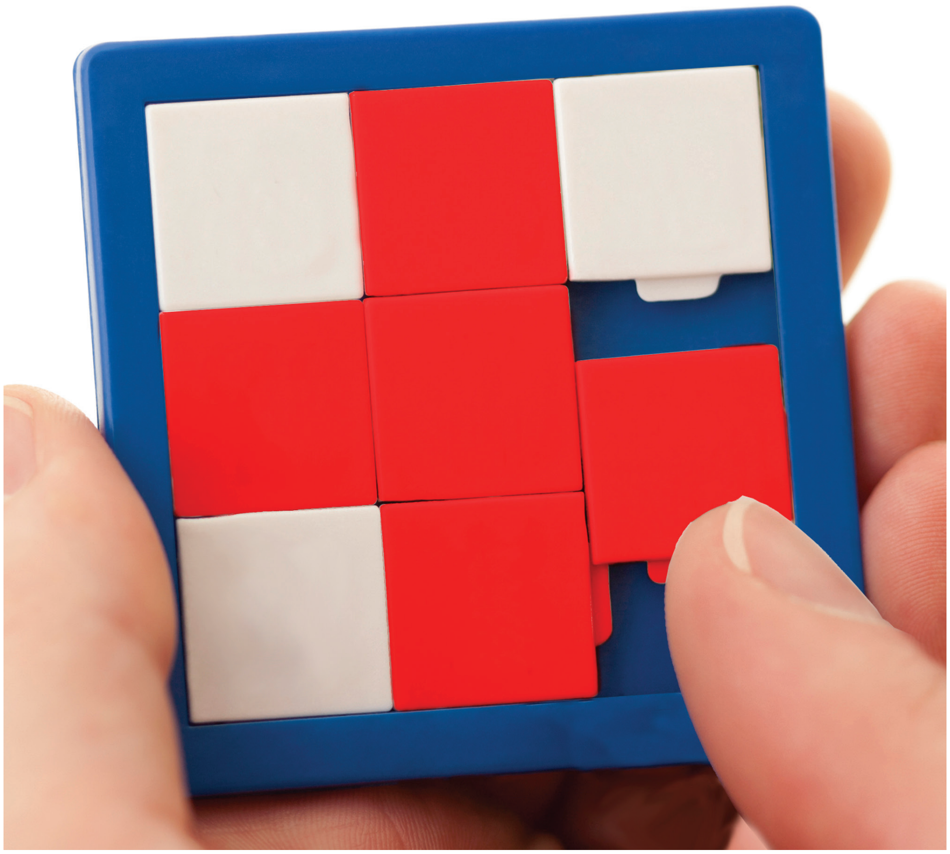
Trustee Insights

INNOVATION



Surviving Disruption in Health Care

The fast-paced disruption of the internet economy is encroaching on America's hospitals

TRUSTEE TALKING POINTS

- The pace and scale of business disruption has been growing in the internet economy.
- Enterprises like Apple and Amazon are positioning themselves to reinvent health care.
- Some are developing strategies to draw volume and revenue from health care providers.
- Providers must respond by learning to deliver friction-free care at the lowest-possible cost.

BY KENNETH KAUFMAN

In the classic path of business disruption, innovators take a complex, high-priced service and offer it with more convenience and at a lower price. The new offering draws volume and revenue away from traditional providers of that product or service, undermining their market share and profitability. For these companies, the result can range from lost relevance to, in cases such as Blockbuster and Borders, bankruptcy.

In the internet economy, the pace and scale of disruption has grown. Large, fast-moving, innovative companies with access to inexpensive capital tackle whole sectors of the economy with advanced technologies, a large consumer base, and a highly competitive attitude.

Health care — with its high costs, often-inconvenient consumer interactions, limited digital engagement, and $3 trillion size — is all but begging for disruption. The complexity of health care may have slowed potential disruption, but we are now seeing evidence from numerous directions that large, well-capitalized entrants are developing innovative strategies to draw volume and revenue from traditional players. Understanding the nature of these disruptive forces can help America's hospitals and health systems to develop their own strategies for success in the midst of disruption.

