Provider 2020
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There is little doubt that hospitals and health systems are at a crossroads. A number of factors are converging to make the next decade likely one of the most tumultuous in the history of the industry. Increased regulatory burden, constrained reimbursement and demographic shifts are likely to place pressure on the already constrained margins of hospitals and health systems. With fundamental mechanisms underlying the purchasing and provisioning of healthcare service changing, providers should develop compelling and differentiated value propositions to avoid commodization and remain financially viable. While challenges lie ahead for hospitals and health systems, there are a series of positive, even aspirational, ‘Strategic Destinations’ that can be accessed moving forward.

Environmental context
In the not too distant future, nearly all hospitals and health systems could be operating in an environment where costs are growing at a faster pace than revenues. While margins could improve as the uninsured gain coverage from federal and state reforms, Deloitte analysis suggests the potential for a significant negative impact on health system margins from coverage shifts, changes in utilization and demographic trends. While various scenarios could play out, US hospital margins could erode from today’s average to a significant operating deficit in 2020.

Given the scale of the potential challenges that lie ahead, hospitals and health systems should extend operational improvements with broader consideration of future strategic positioning. Specifically, hospitals and health system should contemplate how to strategically differentiate themselves in an environment that is anticipated to commoditize their traditional core services.

Figure 1

Key shifts
Reduction in the uninsured from 20% to 12% improves margin profile ($\Delta = +1.2\%$, now 3.2%)

Aging into Medicare and the Exchanges (Small Business Health Options Program / Health Insurance Exchange) reduce proportion of Commercially insured from 50% to 44% and dilutes margin ($\Delta = -1.5\%$, now 1.7%)

With a higher mix of ‘Government’ business, ACA reimbursement reform significantly degrades margin ($\Delta = -10.0\%$, now -8.3%)

A strategic response

Based on industry and client experience, there are four potential “Strategic Destinations” that are likely to support long-term strategic differentiation based on either a revenue or cost-based strategy.

Potential Strategic Destinations for hospitals and health systems could include:
- **The aggregator**: Using actual and virtual scale to drive a sustainable unit cost advantage
- **The health manager**: Integrating care across the continuum to decrease utilization and reduce total cost
- **The innovator**: A ‘leading product’ strategy focused on delivering high-quality outcomes/service which are designed to support a revenue-premium in the market
- **The diversifier**: Monetizing assets or relationships to achieve revenue enhancement at higher incremental margins through entry into adjacent lines of business

Destinations differ in the way they match financial focus (revenue or cost) and business model (traditional or non-traditional) considerations.
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<th>Destination</th>
<th>Description</th>
<th>Representative strategies</th>
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| Aggregator  | The Aggregator combines scale and deep internal integration to achieve a durable unit cost advantage versus peers | • Seeks to operate profitability at or below Medicare reimbursement by reducing unit costs by using economies of scale and ‘system-ness’ as primary strategic levers  
• Reinforces scale / cost advantage through aggressive narrow or concentric network strategies with select insurance providers and purchasers  
• Launches distinctive corporate services ‘products’ that can be offered to affiliates to augment existing scale (e.g., supply chain / purchasing management, IT services, etc.)  
• Regionalizes the delivery of specific bundles, where possible  
• Creates internal competencies to establish and share industry-leading methods for achieving efficiencies |
| Health manager | The Health Manager achieves cost leadership by leveraging capabilities in clinical and technology integration to reduce utilization and achieve significant reductions in clinical variation. | • Develops infrastructure to provide customized health and care management across ambulatory, acute and post-acute settings  
• Uses informatics and customer analytics to assess individual risk, identify personalized treatment options, and predict outcomes  
• Leverages technology to place consumers in the ‘driver’s seat’; provide mobile access to virtual care plans, records, and self-service  
• Exploits expertise in managing utilization and cost by aggressively assuming performance risk |
| Innovator | The Innovator achieves market recognition for delivering high-quality outcomes differentiated by exceptionally higher quality and improved experience to extract leading reimbursement and draw patients from a broad geographic area | • Achieves incrementally higher reimbursement through market recognition as a ‘leading product’ provider  
• Launches a focused unit to disrupt existing care practices, focusing on identifying demonstrably improved outcomes  
• Enhances environment for development and delivery of innovative health care services  
• Use outcomes-based payments for physicians to align incentives to reward excellence in clinical care  
• Sets a defined annual target for innovation investments  
• Develops infrastructure to achieve and maintain ‘magnet’ status for innovative procedures  
• Leverages status to develop preferred contracts with managed care organizations and potential retail offering |
| Diversifier | The Diversifier extends its brand strength and capabilities into adjacent and new lines of business to supplement declining margins within core services | • Achieves revenue growth in high margin, lines of business through the monetization of assets/ capabilities and penetration of adjacent lifestyle and wellness spending by consumers  
• Monetizes capabilities to pursue institutional market opportunities (e.g. sale of shared service capabilities to other providers)  
• Leverages existing brand, reputation and consumer relationships to extend into adjacent products and services, such as:  
  – Capitalizes on customer segments seeking enhanced personalization, service, or convenience (e.g., ‘Gold Card’ service)  
  – Diversifies focus into retail health products to capture greater health spend (e.g., complementary and alternative medicine)  
  – Develops a ‘plug and play’ structure to enable partners to easily access the organization’s consumers (e.g., for growth, licensing, etc.) |
Strategic differentiation is an evolving journey

