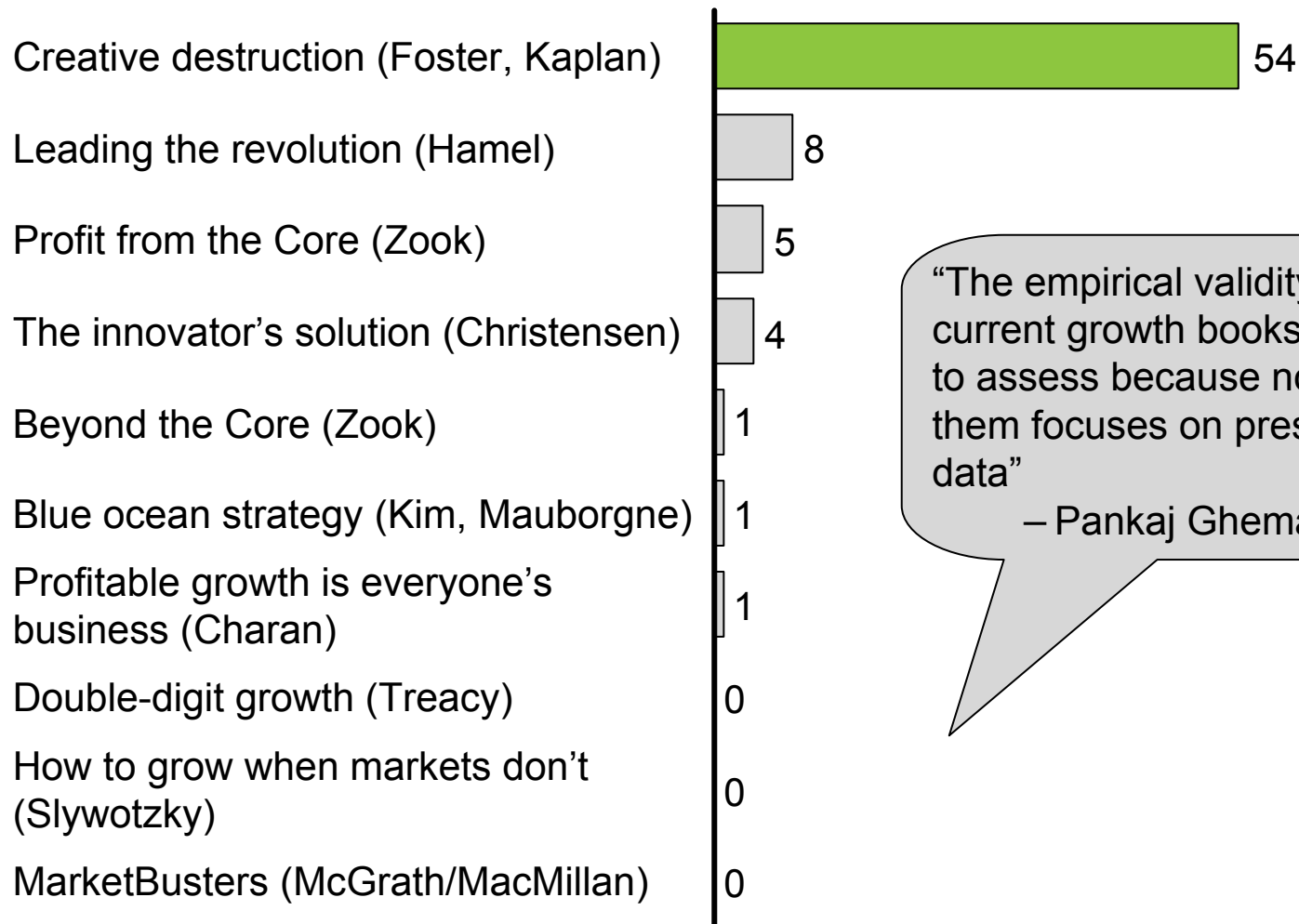


There has been no shortage of advice on growth ...



... but how much of it is founded on fact?

### Number of nonconceptual exhibits



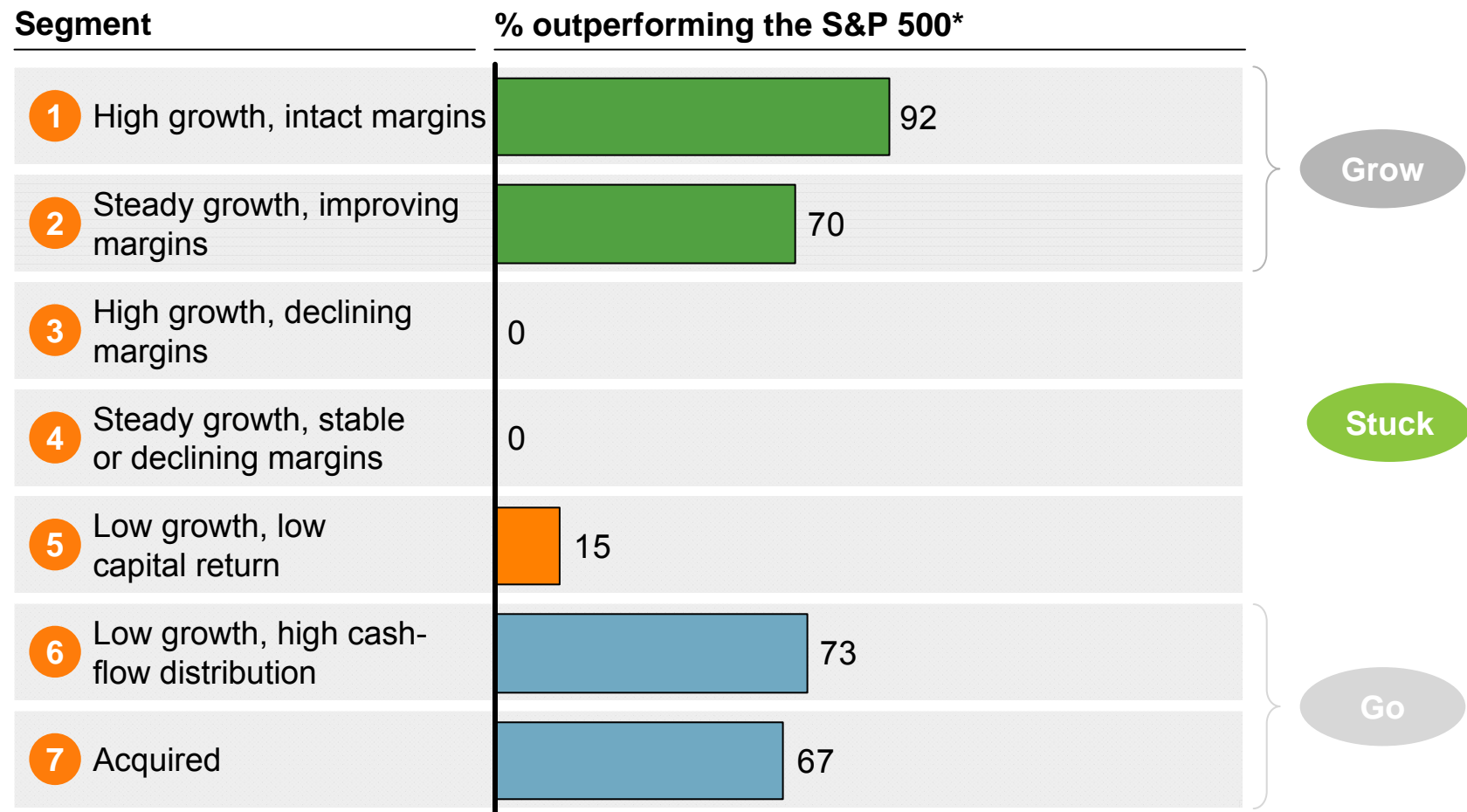
"The empirical validity of current growth books\* is hard to assess because none of them focuses on presenting data"  
– Pankaj Ghemawat, HBR

\* The author refers to *Beyond the Core*, *Profitable Growth is Everyone's Business*, and *How to Grow When Markets Don't*

