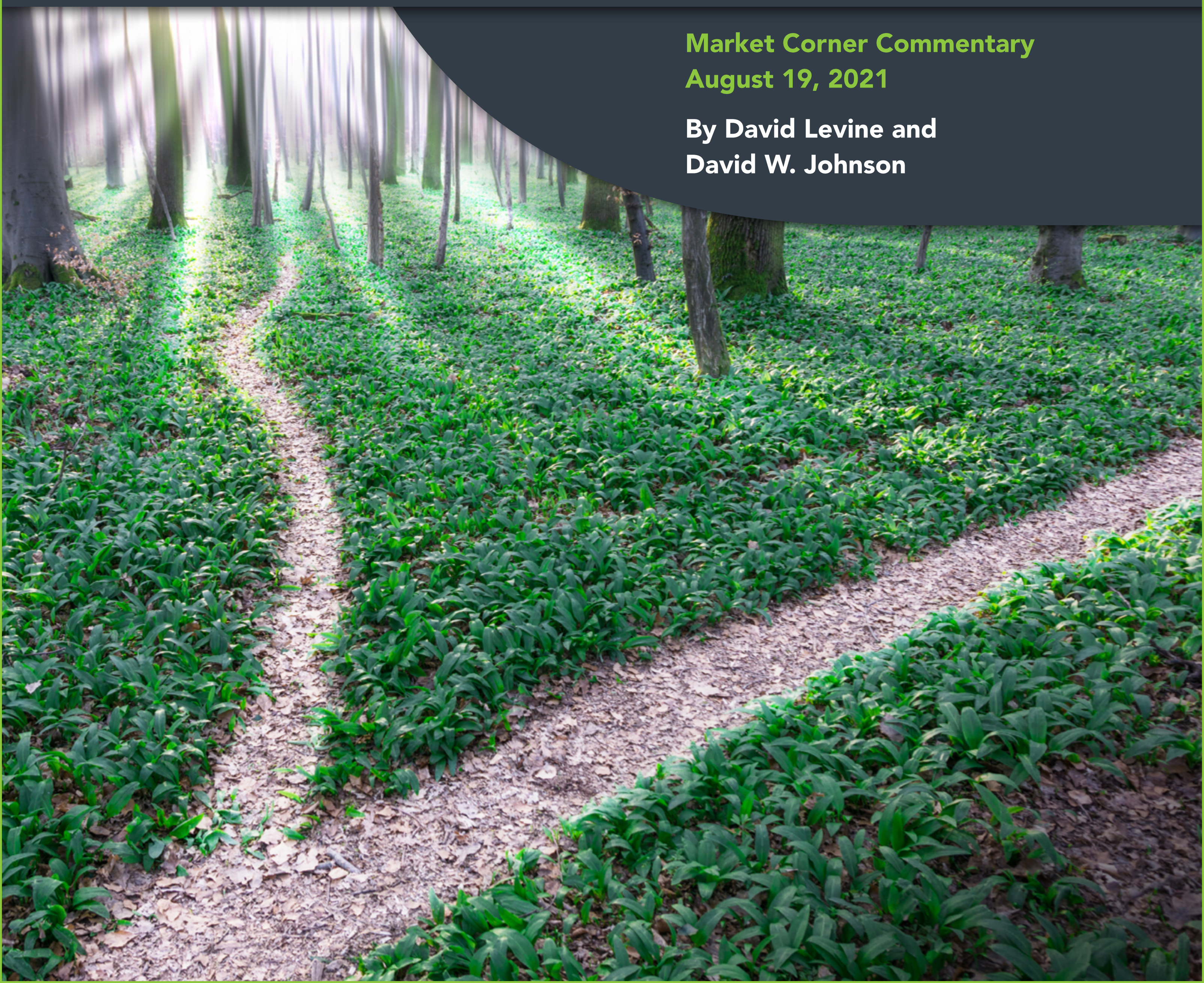
All Roads Lead to Value (Part 1)

Which Road(s) Should a Health System Take?