Picking an appropriate starting point can be a difficult decision for many health systems. The Innovator and Aggregator destination are likely initial destinations for the vast majority of hospitals and health systems as they each seek to build from an operating model where the greatest near-term financial incentives exist. Both the Innovator and Aggregator strategic archetypes offer a logical ‘jumping off point’ for eventual transition to the emerging Health Manager and Diversifier destinations which are likely to be more widely incented over the next several years.

While the opportunity exists in the 5-7 year planning horizon to create strategic differentiation through unit cost advantage (The Aggregator), a ‘leading product’ revenue advantage (The Innovator) or even through enhance demand management (The Health Manager), the underlying economic fundamentals of reimbursement for hospitals and health systems are likely to become so constrained as to point towards revenue diversification (The Diversifier) as a primary long-term strategic path.

Over time, hospitals and health systems may have no choice but to look toward other adjacent businesses to balance margins and replenish capital in a sustainable way.

While signs point to the Diversifier as a strategic end-game for many hospitals and health systems, leading organizations may be in a position to differentiate within the Diversifier space by monetizing capabilities/relationships they have developed along the path of strategic maturity:

- The Aggregator could diversify through resale of the shared service capabilities they have organized and honed
- The Innovator could monetize its market recognition as ‘leading product’ provider through brand licensing and commercialization of intellectual property
- The Health Manager could complement core ‘health care’ services with adjacent lifestyle and wellness services which allow access to greater share of consumer spend

Figure 4

Single point of entry – Providers should make a clear choice on where to focus limited energy and resources

Destination or journey? Profitability limits will likely encourage organizations to adopt new capabilities and evolve their approach over time

Trend to diversification – As reimbursement pressure continues, providers may need to diversify to support reinvestment in core operations
While many hospitals and health systems would appear to fit the mold of one of the Strategic Destinations today, a deeper examination is required to evaluate whether true differentiation has been achieved as there are likely many ‘false positives’ in the current market.

**Sample false positive: The academic medical center as an innovator**

Many academic medical centers and teaching hospitals would claim the role as “Innovator” in their market. However, it is important to note that simply performing research or teaching does not automatically qualify a hospital or health system as an Innovator. Over time, Innovators can command a market premium by demonstrating ‘leading product’ differentiation from their peers. Analysis of publicly available cost and quality information suggests that many of the top 20 academic medical centers are delivering only median quality despite being more expensive (see Figure 5).²

It is unlikely that in the future purchasers will continue to pay a premium for services where only median performance is demonstrated. The access to clinical research and teaching could very well provide an academic medical center with a head start on seizing the Innovator position in their market, but value should be demonstrated through differentiated results in order to extend their current revenue premium over time.