Source: Team analysis

# Public companies create long-term value in only 2 ways: Grow or go

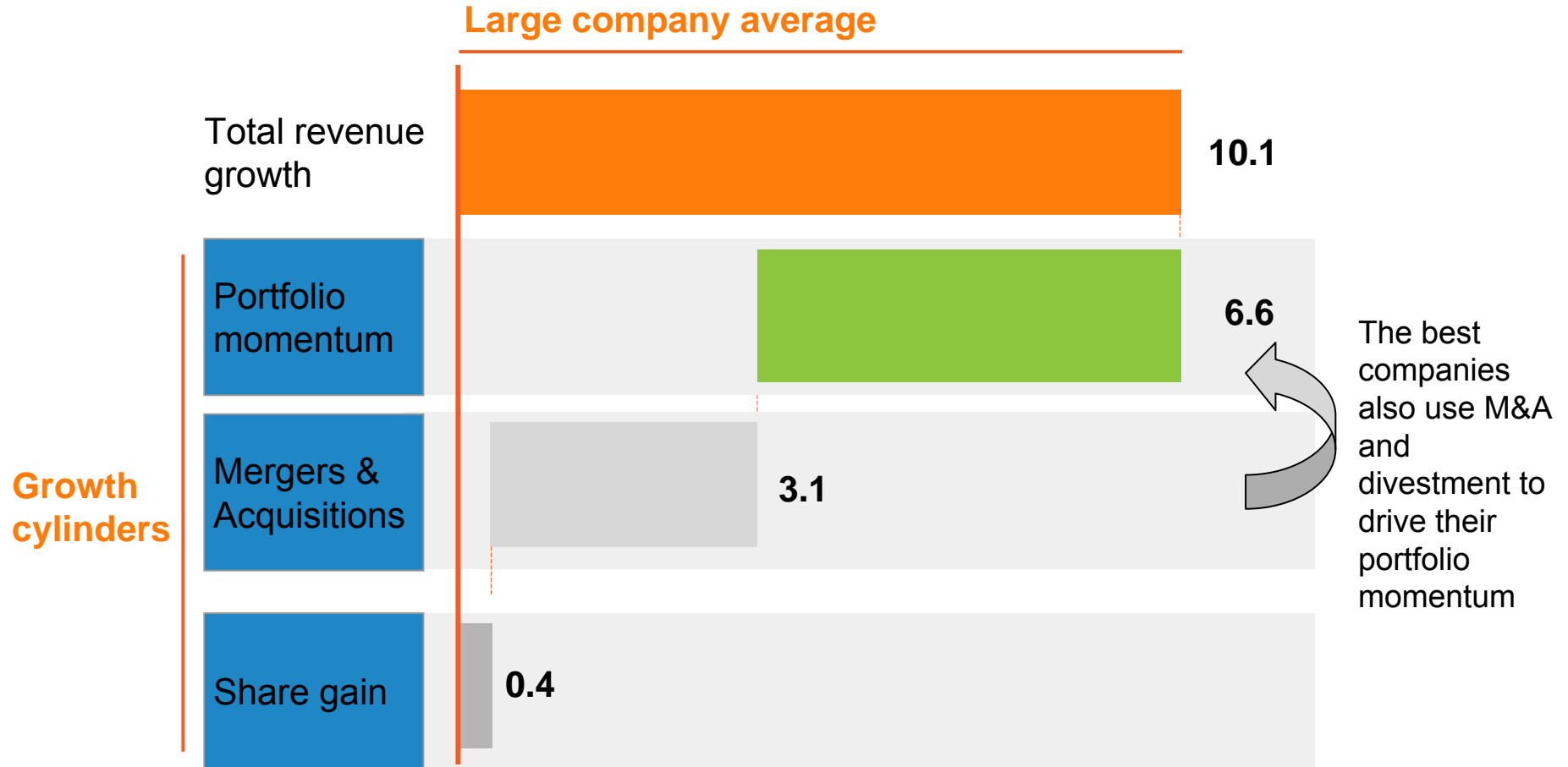
%



\*1984-2004 CAGR  
Source: CPAT

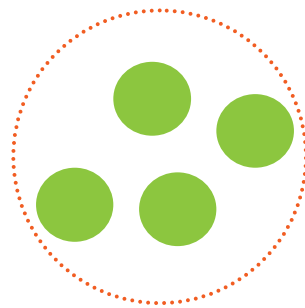
# The way growth happens

Average revenue growth, percent

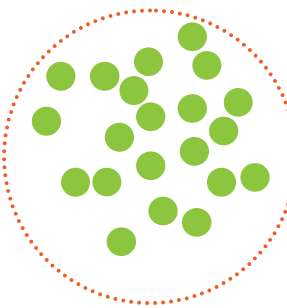


## The power of granularity

- Gaining currency in business context ... widely used in scientific and engineering circles
- Refers to the size of the components of a larger system
- Cuts through the tyranny of the averaged view



**Less granular**  
Coarse-grained

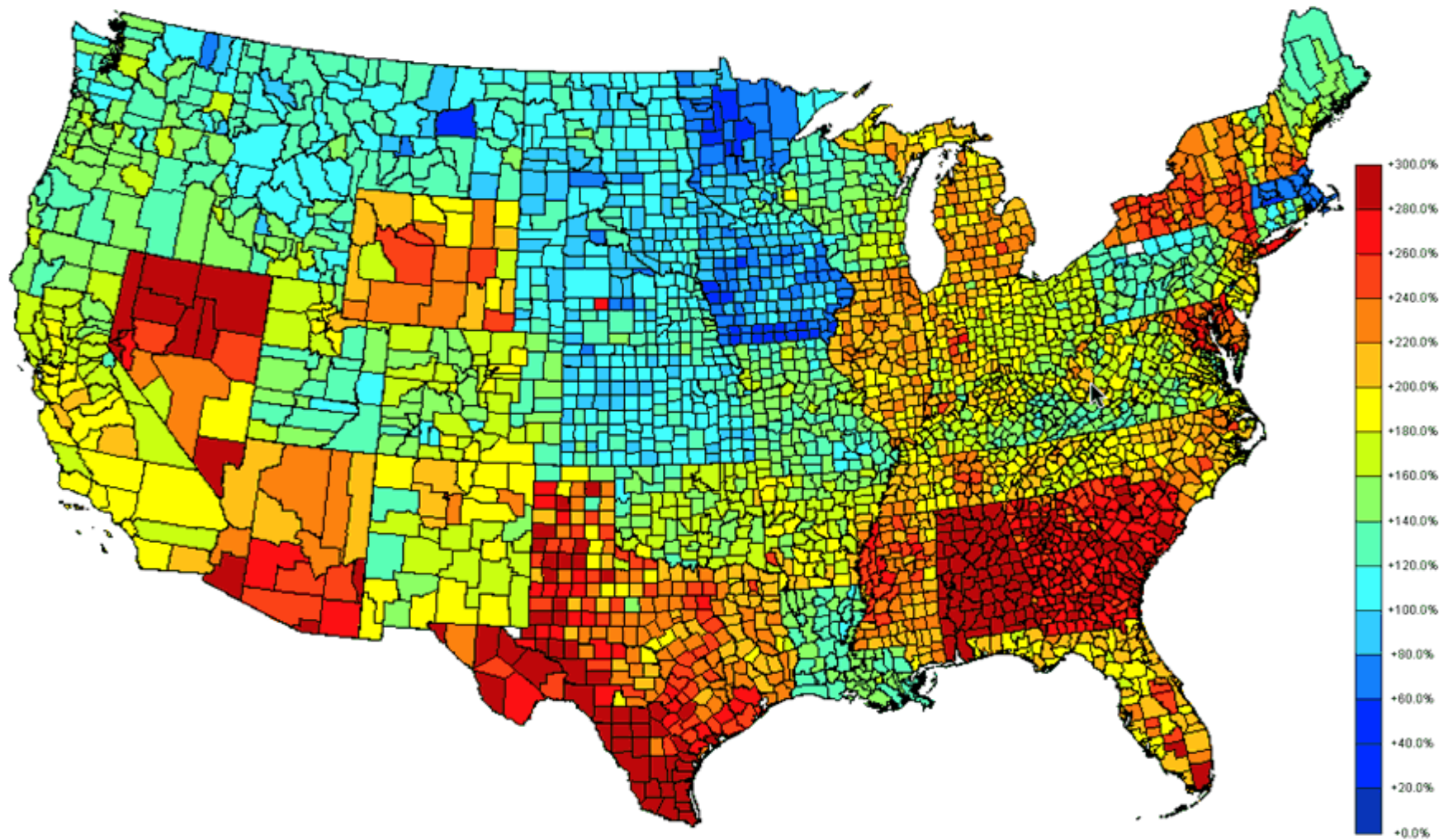


**More granular**  
Fine-grained



## Healthcare example: Significant variance by micromarket

Growth in the individual market, 2009-16\*



\* Based on national reform guidelines, secular ESI disenrollment, and medium employer dumping scenario

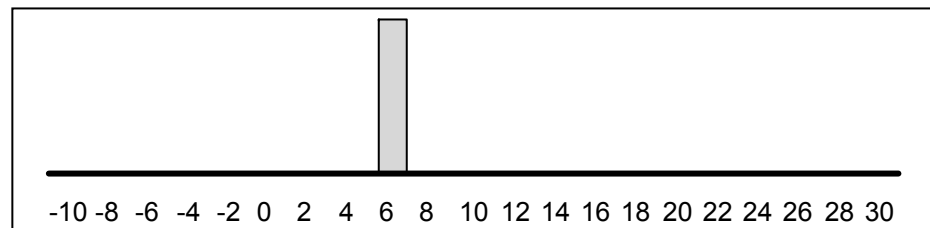
Source: McKinsey MPACT Model Release 4.7



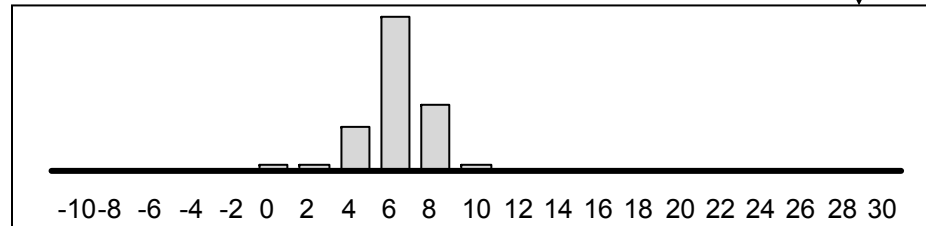
# Variance in growth increases with the level of granularity