Market Corner Commentary
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[Readers' Note: This is the first of four articles on the transition to value-based care models for hospitals and health systems. Risk-based (also known as value-based) payment models, pro-market regulations, new competitors, technology advances and rising consumerism are combining to place enormous pressure on the healthcare industry to deliver better outcomes at lower costs with better customer experience. This article examines how innovative hospitals and systems are adapting their business models to succeed in a value-based environment.]

"All roads lead to Rome" became a popular maxim in the Middle Ages, centuries after the Western Roman Empire had fallen. In modern vernacular, the phrase communicates the overpowering centrality of an enduring idea or inevitable solution. In U.S. healthcare, those roads are changing.

For much of the last sixty years, the medical profession has struggled to balance its mission to provide appropriate care with the business imperative to optimize revenues and profits. Fee-for-service medicine (FFS), entrenched in the Medicare and Medicaid Act of 1965, became the central organizing principle for much of healthcare. All roads led that way.

Today, the concept of value is emerging as the new organizing imperative for engaging consumers, allocating resources and achieving desired outcomes. In that respect, 2020 may represent an inflection point for hospitals. The COVID pandemic dramatically reduced their ability to conduct elective surgeries, the core generator of hospital revenues and profits. If not for emergency funding from the federal government, many hospitals and provider organizations reliant on FFS reimbursement might have faced bankruptcy or severe financial distress.

As hospitals embraced virtual care delivery models to accommodate for lost volume, COVID also altered consumer expectations and further accelerated the migration toward value-based care delivery. Consequently, many health systems are now pursuing risked-based contracts with major payers, enhanced patient engagement strategies and tech-based solutions to position themselves for an increasingly competitive and consumer-driven healthcare marketplace.

In this article, the first in our series, we explore the different approaches that innovative health systems are taking on the road to value.

VARYING HOSPITAL PERFORMANCE DURING COVID

When the COVID-19 pandemic arrived, patient intake volumes plummeted, and hospitals and ambulatory clinics paused elective surgeries. This devastated independent physician groups[1] and threatened many hospitals with staggering revenue declines.[2]

Starting in May 2020, the Department of Health and Human Services began distributing $178 billion in grants to healthcare providers allotted through the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the Paycheck Protection Program and the Health Care Enhancement Act.[3]

While almost all health systems accepted the federal money, providers with diversified revenue streams, and, in particular, those receiving premium revenue from owned health plans reported stronger financial performance. Cain Brothers contrasted the financial performance of traditional tax-exempt hospitals and health systems versus vertically-integrated tax-exempt health systems (i.e., those with health plan arms) during 2020, with and without CARES Act funding.

Traditional providers generated revenue-weighted average operating EBIDA margins of approximately 7.5% in the year 2020, according to Cain Brothers' analysis. In contrast, health systems with insurance companies generated weighted average EBIDA margins of just under 7%. Those operating margins fell by 5% and 2% respectively when subtracting CARES funding. This resulted in net margins of 2.5% for traditional providers and 5% for vertically integrated providers.

In other words, all hospitals experienced lower margins during the pandemic, but the business models for vertically integrated providers proved to be more durable. This makes sense. Under capitated payment arrangements, providers that own the premium dollars generate higher margins.

Commercial insurers experienced a similar boost in profits due to the reduced claim volume. Notably, United Health reported record earnings in 2020.[4] Likewise, digital technology companies, especially telehealth providers, flourished as providers scrambled to deliver care remotely and engage with patients under social distancing guidelines.

In addition to their financial strength, value-based providers exhibited greater flexibility in adapting their service offerings to meet the rapidly changing needs of their patients. Proactive organizations quickly transitioned from clinic-based services to provide in-home meals, frequent check-ins, and administer personal testing and vaccination services.[5, 6]

2020 was also notable for its high volume of healthcare investment activity. Although investors effectively paused most dealmaking at the beginning of the pandemic, capital flows resumed quickly and achieved record levels.