New Competitors with New Strategies

For hospitals and health systems, emerging disruptive competitors are generally not other hospitals. They are large companies looking to accomplish three key goals:

• Carve out the segments of health care with the lowest fixed costs and the highest volume.

• Engage a broad swath of consumers and encounters through a highly convenient, integrated digital and in-person experience.

• Combine health promotion, non-acute care, and insurance in a way that aligns care and payment incentives and allows these companies to truly manage health and costs.

From the hospital point of view, these goals might be summarized this way: to marginalize hospitals. These companies aim to take outpatient services away from hospitals, along with the patient loyalty, and box hospitals into a role of solely providing expensive inpatient care. Three examples of this phenomenon follow.

• **UnitedHealth/Optum.** With $185 billion in annual revenue, UnitedHealth is using its scale to rapidly grow its physician clinic, urgent care, surgery center, and analytics presence. UnitedHealth's most significant recent moves were the $4.9 billion acquisitions of DaVita Medical Group, which has 280 primary and specialty care clinics, and the $2.3 billion acquisition of Surgical Care Affiliates, which has 190 surgical centers in 30 states.

These are acquisitions out of reach for virtually any single traditional health care system. UnitedHealth appears to be interested in acquiring just about any health care asset that doesn't involve the cost burden of a hospital campus. By combining insurance, non-acute care, and analytics, UnitedHealth aims to be a national platform for managing health and costs.

• **CVS/Aetna.** CVS's $69 billion acquisition of Aetna would form a $240 billion company, one of the largest in the country. Even before this acquisition, CVS had been moving into the provider space, offering routine primary care through its MinuteClinics and working with insurers to expand its role in chronic care management. With the acquisition of Aetna, CVS would have a significantly enhanced ability to align incentives for an integrated care and cost-management solution.

A huge strategic advantage for CVS is its 9,700 stores — one within 10 miles of half the country's population — and the 80 million members of its loyalty program — about one in four American households. CVS is aiming to turn its retail stores into health centers and to further its digital health engagement, creating a formidable national footprint.

• **Apple and Amazon.** Signs point to tech giants Apple and Amazon positioning themselves to reinvent health care. On February 27, CNBC reported that Apple is launching a network of primary care clinics for Apple employees and their families in and around its headquarters in Santa Clara County, Calif. Job listings describe the network as consisting of "multiple, stunning state-of-the-art medical centers."

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Apple CEO Tim Cook has spoken about the company's interest in bringing a new way of thinking to health care — one far removed from what Cook sees as a system designed around the goal of payer reimbursement.

On January 30, Amazon, JPMorgan Chase, and Berkshire Hathaway announced plans to form an independent company to address health care for their U.S. employees and to reduce "health care's burden on the economy." Although both this partnership and the Apple initiative are in their early stages, the tone is ambitious and suggests goals broader than reinventing care for the companies' employees. In addition, Apple is exploring health devices and putting medical records on iPhones, and Amazon is exploring a role in the pharmacy industry.

The exact plans of these companies may not be clear, but their track record suggests that everyone in health care should watch them carefully.

A To-do List for Surviving Disruption

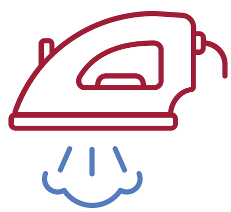
In this environment, remaining strong and relevant requires that health care providers draw lessons from the core capabilities of successful companies in the internet economy. To that end, the following four tasks should be on every hospital's to-do list.

1. Lower and control costs. Hospitals have had only small successes making permanent changes in their cost structure. Instead, as revenues increase, costs tend to increase, and, as revenues decrease, costs tend to decrease.

Successful companies in the internet economy take a very different approach to cost. Their point of view is that they will deliver excellence at the lowest-possible cost — no matter the level of revenue. Thus, a company like Apple maintains high margins by pricing the iPhone as a luxury item and producing it at the lowest cost possible, using a rigorous approach to materials, supply chain, and assembly.

For hospitals and health systems, getting serious about costs requires a holistic approach to the efficiency of the enterprise: divesting or repurposing services or facilities that are duplicative or low-performing, reducing unwarranted clinical variation, and dramatically redesigning processes for better quality and efficiency.