Range of growth rates (CAGR, 1999-2006), %

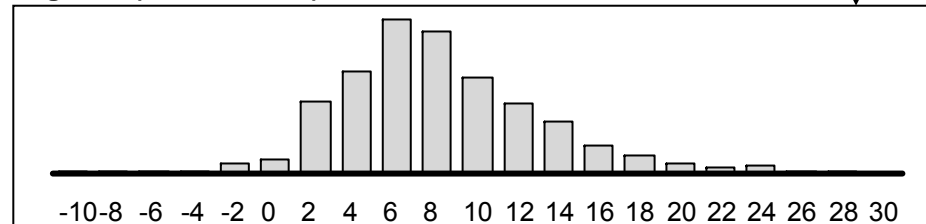
U.S. P&C



Line or state



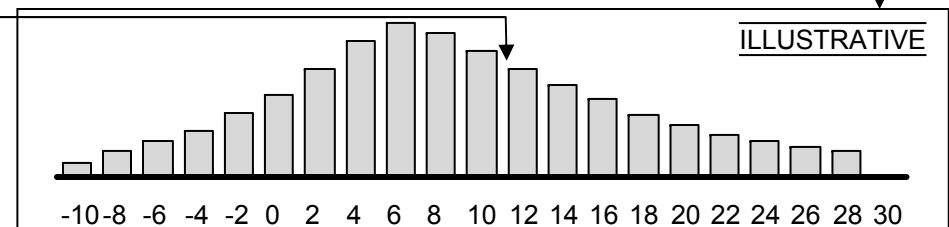
Segment (line and state)



Additional variance

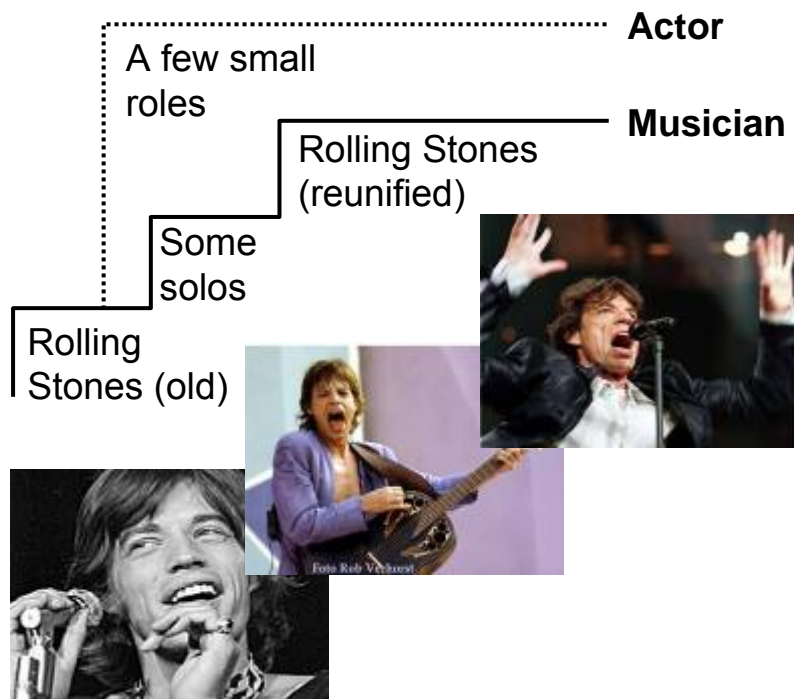
**Other sources of variance**

- Locality
- Product type
- Segment

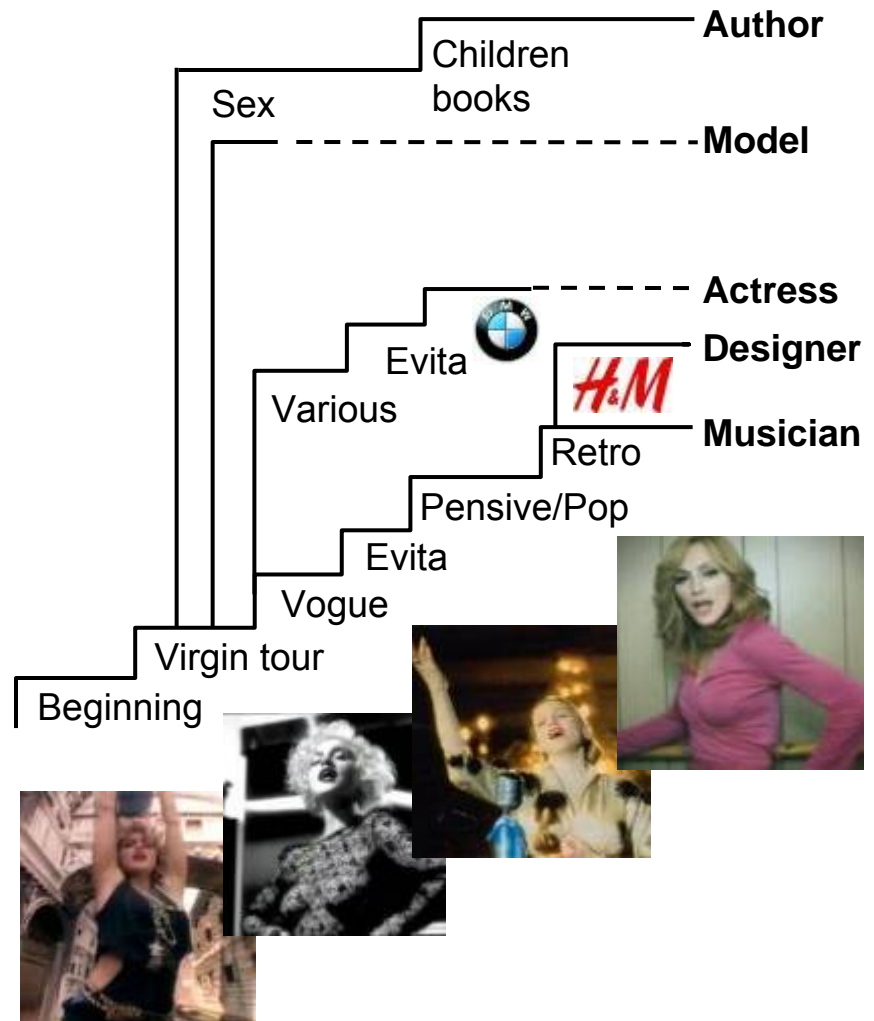


# Even with all those tools, growth remains an art: There is more than 1 way to move

## Growth staircase – Mick Jagger



## Growth staircase – Madonna



## Implications for hospitals



Focus, then focus some more. Get granular down to the sub sub service lines

Analytic advantages are possible, even probable

Deciding what NOT to do is as important as what to do

Big bets and new offerings are important for a serious growth agenda



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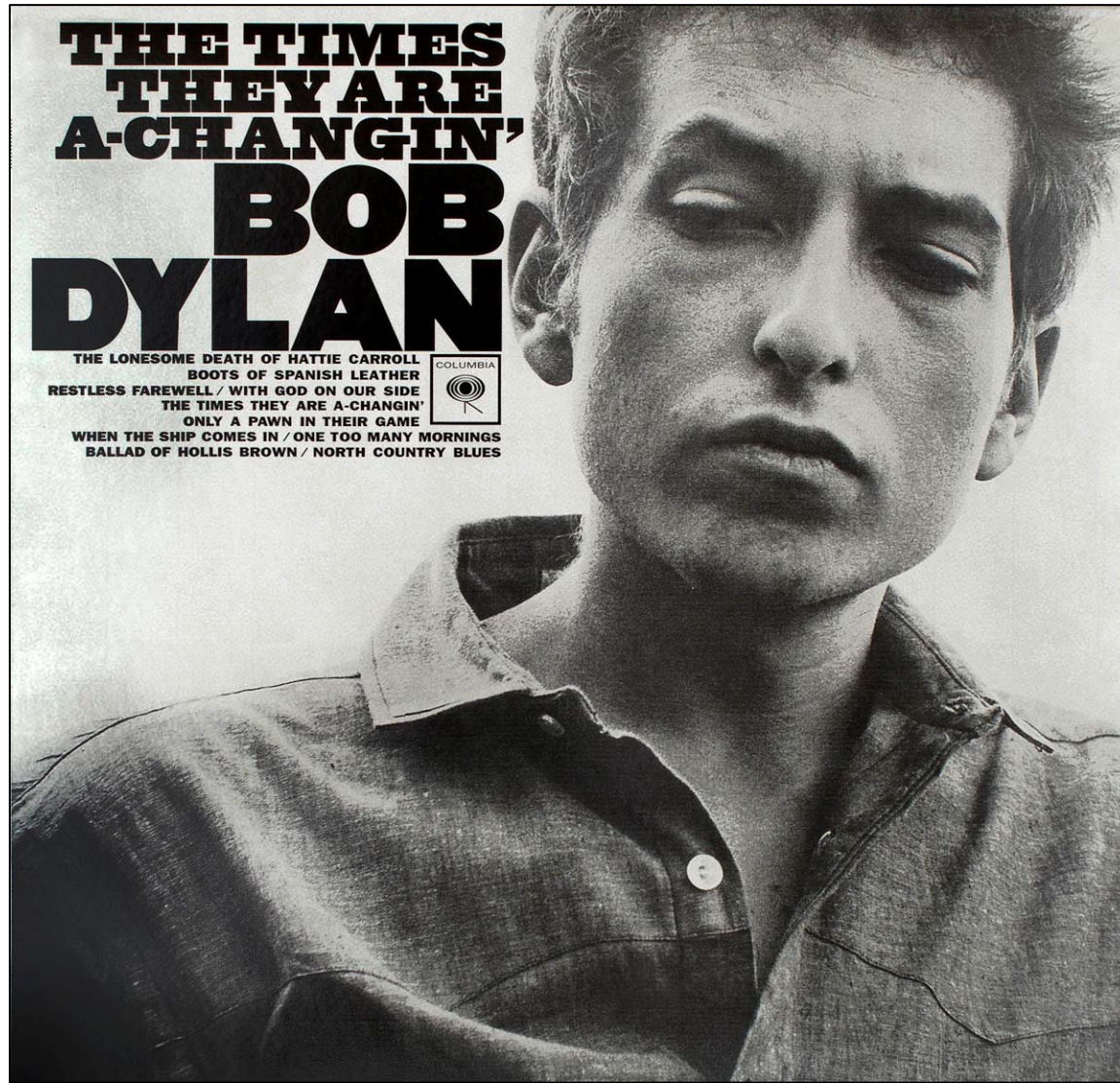
## Situational Analysis



How will reform impact the *earnings* of your hospital?