The most notable transactions (including IPOs, acquisitions and consolidations) supported strategies aimed at value-based care delivery and consumerism. Valuations of companies addressing value-based care and consumer priorities exceeded expectations and, indeed, achieved levels never before seen in the healthcare industry. An obvious conclusion is that investors and private equity sponsors see more potential for long-term growth in consumer-focused markets and value-based care business models. They recognize arbitrage opportunities in capturing the savings from keeping people healthy and providing care, when needed, outside the hospital setting.[7]

As value entrenches itself within the healthcare ecosystem, routine services shift from high-cost acute settings toward high-volume, low-cost centers. Preventive, chronic disease management, mental health and wellness services also benefit. These trends reflect a shifting market preference for rewarding providers that both deliver better outcomes at lower costs and prevent unnecessary utilization.

HOSPITAL REPOSITIONING

Confronting an increasingly difficult market environment, hospitals are struggling to define their role within a value-based healthcare system. Clearly, hospitals remain critical for essential services, including emergency care, higher acuity and specialized care, and some surgeries. Routine services, however, are vulnerable to nontraditional competitors that offer lower prices, more convenience and better customer service.

The following five strategies represent emerging approaches that health systems are undertaking to improve their competitive positioning.

1 Consolidate Regionally to Increase Operational Efficiency and Scale

With 186 hospitals and 2,000 ambulatory care sites across 20 states and the U.K., HCA Healthcare is among the nation's most efficient hospital operators. Contrary to almost all other traditional providers, HCA operated profitably during COVID and returned its CARES Act funding.[8]

HCA exits markets where it lacks sufficient scale to compete effectively. In early May 2021, it sold four hospitals to Atlanta-based Piedmont Healthcare.[9] A few weeks later, HCA sold another hospital in Georgia to Florida-based AdventHealth.[10]

Piedmont Healthcare bought the HCA hospitals to increase its presence in the Georgia marketplace. It currently operates 11 hospitals, 35 urgent care centers, 25 retail pharmacy care locations and 555 physician practices in Georgia. Piedmont also purchased Georgia's second-oldest hospital, located in Augusta.[11] It plans to invest $1 billion into facilities, IT, clinical infrastructure and operations over the next ten years.[12]

Greater regional scale increases health Piedmont's capacity to undertake and manage risk-based contracts.

2 Develop Insurance Capability to Manage Risk Contracting

Health systems are pursuing multiple strategies to increase their ability to engage in risk-based contracting. Health systems that own health plans can expand their insurance footprint through acquisitions. In May 2019, for example, Sentara Healthcare became the majority owner of VCU Health System's Virginia Premier, a largely Medicaid-focused health plan with nearly 300,000 members.[13]

Other health systems are entering the health plan space by partnering with health insurers in their regional markets. **Cone Health,** based in Greensboro, NC, launched a Medicare Advantage plan called **HealthTeam Advantage** in 2016.[14] **UMass Memorial Health**, based in Worcester, MA, announced in May 2021 that it is launching its own health insurance company, **Central Mass Health**.[15] In 2020, **Duke University Health System** and **Blue Cross and Blue Shield of North Carolina** jointly created a Medicare Advantage plan named **Experience Health**[16], and **Montefiore Health System** launched a co-branded Medicare Advantage plan with **Oscar Health** in New York.[17]

3 Enhance Consumerism through Strategic Partnerships

Non-core hospital services are increasingly vulnerable to competition from specialized, retail-savvy, consumer-focused businesses that can operate at lower costs with greater convenience and service.

In response, health systems are building out their service platforms through strategic partnerships. Such partnerships supply the expertise, savvy customer knowledge and operational excellence that hospitals cannot match. Opportunities for these types of strategic partnerships exist in home care, telehealth, urgent care and primary care, among other non-core services.

This strategic approach enables health systems to assemble the right configuration of capabilities to meet market demands for convenient high-value service delivery. The best health systems link these platform capabilities within integrated networks to offer consumers a more seamless experience. Examples include:[18]

- Minnesota-based **MHealth Fairview** established a joint venture in November 2020 with AccentCare, a post-acute care operator. **AccentCare** assumed ownership and operational responsibility for MHealth Fairview's home care and hospice assets. This transaction provided vital investment capital for other high-priority initiatives while enabling the system to offer high value post-acute care services through AccentCare.

