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Value Rules:
Playbook for Post-Reform Healthcare

Market Corner Commentary
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By David W. Johnson

Warren Buffett famously noted that *"price is what you pay and value is what you get."* In fee-for-service medicine, price and value never correlate. Payments to hospitals, doctors and pharmaceutical companies reflect complex reimbursement formularies, not straight-forward supply-demand relationships. Value is ephemeral. Or worse.

The United States achieves one of the world's highest living standards despite a high-cost, inefficient and acute-centric delivery system, riddled with perverse incentives, sub-optimal resource utilization and uneven performance. Americans pay too much for healthcare and receive too little. Overall value is negative.

After fifty-plus years of activity-based payment and excessive medical inflation, American governments, businesses and people want more from healthcare providers. They want better outcomes at lower prices. They want greater access and more convenience. They want medical services tailored to individual needs and preferences. They want value.

The fee-for-service playbook still has life, but it cannot win in post-reform healthcare. Incumbents must develop value-based business models with new playbooks. This isn't easy, but providers have no other choice if they want to maintain relevance. As Buffett notes, *"Chains of habit are too light to be felt until they're too heavy to be broken."*

SHIFTING LANDSCAPE: THIS TIME IS DIFFERENT

Recent healthcare performance indicators suggest a return to normalcy after turbulence created by the Affordable Care Act. More people are accessing the system. Demographic trends suggest accelerating demand for acute services.

Hospital employment, profitability and facility construction are on the rise. After years of quiescence, medical inflation is back and pushing the nation's healthcare costs ever higher.

While health systems have never been stronger, they confront an uncertain future. Below the surface, the following forces are mobilizing to drive U.S. healthcare toward value-based delivery:

- **Shrinking Governmental Fee-for-Service Payment:** Medicare's decision to employ "bundled payments" for joint replacement surgeries heralds the arrival of value-based payment for routine surgical procedures. Expect payment for routine cardiology, urology and oncology procedures to shift to bundles. Beyond bundles, Congressional payment reform will dramatically reduce fee-for-service payment to physicians over time. Likewise, state governments are experimenting with expansive risk-based payment models. Meanwhile, Medicare Advantage and Medicaid managed care continue to grow membership and shift care responsibility to private insurers.

- **Enlightened Self-Insured Employers:** historically passive, self-insured employers are becoming more discerning purchasers of healthcare services. Iconic corporations, such as Boeing, GE, Intel and Walmart, are contracting directly with providers for outcomes-based care delivery with transparent pricing. Others are shifting employees to into high-deductible health plans, private exchanges and public exchanges.

- **Engaged Consumers:** with more healthcare purchasing alternatives and expanding use of high-deductible health plans, individual consumers are becoming price-sensitive purchasers of healthcare services. Better information regarding prices, outcomes and service performance position consumers to reward value-based providers.

- **"Smart Money" Investment:** increasing levels of private equity and venture investment are pouring into healthcare services and provider-based services. Inefficiencies in healthcare delivery present a target-rich marketplace for companies delivering or enabling better healthcare at lower prices in more convenient venues.

VALUE RULES

Enlightened health systems are embracing value-based service delivery to prosper in post-reform healthcare. It will take years of focused effort to overturn entrenched business models and "heads-in-the-beds" operating cultures.

The new post-reform "playbook" has the following five "Value Rules:"

Rule #1. Quality is "Job 1": Trying to overcome a "planned obsolescence" managerial mindset and respond to voracious Japanese competition, Ford Motor Company launched its "Quality is Job 1" campaign in the early 1980s, transformed operations, started building great cars again and turned the company around.

By definition, there can only be one "Job 1". Health companies that don't give quality primacy can never hit targeted quality, safety and outcomes metrics. Left unopposed, the energy generated from optimizing revenues (Job 1 at most health systems) overwhelms well-meaning quality initiatives. There is no wiggle room in pursuing quality.

Rule #2. Care Episodes, Not Treatment Codes: As more care becomes routine (episodic with high outcome certainty), customer assessment of quality shifts to price, convenience and customer experience. Most treatments, even surgical procedures, are increasingly routine and potentially vulnerable to commodity pricing from retail competitors (see chart below).

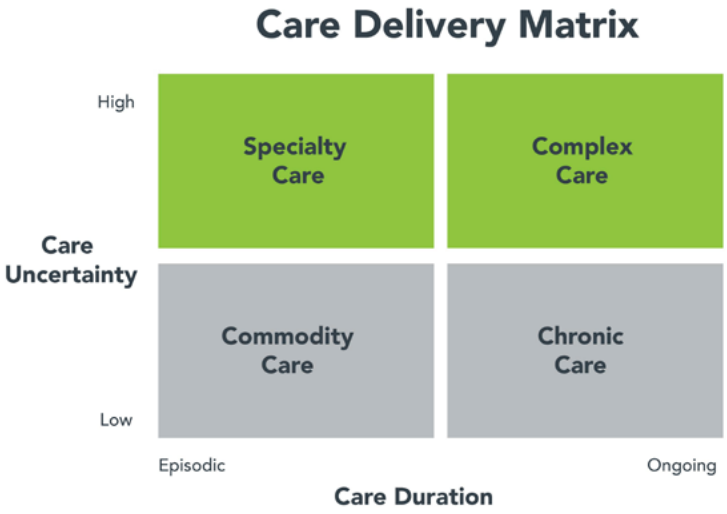
Piecemeal treatment activity is the principal revenue driver for hospitals and doctors. As delivery migrates toward value, entire "care episodes" will emerge as the logical units of outcome measurement and payment. Providers will "bundle" all pre-acute, acute and post-acute activity into single cohesive treatment regimens that incorporate relevant clinical, operational and financial data.