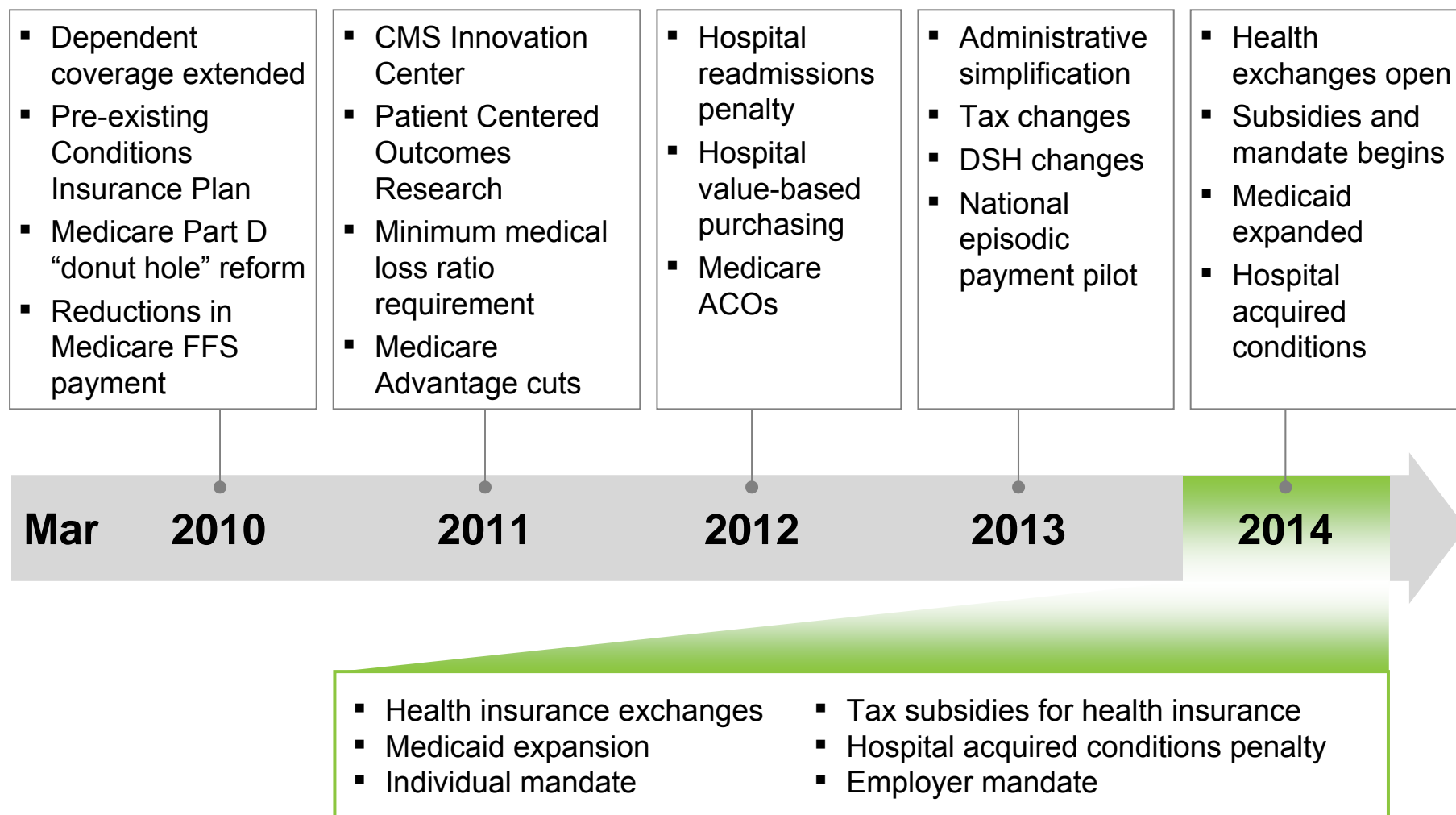


“May you live in interesting times”



## Health reform has gradually been implemented, with the biggest impacts still to come

NOT EXHAUSTIVE



## **The future direction of health reform will be significantly impacted by political events this year**

- Supreme Court case on constitutionality (decision anticipated in June)
- Presidential election in November
- Federal government busy at work on implementation
  - Exchanges, Stage 2 Meaningful Use, DSH, Next Generation VBP, Wage index reform, National Bundled Payment pilot
- Some states setting up their exchanges
- Several other states waiting to see based on Supreme Court decision

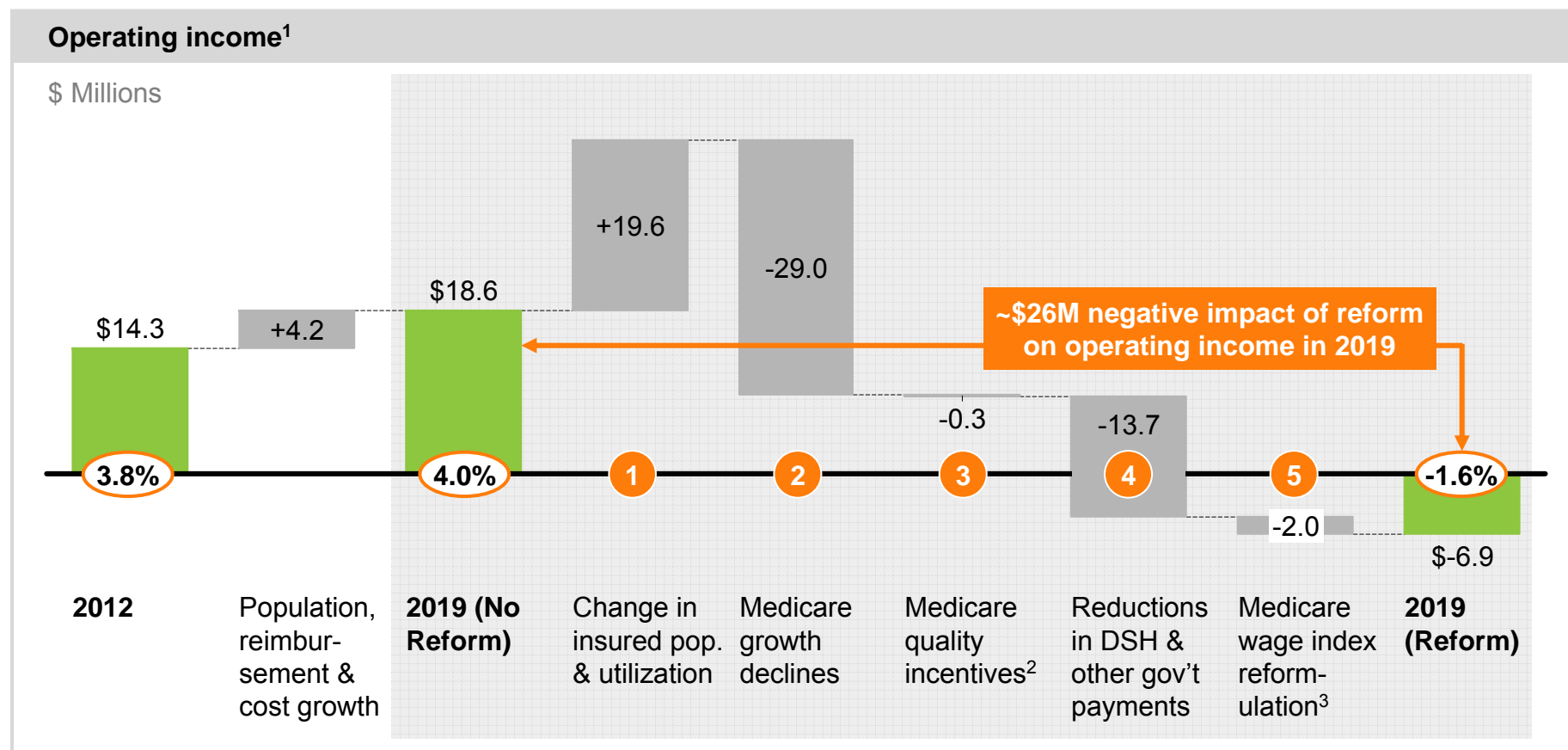




# Assuming health reform is implemented as enacted, many hospitals will experience margin compression

DISGUISED CLIENT EXAMPLE

% Operating margin



1 Includes Medicare DSH, other federal/state payments, other operating income, Exchange reimbursed at 98.5% of commercial