- **Trinity Health** acquired a controlling interest in **Premier Health**, an urgent care operator, in March 2021. The acquisition increases access points for Trinity Health's services while growing its portfolio of urgent care centers. Trinity patients benefit from convenience and customer service.

- **Advocate Aurora Health** formed **Advocate Aurora Enterprises** to invest in service lines that go beyond traditional care delivery and help position the health system to compete on value. The system has invested in **Foodsmart**, a nutrition telehealth platform, which focuses on promoting healthy eating habits through personalized recipes, grocery discounts and nutrition guidance.[19] More recently, Advocate Aurora acquired **Senior Helpers**, an in-home care company that provides specialized and companion care to seniors.[20]

4 Build a Powerful Consumer Brand and Aligned Platform

Consumer businesses understand their brands communicate their organizational identity, personality and promise to existing and potential customers. At their most effective, brands are consistent and seamless across all touch points.

Lacking consumer experience, most hospitals rely on their legacy community relationships as a proxy for brand. This makes hospitals vulnerable to brand-savvy competitors.

Unique among health systems, **Cleveland Clinic** has established a global "patients first" brand that emphasizes the application of its clinical expertise in providing complex care solutions. The brand and aligned platform welcome patients and helps them navigate to find the care solutions they desire.

Cleveland Clinic's brand identity combines quality outcomes with high-touch consumer experience. All Cleveland Clinic employees receive training that emphasizes the importance of courtesy, compassion, and listening.

Cleveland Clinic employees treat patients like guests, both in-person and virtually. Emphasizing their all-encompassing commitment, Cleveland Clinic has designed their facilities and online platforms to be welcoming, pleasant and open. They also engage strategic partners and integrate their services seamlessly into their offerings.

In 2021, Cleveland Clinic and **Amwell**, the Boston-based telemedicine company, launched their second joint venture, **The Clinic**, which offers virtual medical second opinions.[21] The interface facilitates easy consumer access to Cleveland Clinic expertise. Behind the scenes, clinicians integrate tests, data, and clinical knowledge to improve decisions and outcomes while lowering costs.

5 Establish Segment Expertise

Many traditional hospitals still strive to be all things to all patients in their regions. The continued growth of digital technologies in healthcare, brand and platform companies make it easier for consumers to choose specific providers based on service, convenience, price and quality. In response to this market trend, some health systems aim to be "best in class" within specific market segments.

Houston-based **MD Anderson** focuses exclusively on cancer research and treatment. While growing its footprint through new facilities in Texas, MD Anderson has expanded its nationwide market reach through partnerships with other health systems and physician groups.

The Hospital for Specialty Surgery in New York has built a gold-plated reputation for providing traumatic care for bone injuries and joint replacements. While it has affiliations with regional health systems, the Hospital markets itself as the destination for expert orthopedic care. It also offers second opinions to patients worldwide, in partnership with **Grand Rounds**.[22]

CONCLUSION: RISE AND SUCCEED

Rome was not built in a day. It did not fall in one either. It took centuries and a series of maladaptive decisions to expose vulnerabilities and accelerate decline.

Similarly, American health systems have become increasingly vulnerable to market-based competition. Still central to community-based care, many face daunting pressure in meeting value-based demands for routine service delivery while managing an increasingly intensive patient mix. The decline and fall of traditional health systems is not inevitable, but they must develop strategies that create value for consumers or risk that fate.

More of the same FFS business practices will generate more of the same high-cost, consumer unfriendly services offerings. Those that cling to FFS payment models and fail to adapt to value-based care delivery will struggle to survive. Changing market dynamics during COVID have accelerated that day of reckoning.

Evolution is both possible and necessary. The five options described in this paper are not comprehensive, nor do they represent the only roads to success and migration to value-based care strategies. They are, however, examples of ways in which innovative health systems are adapting to post-COVID market realities. Winning health systems will engage consumers, build strong brands and deliver the right care at the right time in the right venue at the right price.

The greatest risk health systems confront is complacency. All healthcare roads now lead to value. Each health system must chart its own course. The future belongs to health systems that rise to the challenge and succeed on value.

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