![Figure 5. Innovators – Are academics better able to improve the relationship between cost and quality?](image-url)

2 Academic Medical Center (AMC) Facilities subset based on US News & World Report 2010 and 2011 ‘Honor Roll’, community-based hospital peers selected based on bed size, case mix, and mix of inpatient / outpatient services, Data reported from 2009 Medicare Cost Report information reported from DataAdvantage
Sample false positive: The multi-hospital system as an aggregator

Consolidation of hospital assets into a system does not, on its own, qualify a provider as an Aggregator. It is the deep integration of assets to create a unit cost advantage which creates strategic differentiation. Many large health systems have failed to deliver on the promise of scale, only delivering incrementally better cost per unit relative to stand alone hospitals or smaller systems. Between 2007 and 2009 only 8 of the largest 22 health systems were able to reduce their cost on a unit of service basis.

The remaining systems saw their costs increase, with 10 of the 22 actually increasing costs at a faster rate than the consumer price index (see Figure 6).¹

An important consideration for Aggregators will likely be increasing the value created by scale through deep integration. In fact, smaller systems may be in a better position to reduce variation and excess cost than multi-market systems. Only those systems that drive deep clinical and administrative integration to strip out costs may enjoy the benefits of being an Aggregator in the future.

Figure 6

Aggregators – How many large systems are able to constrain cost inflation at or below CPI?

3 Systems selected from US News & World Report 2011 & 2010 Honor Rolls and Modern Healthcare 2009 & 2010 List of Largest Health Systems, Data sourced from provider annual reports and audited financial statements
Where to start

Some of the Strategic Destinations are more likely to make sense for some health systems versus others. So how should a hospital or health system narrow its focus and arrive at a preferred strategic path? A good place to start the evaluation process is to understand how each destination compares to existing capabilities. Said another way, a health system should start navigating towards a destination that leverages its core strengths and capabilities.

For example it would be unlikely that a small regional provider would be effective pursuing the Aggregator destination due to its current lack of scale. Similarly, a large regional health system without a track record of research or new project development might struggle in achieving the Innovation destination.

Beyond proximity to current capabilities, there are a number of steps providers should take as they begin to explore paths for strategic differentiation. Reflecting on the following considerations should help providers further narrow their options and get started on the path to sustainability:

Selecting the suitable path for strategic differentiation

1. Reflect on your purpose – Understand who you are, what is central to your mission and vision? Your strategic differentiation journey may be more effective if aligned with the core of who you are and where you have passion.

2. Look around – Examine your local market. How are the existing players positioned and how do you expect them to be positioned going forward? The last thing you want is to replicate your competitor’s strategy.

3. Check the coffers – Evaluate your capital position. Do you have access to sufficient capital? Pursuing a destination will likely require investments to develop strategic capabilities.

4. Find friends – Assess potential strategic relationships. Who is available and a good fit? Consider how alliances with payers, and non-traditional industry players could accelerate your journey and strengthen your position.

5. Make a plan – Develop a concrete roadmap. What is the logical first, second step? What comes three and five years down the road and how will you define success? Pursuing strategic differentiation while keeping the lights on requires a clear path and accountability amongst stakeholders.

What if none of the destinations seem to fit?
If it turns out that none of the primary Strategic Destinations is a good fit, or chances of attaining it are slim given your starting point, then leadership should consider one of two options:

1. Align or join with other health systems that are well positioned to achieve one of the other primary destinations, or…

2. Proactively scale back the footprint of the organization to reduce future financial and operating risk. Organizations can achieve this focused market role by positioning themselves as a “Connector” (see Table 2)

Table 2

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<tr>
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| The connector | - The Connector delivers a very narrow set of community-based services and directs patients to a more appropriate site of care for other services through a network of affiliated high-value providers thereby limiting their exposure to financial/operational risk  
- For other services, the Connector develops a regional delivery network of ambulatory, tertiary, quaternary and post-acute care partners based on quality, cost, and proximity  
- The Connector works with preferred network partners to create ‘frictionless’ connections  
- Develop virtual care collaborations where possible (e.g., administration of TPA for stroke, neuro-telemedicine consults, etc.)  
- For others, develop expedited transfers (to/from partners) with appropriate health information  
- The Connector leverages regional network partners for efficient access to resources such as technology, purchasing, and performance improvement |

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Final thoughts

While it may seem premature or even risky to begin planning for a future that is uncertain, the greater risk is failing to take decisive action now. Large strategic transformations can take years to fully achieve. Starting the process now can allow you to have a plan in place to address a future that will come into greater focus over time. Careful planning is needed to ensure the strategy takes local market considerations, competition and an organization’s capabilities into consideration.
Key contacts

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