2 Quality performance assumes client maintains current quality performance relative to U.S. hospitals

3 Medicare wage index adjustments are budget neutral at national level

SOURCE: OH Hospital Economics Simulator

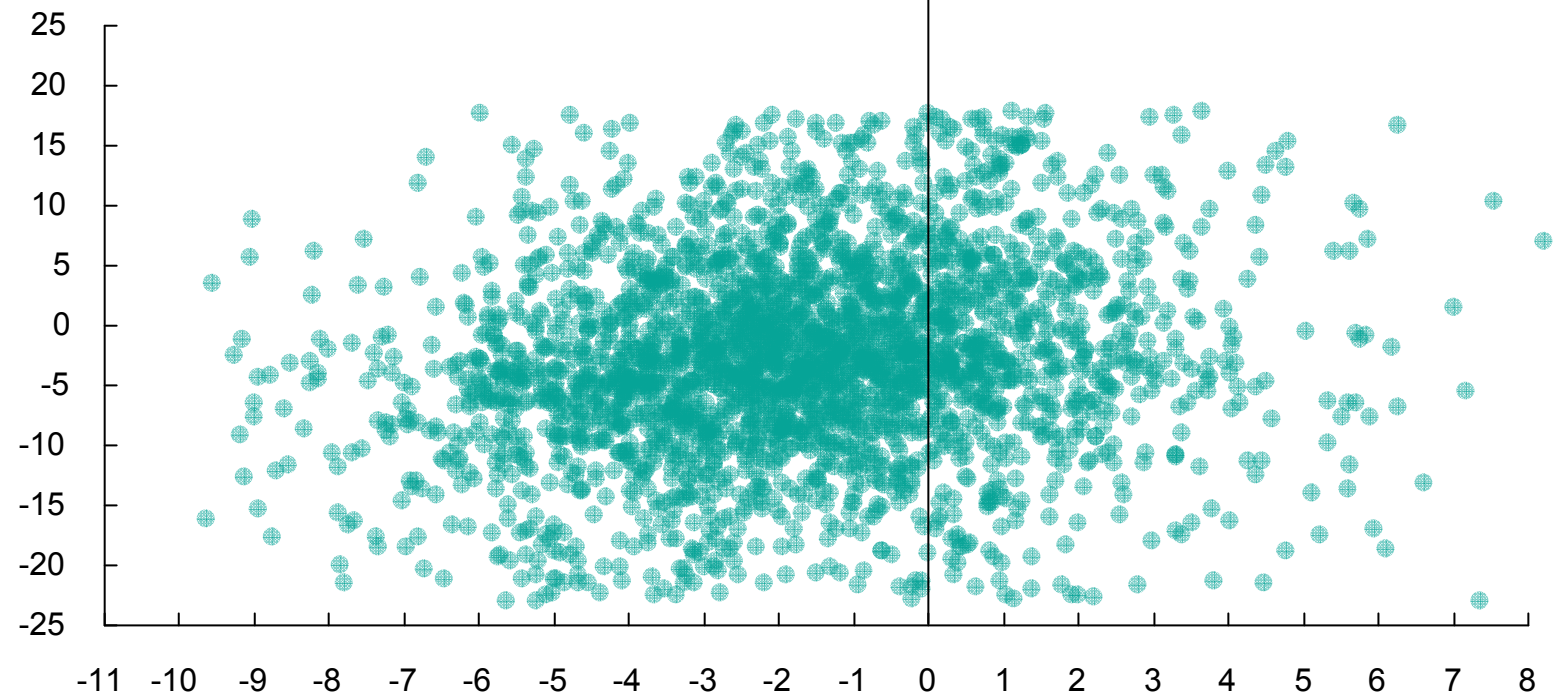
# The US snapshot

## Impact of reform on hospitals in US

*Patient service margin % points, 2019*

### Patient service margins

*Percent*



**Impact of reform, 2019**  
*Patient service margin points*

## Implications for hospitals



Healthcare reform is the opportunity of your lifetime to create a platform for anything

However, specifics matter. Sizing the gap is essential. We believe that strategy should lead cost



