4sighthealth imagine better healthcare

Oct 7, 2015

Calm Before the Storm? Rating Agencies Lift Negative Industry Outlooks

David Johnson, CEO

Market Corner Commentary for October 7, 2015

Summer was good to health companies. Many have never been stronger. On August 26th, Moody's revised its not-for-profit healthcare outlook to stable from negative where it's been since 2008. Two weeks later, Standard & Poor's followed suit by raising its sector outlook to stable from negative. Only Fitch maintains a negative industry outlook.

So far, the Affordable Care Act (ACA) and industry consolidation have benefited health systems. Driven by Medicaid expansion, volumes are up. Bad debt is down. Cash positions are stronger. Rating upgrades are outpacing downgrades. Movement away from fee-for-service payment has been slower than expected. Cash-flow is strong. Investment in new facilities is increasing.

The financial ratios speak for themselves. The rating agencies had little choice, but to reflect this positive performance news in their industry evaluations.

Does this mean the worst is over and health companies can return to business as usual? Hardly. The value "genie" is out of the bottle and its onslaught against fragmentation, waste and inefficiency continues.

Rating Agency Forecasting Limits

Unlike equity analysts, not-for-profit healthcare analysts evaluate debt repayment ability, not long-term organizational viability. Their assessment processes are disciplined, incremental and metric-oriented. Their forecasts have time horizons. Both Moody's and S&P stressed their outlooks reflect anticipated performance through 2016 and not beyond.

Rating agencies excel at assessing stable industries. Their credit review mechanics can falter when new competitors and new business models disrupt industry incumbents. The intensity of fundamental change overwhelms the reliability of fundamental analysis. Operating losses can deplete cash reserves quickly. Ratings can fall with little warning.

While recognizing the sector's current strength, rating agencies continually monitor demand for health company services. When appropriate, they revise their opinions to reflect changing market dynamics. That's just it. Rating agencies adjust "opinions" when they receive actionable information. They do not "front-run".

Mission Accomplished?

Premature declarations of victory deflate organizational will for change and reinforce outdated business practices.

This is a dangerous moment for health

companies. Improved performance reduces pressure to attack entrenched cultures that emphasize treatment volume and revenue growth over outcomes and constant process improvement.

In The Road Ahead, Bill Gates made the following observation,

"We always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten. Don't let yourself be lulled into inaction."

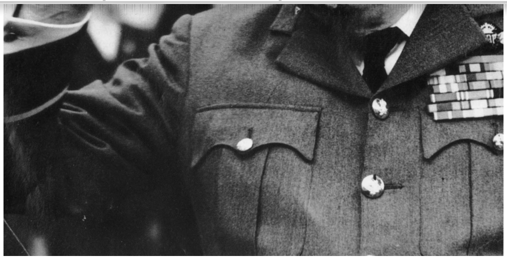
It's clear that governments are driving toward value-based payment through bundles, Medicare Advantage, Medicaid managed care and readmission penalties. It's clear that influential companies like General Electric, Walmart, Boeing and Intel are redefining how employers pay for healthcare services. It's clear that "smart" private equity and venture investors are moving into provider-based services. They are funding companies that deliver better, more convenient and lower-priced healthcare services. It's clear that consumers are making more healthcare purchasing decisions. It's also clear that prices increasingly matter in healthcare purchasing.

These trends will establish themselves and reward value-based service providers – perhaps not in two years, but certainly within ten.

Unlike the rating agencies, health companies cannot wait for market trends to clarify. They must adapt to market forces in real time to remain competitive. Leadership, strategic clarity and execution will differentiate winning companies in post-reform healthcare.

The Gathering Storm

Winston Churchill became Great Britain's Prime Minister in May, 1940 as German tanks rolled through northern Europe. War was coming to British soil. Over the next month, Churchill gave three remarkable speeches to prepare England for a merciless air war with Germany.



These "Never Surrender" speeches galvanized the country, invigorated England's people and prepared them for the difficult times ahead. Each speech's theme relates to the transformational challenge confronting American healthcare:

- In the first speech on May 13th, Churchill offered nothing "but blood, toil, tears and sweat" to confront the looming Nazi menace. He concluded there would be no survival without victory. Moving to better, more affordable and convenient care delivery is not a choice. Health companies that make the transition will win and survive.

- Churchill gave his second speech on June 4th as France was falling to Germany. With eloquence and purpose, Churchill prepared the English people for the approaching war. He never wavered, "We shall fight them on the beaches…we shall fight in the fields and in the streets…we shall never surrender." In every American community, the "value" fight (best outcomes at lowest prices) requires the same singular dedication within hospitals, clinics and physician offices.

- Churchill gave the final speech on June 18th as France surrendered to Germany. With war now imminent, Churchill reminded England of its strengths, magnificent history and commitment to freedom. Through intense resolve, vigilance and exertion, England would emerge victorious. History would acknowledge "This was their finest hour". For the good of the country, healthcare must deliver greater value and stop stealing resources from other national priorities, including education, infrastructure and social services. Those that accomplish this will be heroes. The many will owe them much.

Moving to Higher Ground: Mt. Sinai Takes a Stand

On July 19th, Mount Sinai Health System launched a remarkable advertising campaign that centers Mount Sinai's future in population

health, convenient access and community health.

Mt. Sinai's vision is bold. Achieving this vision will require Mt. Sinai to balance its population health strategies with its ongoing teaching, research and clinical commitments.

This will not be easy; yet, this combined strategy is Mt. Sinai's best alternative. They've embraced the existential challenge of making their organization relevant in a "value-driven" healthcare marketplace. We admire Mt. Sinai's courage and moxie. We wish them well.

Healthcare's Finest Hour

Like Britain in the spring of 1940, health systems confront an uncertain future. The near-term uptick in financial performances masks the real threat population health presents to acute medicine. As better care management emerges, it will drain volume, revenues and customers from traditional acute facilities. Health systems must adapt.

The best strategic option for health systems is to dig deep, accept the daunting realities and fight to establish winning positions in post-reform healthcare.

Society's demands for better, more affordable healthcare are at war with powerful incumbents' desire to keep the status quo intact. Incumbents are fighting with everything they've got to retain their privileged (and profitable) positions. Healthcare's heroes will be the companies that disrupt current business practices and deliver better outcomes at lower prices.

For those pursing better, affordable healthcare for all Americans, Winston Churchill has this advice, "Never, ever ever ever ever give up."

A version of this commentary appeared in "Academy 360" on October 1st

Subscribe

Achived Commentaries

David Johnson

David Johnson is the CEO of 4sight Health, a boutique healthcare advisory and investment firm. Dave is a frequent writer and speaker on market-driven healthcare reform. His expertise encompasses health policy, academic medicine, economics, statistics, behavioral finance, disruptive innovation, organizational change and complexity theory. Dave's forthcoming book, Market vs. Medicine: America's Epic Fight for Better, Affordable Healthcare, will publish in early 2016.

4sight Health is a healthcare boutique specializing in thought capital, strategic advisory services and venture investing/capital raising. 4sight Health operates at the intersection of healthcare economics, strategy and capital formation. The company's 4-stage analytic (Assess. Align. Adapt. Advance.) reflects the bottom-up, evolutionary character of market-driven reform.

Follow on Twitter Friend on Facebook Forward to Friend
Sign up for our list!