Reducing performance and pricing variation, particularly in post-acute, care will differentiate high-performing health systems.

Rule #3. Price Matters: Third-party reimbursement for treatment activity has protected providers from traditional market forces governing supply and demand. Increasing transparency regarding treatment outcomes and prices is reshaping market dynamics.

When reimbursement payments are higher than market prices for routine treatments, it creates opportunities for independent entities to disintermediate tradition provider-patient relationships. Overtime, market forces will drive payments for routine care to lower price points.

Expect value-driven behavior to shape pricing and service delivery for insurance products, diagnostic procedures and routine treatments. Using programs like SmartShoppers, employers offer payment incentives to direct employees to lower-cost, high quality treatment centers.



Rule #4: Data is as Data Does: Data informs decision-making when metrics and analytics support desired outcomes. Providers have excellent data for measuring treatment volume, payment flow and revenue optimization. Unfortunately, health systems have not developed effective metrics and analytics for optimizing care management and outcomes.

As "Big Data" evolves, precision searching of massive data sets informed by cutting-edge analytics will give external reviewers the ability to assess and rank health system performance. For better or worse, every provider and procedure will have a score.

The race is on. Data must support quality and cost-effective delivery. Health companies that advance value-based care delivery will develop enhanced data capabilities, earn external praise and gain market share. Paraphrasing Buffett, "Time is the friend of value-driven companies and the enemy of revenue-driven ones."

Rule #5: It's the Customer, Stupid! As the healthcare marketplace becomes more "individualized", consumers will exercise more control over medical decision-making. Unleashed, consumers become value-seeking machines, rewarding companies that offer more selection, lower prices, greater convenience and better customer experience.

Businesses exist to serve customers in healthcare as well as every other industry. Beyond providing appropriate care, health companies must engage customers through shared medical decision-making and offer meaningful second opinions. Health companies that help customers navigate healthcare's complex pathways will earn their loyalty.

Providers have executed transactions for decades with little customer involvement. As healthcare becomes more consumer-centric, health companies must connect with customers, listen to their concerns and tailor their services to individual needs. A good marketing campaign isn't sufficient. Rhetoric and performance must align or valuable customers will seek care services elsewhere.

LAUNCHING "THE VALUE CYCLE"

Health systems are not the only companies scrambling to reinvent themselves as healthcare moves toward value-based delivery. Companies that provide consulting, management and outsourcing services are reorienting their product lines to offer solutions that advance care design, effectiveness and efficiency.

During the last year, Craneware has reengineered its product mix to provide solutions for health systems that enhance value-based delivery.

The result is "The Value Cycle." Through The Value Cycle, Craneware has identified the essential clinical, operational and financial assets that health systems must employ to deliver quality patient outcomes and achieve optimal financial performance.

For Craneware to succeed, the company's solutions must become essential components within larger ecosystems that discover, convert and optimize value potential. Craneware wins when health companies and their patients/customers win.

THE ORACLE SPEAKS

Warren Buffett is affectionately recognized as the "Oracle of Omaha." Buffett's common sense, value-focused approach toward investment has generated enormous wealth and returns for his shareholders.

Buffett once observed, "Only when the tide goes out do you discover who's been swimming naked."Real value in healthcare delivery is delivering the best outcomes at the lowest prices.

As the fee-for-service tide recedes, America will discover which health companies are prepared for the value-driven demands of the post-reform marketplace.

Winning health companies will employ a new playbook that emphasizes quality, embraces transparency, optimizes performance and, most importantly, embraces customers. Health companies that follow the value rules will rule their markets.

AUTHORS

David Johnson is the CEO of 4sight Health, a thought leadership and advisory company working at the intersection of strategy, economics, innovation and capital formation. Dave wakes up every morning trying to fix America's broken healthcare system. Prior to founding 4sight Health in 2014, Dave had a long and successful career in healthcare investment banking. He is a graduate of Colgate University and earned a Masters in Public Policy from Harvard Kennedy School. Employing his knowledge and experience in health policy, economics, statistics, behavioral finance, disruptive innovation, organizational change and complexity theory, Dave writes and speaks on pro-market healthcare reform. His first book ***Market vs. Medicine: America's Epic Fight for Better, Affordable Healthcare***, and his second book, ***The Customer Revolution in Healthcare: Delivering Kinder, Smarter, Affordable Care for All*** (McGraw-Hill 2019), are available for purchase on www.4sighthealth.com. His third book, ***Less Healthcare, More Health: The Prescription for a Happier, More Equitable and Productive America***, will publish in 2024.