## Service Line Competition

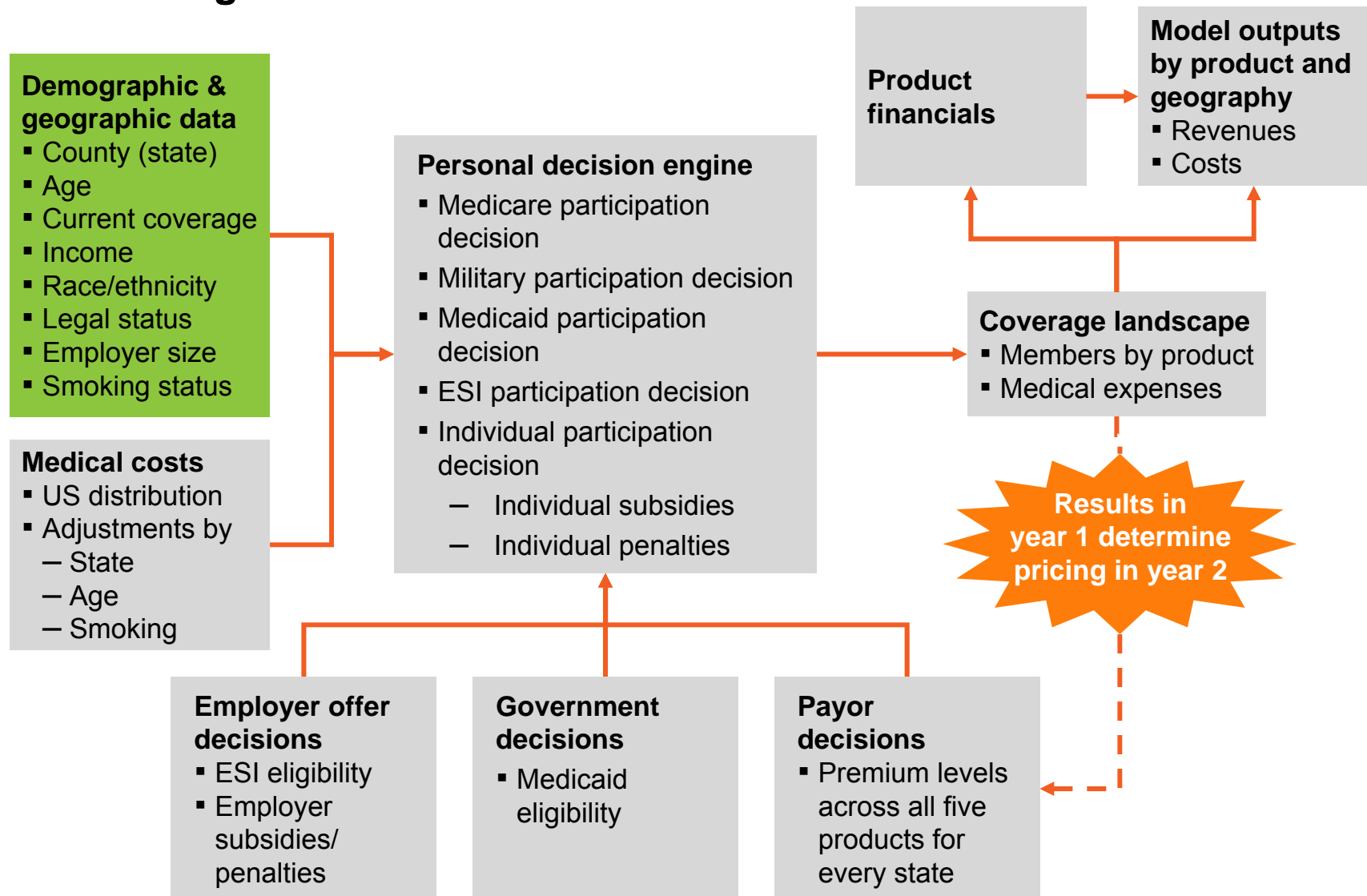


**Which service lines will drive your earnings over the next five years?**

## Advantage: data nerds

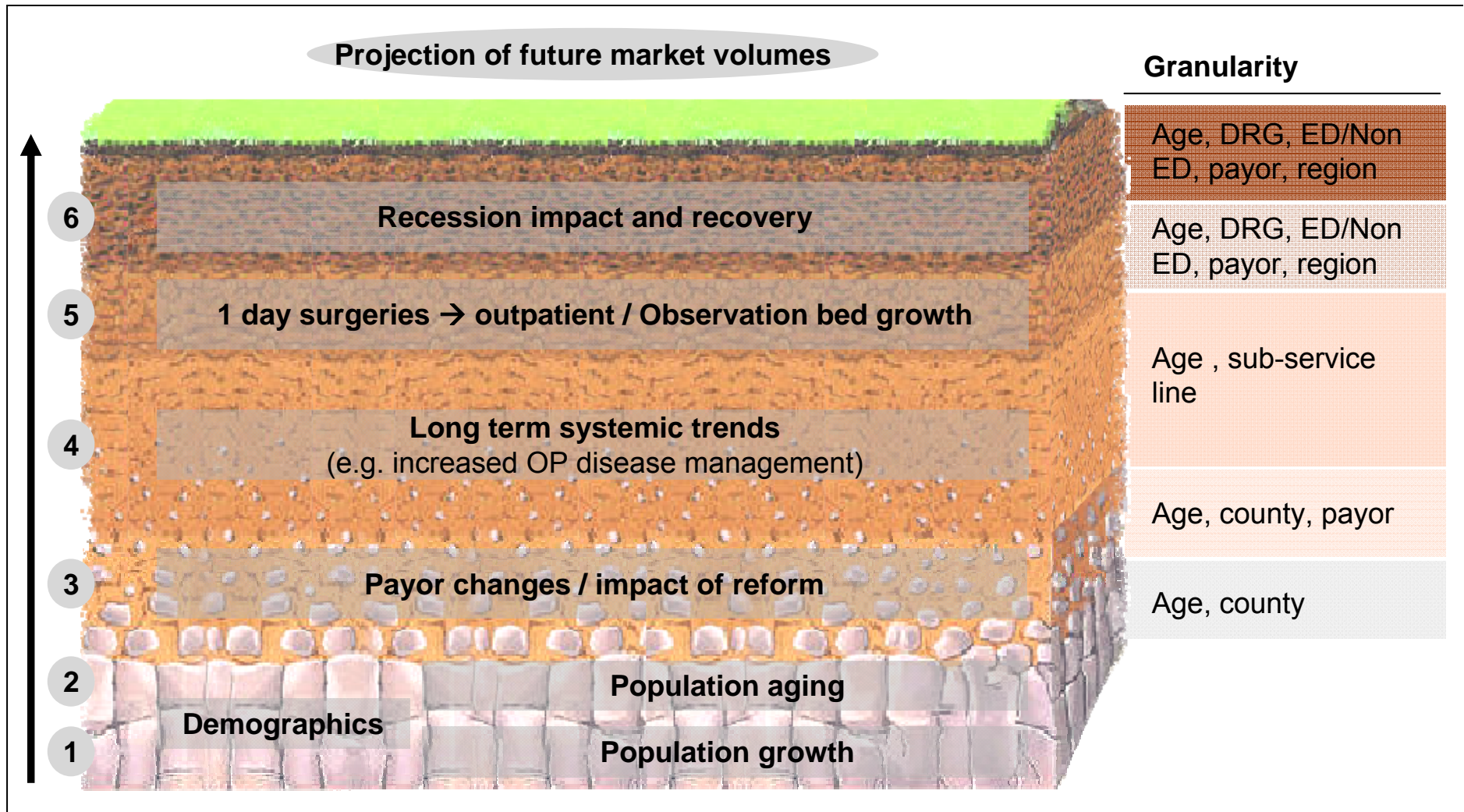


# Behavioral economics-based modeling of how healthcare reform will impact coverage





# Layers of independent modeling



SOURCE: Objective Health de-identified client data; Premier discharge database 2010; Objective Health analysis

## We project orthopedics to be the fastest growing macro service line in most U.S. counties in this decade

1500-2900 100-299  
299-1499 0-99

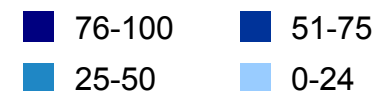
Projected market growth (CAGR), 2010-2019						
Number of counties						U.S. CAGR
Service line	Rankings (1=highest growth, 5=least growth)					Percent
	1	2	3	4	5	
Orthopedics	2,540	512	35	11	2	2.0
Hematology/ Oncology	514	2,457	72	20	32	1.7
Neurosciences	31	110	2,782	158	20	0.7
General Surgery <sup>1</sup>	8	18	178	2,685	212	0.4
Cardiovascular	1	4	34	227	2,835	-0.2

1 Includes oncology surgery

SOURCE: Objective Health's Market Volumes Explorer (HCUP, NIS, Claritas, Census, Objective Health analysis); Objective Health analysis

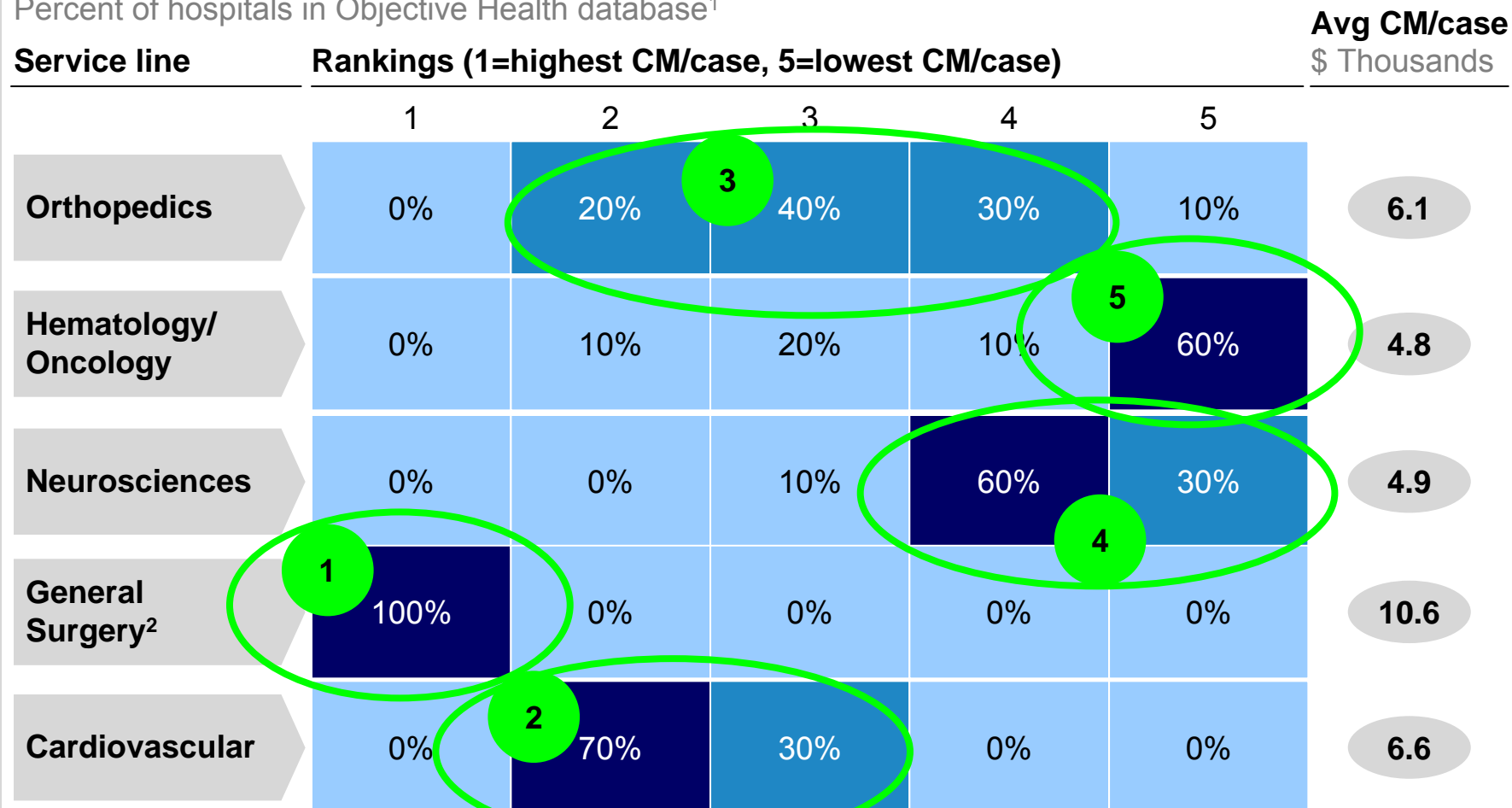


## Turning to profitability, service lines across hospitals and geographies show 'clusters' of performance



### Contribution margin per case, 2010

Percent of hospitals in Objective Health database<sup>1</sup>



<sup>1</sup> Database filtered for hospitals with high quality cost accounting and revenue data (includes 10 hospitals)

<sup>2</sup> Includes oncology surgery

## Implications for hospitals



Cost accounting increasingly important

Don't be a jack of all trades (and master of none)

Service line decisions disproportionately impact cost

Analytics still a differentiator



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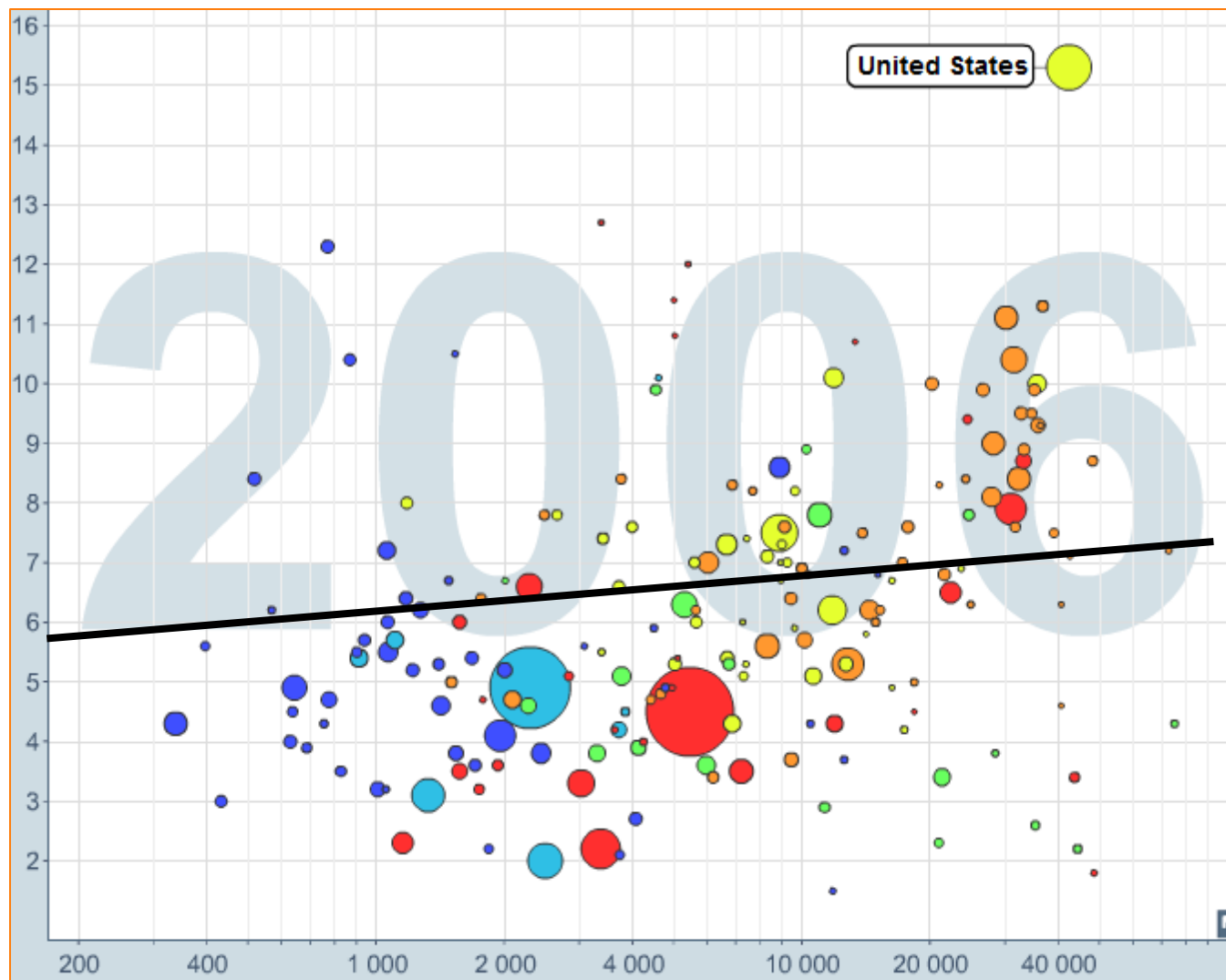
## Option Generation



