MARKET TRANSFORMATION 2018: STRATEGIC PRIORITIES FOR HEALTH SYSTEMS

Amid a major realignment of human and financial assets in health care, industry stakeholders should consider four major priorities as part of their strategic planning in 2018.

By David G. Anderson, PhD, and Dudley Morris

While government-led healthcare reform has slowed, 2018 promises to be another dynamic year of change.

Health systems nationwide are being forced to pay more attention to costs as they experience higher expenses, a payer mix that increasingly tilts toward Medicare and Medicaid, and constrained reimbursement. Major deals—mergers, acquisitions, and partnerships—will continue to unfold and redefine the healthcare landscape. Technological change will accelerate, continuing a shift to lower-cost treatments that is being driven by breakthroughs in care delivery, especially molecular engineering and gene therapy.

The continuing quest for scale will take center stage in 2018. Just look at what happened in December:

- CVS announced its purchase of Aetna for $69 billion, combining a leading health insurer with the largest drugstore chain, the largest chain of immediate-care clinics, and a major pharmacy benefit manager.
- Advocate and Aurora Health Care, the largest regional health systems in Chicago and Milwaukee, respectively, announced a merger to form a multi-state system with 27 hospitals.
- Dignity Health and Catholic Health Initiatives signed a definitive agreement to merge, creating a national Catholic system with 139 hospitals and over 25,000 physicians and advanced practice clinicians.
- Providence St. Joseph Health (which just merged last year) and Ascension Health began discussing a merger to create the largest hospital system in the country, with 191 hospitals in 21 states.
- Highmark Blue Cross Blue Shield announced a partnership with Penn State Hershey Medical Center to invest $1 billion jointly in care delivery in central Pennsylvania, creating a competitive alternative to the UPMC-Pinnacle affiliation that was announced in September.

In short, a major realignment of healthcare financial and human assets is underway. After realizing that the federal government is not going to solve our healthcare cost crisis, health plans and providers have taken the gloves off in their ongoing competition to control how health care is financed and delivered. Health plans are employing capital aggressively to expand control over care delivery, and provider systems are consolidating to protect their historical hospital franchises and expand their geographic reach.

SUCCESSFUL TRANSFORMATION STRATEGIES: 4 MAJOR PRIORITIES

There seems little doubt that the transformation from volume to value will continue. The Affordable Care Act (ACA) promoted provider-sponsored accountable care organizations (ACOs) that could help not-for-profit provider systems move into health plans’ business of managing population health. The ACA also capped the profit...
margin that insurers can earn on their books of business. In response, health systems began searching for their “sweet spot” in value-based contracting, with ACOs that take risk and with provider-owned health plans.

In addition, health systems are now in the physician business, employing 40 percent or so of the nation’s physicians. At the same time, for-profit companies like UnitedHealthcare, CVS, and Humana have been aggressively acquiring physician practices and building primary care in their continuing effort on behalf of their customers and members to force the sector to become more cost-effective.

Beyond pursuing value-based care, however, health systems need to incorporate four major planning priorities in their strategic thinking for 2018.

1. System value and affordability. The post-reform financial picture of health care is not pretty, given the shrinkage of commercial insurance, potential cuts in Medicare, looming cuts to state Medicaid programs, and the significant portion of the population that remains uninsured or underinsured.

Moody’s and Fitch have both issued negative forecasts for the not-for-profit healthcare industry, while being somewhat more sanguine about their for-profit counterparts. BDC’s own Survey of Leading Academic and Community Health Systems is somewhat more optimistic, with C-suite leaders in a dozen market-leading organizations indicating they are shaking off the uncertainty caused by the legislative and court battles over the future of the ACA and plan to press forward in pursuit of financial and competitive advantages.

One key to these efforts will be to have a blended revenue accountability model that aligns incentives and infrastructure requirements for capitated total-cost-of-care arrangements, ACOs, and episodic care models. Being able to compete as relatively low-cost providers will be key to value-based contracting, which entails understanding how both patients and payers perceive value and demonstrating the ability to meet expectations.

2. Merger, acquisition, and partnership activity. The acceleration of merger-and-acquisition activity at the end of 2017 suggests we are on track for radical consolidation of not-for-profit health systems. It is not far-fetched to think that super-regional consolidation and national mega-deals could result in a national not-for-profit market dominated by 20 to 30 large provider systems in five to 10 years. An alternative scenario is that provider systems and health plans will merge, creating a network of large ACOs across the country.