2. Get the friction out of your provider products. Amazon has become one of the most successful companies on the planet through its obsession with providing a friction-free shopping experience, an obsession shared by other successful internet companies. For example, in just two years, ride-sharing companies' share among ground transportation for business travelers increased almost six times, in large part because they removed the friction of hailing, directing, and paying for a cab.



Friction is rampant in health care — appointment scheduling, communication with and among providers, wait times, difficult wayfinding, repetitive paperwork, confusing billing, and perhaps most of all, lack of digital options for care and communication. Consumers put their heads down and tolerated the friction of the taxi experience until an alternative emerged, and then they shifted loyalty fast. It may well be that the most influential health care company of the internet economy will be the one that truly simplifies the experience of care.

3. Control the last mile. The last mile is a critical concept in today's economy. It means attacking the final step in connecting the consumer with a service or product, applying every resource — technology, process redesign, and imagination — to making the last mile disappear.

Amazon is closing in on $1 trillion in market value by relentlessly attacking the last mile between consumer and product. Next-day delivery, same-day delivery, drone delivery, bicycle delivery, in-home delivery, and yes, even a store without cashiers — Amazon has and will continue to throw everything it has at the last mile.

In health care, the last mile is the longest part of the journey. Taking off work, driving, parking, checking in, waiting — the barriers seem exhaustingly high. Health care is just barely beginning to apply internet-era capabilities to make the last mile less of a chore. Mobile health care and telehealth, conveniently located clinics, online scheduling and information, remote monitoring — all of these are in their infancy for most hospitals and health systems.

Much of the effort to master the last mile of health care is taking place outside legacy organizations — by tech companies, app developers, telehealth companies, and entrepreneurs. Internet-era companies know that controlling the last mile is key to customer engagement, trust, and loyalty. Legacy health care organizations cannot cede this consumer connection to others and expect to thrive.

4. Digitize engagement and care. Today, 80 percent of U.S. adults own a smartphone, almost three-quarters of adults have used an on-demand online service, and the top four companies by market capitalization all are technology companies: Apple, Alphabet/Google, Microsoft, and Amazon. The consumer expectation for a digital experience is coming to health care. Among millennials, the largest population segment, almost three-quarters want to book appointments with mobile apps, would prefer to see a doctor virtually, and look online for reviews before selecting a doctor.

Yet hospitals are still largely analog in a digital world. Only 14 percent offer digital tools and information to enable consumer engagement, less than one-quarter offer a range of virtual/telehealth access points, and only about two-fifths provide messaging between patients and providers. In many cases, even when these capabilities exist, they are not up to the contemporary standards set by companies like Amazon and Apple. Even more daunting — and potentially disruptive — for providers will be tapping into capabilities provided by artificial intelligence and genomics to improve diagnosis and treatment decisions.

What It Takes

Tackling this to-do list requires capabilities and characteristics that may be difficult to achieve for traditional hospitals and health systems. Some organizations have come to a conclusion that accomplishing these tasks will require a greater amount of financial and intellectual capital than even the largest provider organizations currently have. Financial strength is needed for greater strategic flexibility to experiment and innovate; greater scale will help attract top talent and innovative partners.

Even tougher will be the major shift in culture that will be required. Many health care organizations have had clear and long-term success with their traditional business models. Recognizing the need for fundamental change and a significant pivot in strategy will be a big leap.

Health care's historically risk-averse, inpatient-focused, and slow-to-change culture will need to be reoriented for a fast-changing, highly competitive, high-tech environment. The leadership fortitude and perseverance that will be necessary to accomplish this reorientation may be the toughest item of all on the to-do list for thriving in this fast-moving and disruptive environment.

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THE Value Initiative

The Value Initiative at the American Hospital Association is a member-driven initiative to provide leadership to the hospital field on the issue of affordability. Through The Value Initiative, AHA provides hospital and health system leaders with education, resources, and tools to advance affordable health care and promote value within their communities.

Please visit www.aha.org/value-initiative to learn more and access stories and resources related to value and affordability.