**How do you get new growth ideas?**



Total health spend as % of GDP



Income per person

# Four clusters of delivery innovation

## Integrated care

- Aligns information and incentives so providers collaborate in best interests of patients
- Reduces costs while raising patient satisfaction and quality

## Franchising

- Delivers highly-standardized, one-way flows of information, products, or services
- Harnesses the talents of local entrepreneurs to operate at a local level
- Lowers distribution costs and improves adherence to clinical protocols

## Technology enabled networks

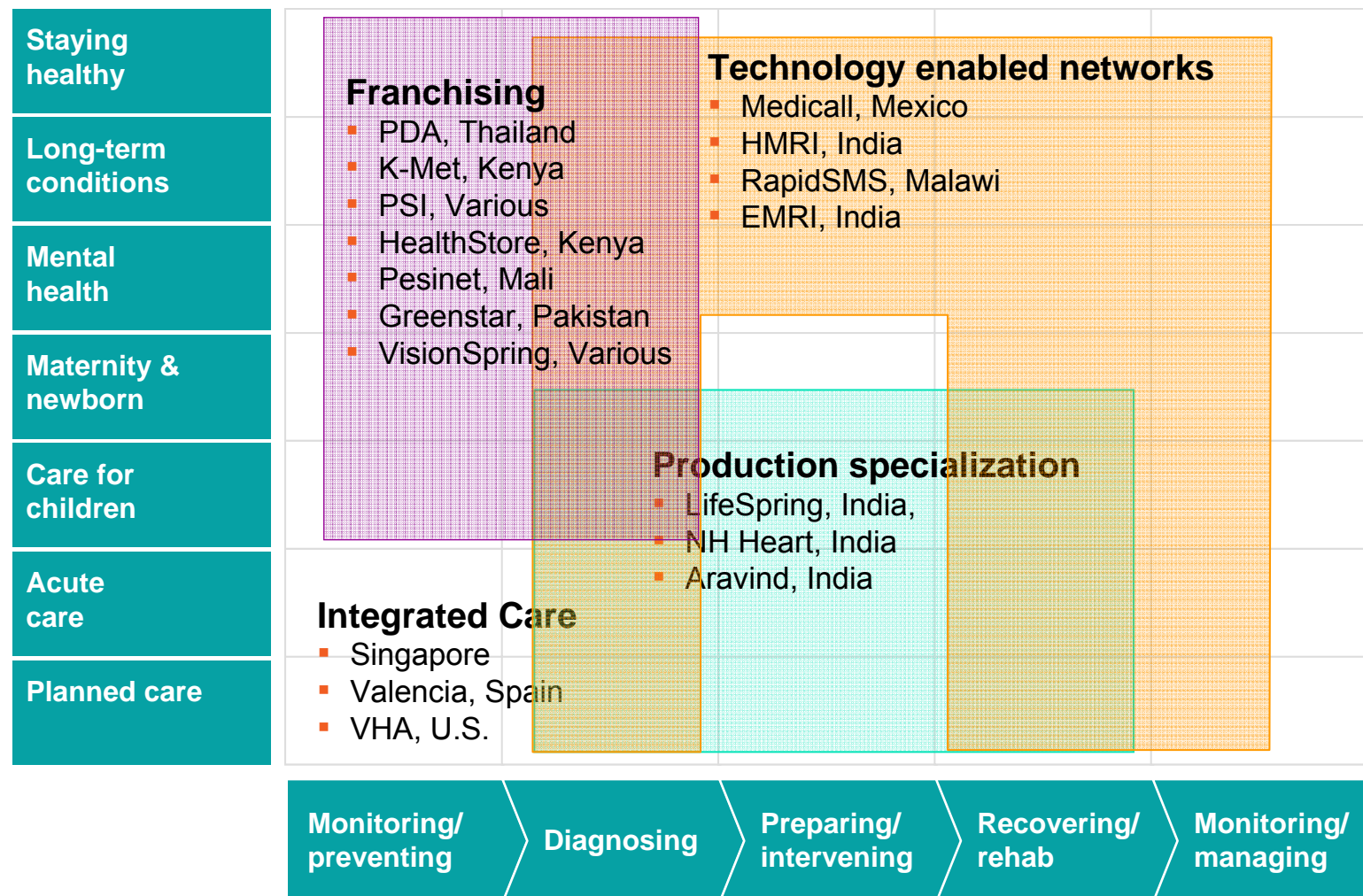
- Leverages existing infrastructure, centralizes medical talent to raise utilization, and follows existing patterns of patient behavior
- Allows organizations to deliver care at a distance, reduce cost, and raise quality

## Production specialization

- Standardizes operating processes, eliminates waste, and reduces cost of care
- Introduces “lean” thinking to healthcare