Partnerships offer greater flexibility than mergers—particularly for academic medical centers (AMCs), given the restrictions frequently imposed by university ownership structures. While challenging to manage and not without risk, these agreements can create real value in terms of geographic scope, economies of scale, and access to AMC skills and technology. Joint ventures between AMCs and well-financed for-profits—such as the Duke-LifePoint joint venture, which includes 14 jointly owned community hospitals and approximately $2 billion in revenues—will seem more attractive.

One beneficial outcome of consolidation is the creation of greater resources and leadership for continuing the transformation from a business model centered on acute care to one centered on population health and chronic care management.

3. Consumer engagement and brand focus. A number of observers have noted that consumers are dissatisfied not only with their healthcare costs but with the complexity of accessing care.

It is not clear whether we are at the same inflection point that industries such as retail or technology have reached, where control over the buying decision is

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**2018 HEALTHCARE MARKET ASSUMPTIONS**

- Competing on value with increasing transparency on quality and cost will be essential for all providers.
- Margins will contract, leading to a big focus on horizontal consolidation and scale, in turn leading to continued expansion by large players, more partnering, and roll-ups of small systems.
- Capital access and low cost will become key differentiators with changes in the tax-exempt bond market and expected rises in the cost of capital.
- Vertical integration will occupy more C-suite attention as health systems figure out how to build high-performing employed medical groups and decide their insurance-risk plays going forward.
- Consumerism and branding will become more important as patients gain more choices for understandable pricing and easily accessible, high-value care.
- Cross-sector “chaotic competition” will require all healthcare organizations to become more flexible, nimble, and innovative.

Source: David G. Anderson and Dudley Morris, BDC Advisors LLC.
fiercely in the hands of consumers. There are plenty of investors betting on such an outcome, however, given the billions invested in healthcare start-ups like Oscar Health, One Medical, and Zocdoc, with their consumer-centric business models. Even the giant CVS-Aetna deal is predicated on creating a new front door to the healthcare system through thousands of in-store clinics—as well as on increasing value by reducing pharmacy costs.

For 2018, there will be an increasing focus on consumer engagement, with the winners being consumer-centric organizations that are able to build positive “touchstones”—critical points where customers interact with the healthcare system and its services—throughout the customer’s lifecycle with a “whole customer” approach.

Closely related to consumer engagement is brand-building. A furious branding competition is being fought by health systems, insurance companies, medical groups (in some areas), and new specialist disruptors like CareMore Health—an integrated health plan and care delivery system that focuses on relatively sick Medicaid and Medicare patients, with a business model prioritizing disease management, limited specialty referrals, and reduced hospitalization—over how to capture and retain consumer loyalty.

Thirty years ago, private practitioners had the strongest claim to patient loyalty, but with the institutionalization, consolidation, and digital transformation of health care, consumer loyalty is up for grabs. Health systems that fail to build a coherent, defensible, and powerful franchise with consumers are vulnerable to being marginalized by other health sector players. While not often discussed, brand-building is an important driver of health system consolidation.

4. Investment in innovation to drive value. Succeeding in the post-reform “transformation market” requires focusing on investments that create new value within areas of market growth, or that improve care quality and control costs. The shift of risk from payers to providers through value-based payment systems has proved to be an expensive transformation, requiring the development of physician networks, care management and delivery systems, new approaches to contracting, and investment capital.

To succeed in this challenging environment, many health systems are turning to venture investing, as well as internal innovation labs, to launch initiatives to improve quality of care, increase efficiency, diversify revenue streams, and build more flexible, innovative corporate cultures. In the first half of 2017, U.S. healthcare venture fundraising totaled $5 billion, putting it on track to exceed the record of $7.5 billion raised in 2015. Of this total, a growing proportion represents investment by health systems—and this trend is not likely to slow anytime soon.

BRINGING EVERYTHING TOGETHER
These four priorities—increasing value and affordability, pursuing consolidation and partnerships, focusing on consumer engagement and brand, and investing in innovation—define overarching strategic priorities for health systems in 2018. Beyond responding to shifting government policies and competitive dynamics, health systems should make sure these priorities are explicitly considered in their strategic-planning processes.

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Footnotes:
3. A recent survey conducted by the American Hospital Association (AHA) and AVIA reports that 72 percent of the 400+ hospitals in the U.S. with over 400 beds have already built innovation centers that support venture investing or plan to do so in the near future.