# Four clusters of delivery innovation

## Categories of care



Care delivery value chain

## Implications for hospitals



Need to look outside normal sphere for ideas

Talk to employers in your market

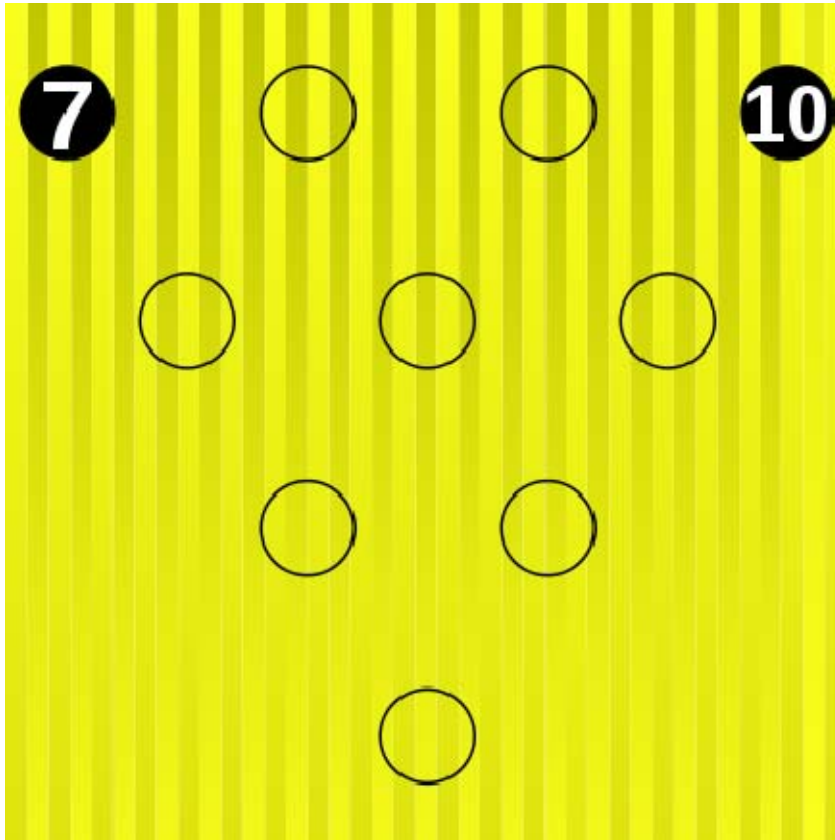
Partnerships will be important

Small, higher risk bets can reap big rewards





## Changing Payment Models



**How are you meeting the “straddle challenge” in payment models -- fee for service versus ACO/ capitated risk?**

# The portfolio of initiatives framework

## Risks

### Familiar

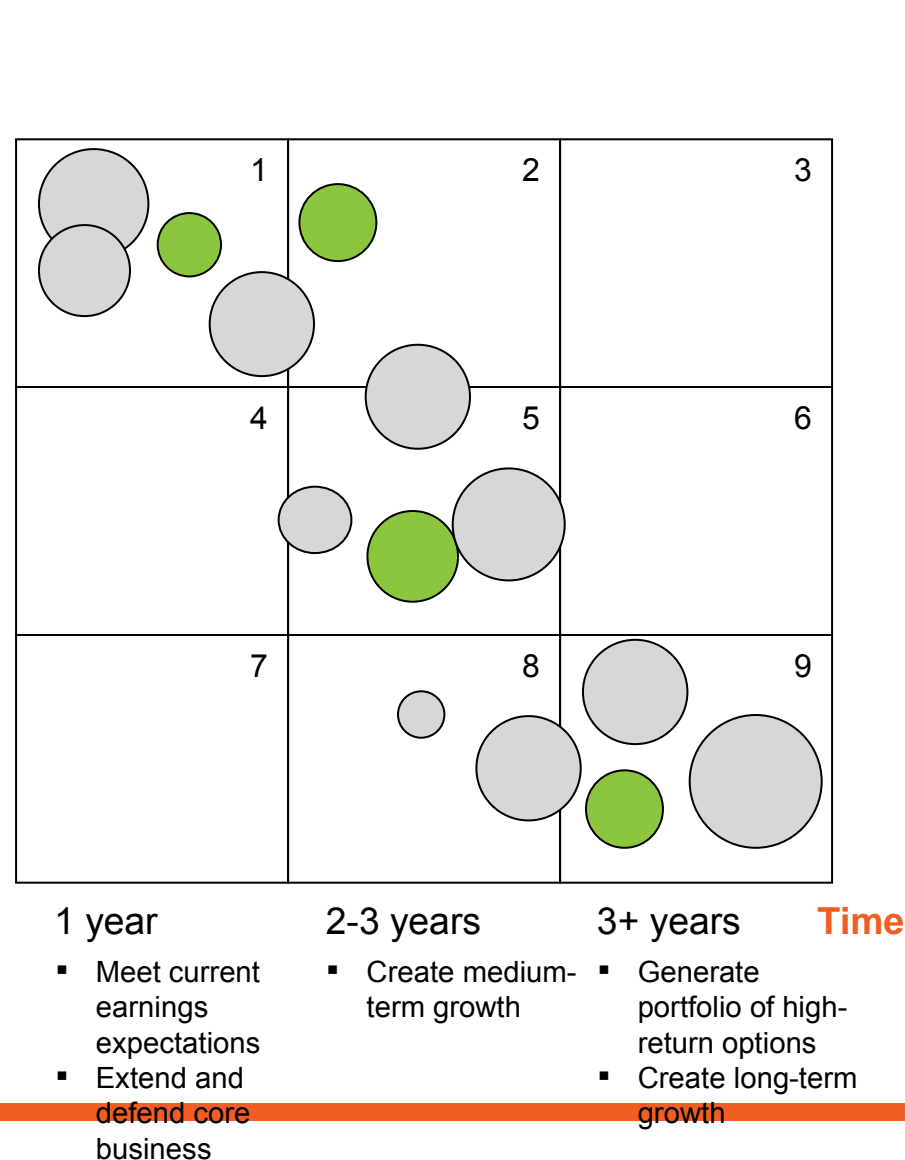
- Distinctive knowledge surpassing competitors
- Invest in initiative possessed by company or easily acquired
- Involves execution risk

### Unfamiliar

- Knowledge surpassed by competitors'
- Attempt small to mid-size investments to gain familiarity

### Uncertain

- Possibility of success difficult to estimate
- Can be overcome by using management of passage of time and diversification
- Attempt small initial investments to gain familiarity

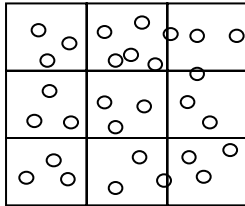


○ Bubble size reflects NPV of initiative

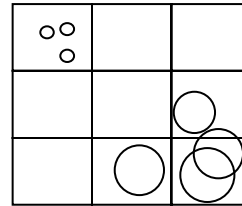
■ Highest "strategic value"

# THE FRAMEWORK PROVIDES A QUICK METHOD TO IDENTIFY ISSUES WITH CURRENT GROWTH PROGRAMS

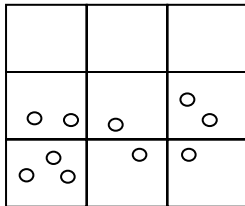
- Lack of focus



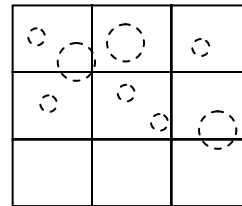
- Big future bets



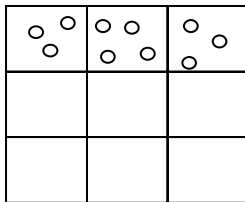
- Risky future



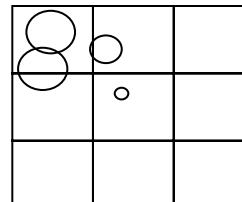
- Poor initiative definition



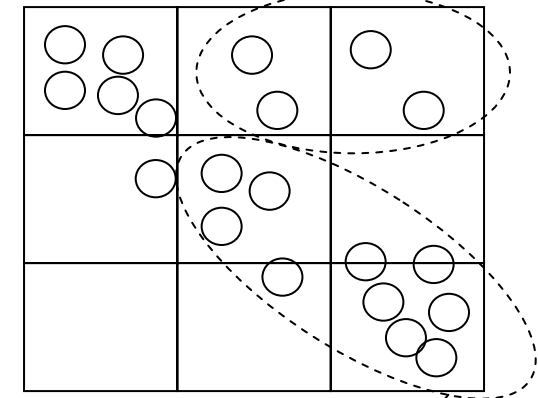
- Risk-averse



- Poor innovation/improper management



**Initiatives to protect/grow share in current market**



**New initiatives (e.g., products, sales models) for adjacent markets**

## Implications for hospitals



Need a spectrum of initiatives in your portfolio

If all you can think about is survival, it is time to strongly consider being acquired

Don't forget to defend your core



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## Execution



# FAILURE

Sometimes you just don't have an excuse

When your organization last failed in execution phase, why did you fail?

## Barriers to execution



Management focus and bandwidth

People: Skill and will

Tools

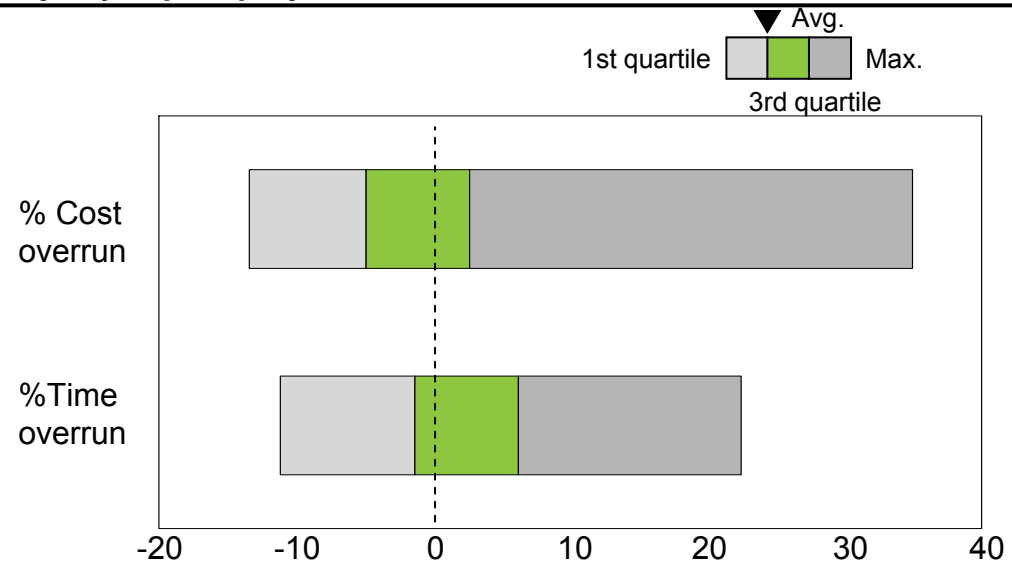
Culture

# Large projects experience significant time and cost overruns caused by 5 recurring failure modes

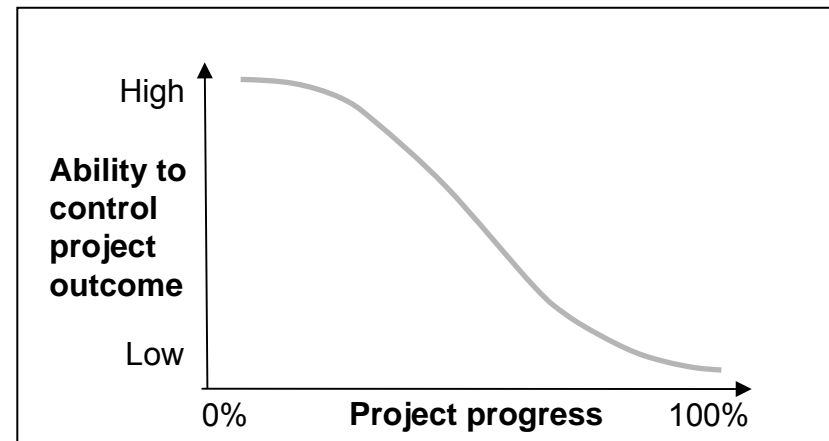
## Recurring failure modes

- 1 Snowballing impact of issues through the project phases
- 2 Inadequate front end loading and progressively decreasing ability to control outcome
- 3 Variation in execution and deliverable quality
- 4 Dilution of accountability through project lifecycle
- 5 Friction in interface management

## Majority capital projects overrun on cost and time



## Ability to control outcome decreases with increasing project maturity





## Implications for hospitals



Change management is a survival skill for hospitals



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# Conclusion

To some degree, the future is always “clouded”

There has never been a better time to sort winners from losers

Avoiding the four pitfalls will help ensure success

- Unclear direction, with unclear implications
- Poor situational analysis
- Unsatisfactory option generation and lack of portfolio approach
- Execution risk



# Questions?

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