What’s your specialty?

Service line strategy to remain competitive in the evolving healthcare environment

Webinar
March 28, 2012

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What’s your specialty?

Service line strategy to remain competitive in the evolving healthcare environment

- Context
- Our approach to service line strategy
- Case study
- Conclusion
What is the expected impact if the Supreme Court strikes down the individual mandate but allows the rest of the ACA to stand?

Out of the 30 million people expected to gain coverage under current law:

A. 8 million fewer people would gain coverage
B. 16 million fewer people
C. 20 million fewer people
D. 24 million fewer people
Health reform has gradually been implemented, with the biggest impacts still to come

- Dependent coverage extended
- Pre-existing Conditions Insurance Plan
- Medicare Part D “donut hole” reform
- Reductions in Medicare FFS payment

2010

- CMS Innovation Center
- Patient Centered Outcomes Research
- Minimum medical loss ratio requirement
- Medicare Advantage cuts

2011

- Hospital readmissions penalty
- Hospital value-based purchasing
- Medicare ACOs

2012

- Administrative simplification
- Tax changes
- DSH changes
- National episodic payment pilot

2013

- Health insurance exchanges
- Medicaid expansion
- Individual mandate

2014

- Tax subsidies for health insurance
- Hospital acquired conditions penalty
- Employer mandate

NOT EXHAUSTIVE
The landscape in 2012

Context
- Supreme Court decision on constitutionality
- Presidential election
- Federal government busy at work on implementation
  - Exchanges, Stage 2 Meaningful Use, DSH, Next Generation VBP, Wage index reform, National Bundled Payment pilot
- Some states setting up their exchanges; several others waiting to see based on Supreme Court decision

Provider agenda
- Providers continuing to prepare themselves for the coming post-reform era, characterized by:
  - More patients, but fewer dollars per patient
  - Greater integration
    - Horizontally among hospitals; and
    - Vertically between hospitals, payors / employers and physicians
- In 2012, providers will be focused on:
  - Execution of “no regrets” moves to hold down costs
  - Pursuit of targeted service line growth opportunities
  - Execution of IT transformation to achieve Meaningful Use and lay foundation for potential clinical integration
  - Development of long-term strategy to thrive
How many service lines have you prioritized for growth?

A. 1
B. 2
C. 3
D. 4
E. 5 or more
Why focus on service line strategy?

- Reform is coming, and placing more financial pressure on hospitals; focus is essential

- National utilization and demographic trends will drive growth in some clinical service lines, but hospitals vary in their ability to capitalize on this

- Success requires a distinctive value proposition (low cost, high touch, etc.), but most hospitals choose to be a “jack of all trades yet master of none”

- In our experience: the consequences of getting this right make massive margin differences at hospitals
What’s your specialty?
Service line strategy to remain competitive in the evolving healthcare environment

- Context
- **Our approach to service line strategy**
- Case study
- Conclusion
Leaders must choose a few focus areas from the broad landscape of service lines.

- Medicine
- Cardiovascular
- Oncology
- Orthopedics
- Radiation Oncology
- Neurosurgery
- Emergency Medicine
- Pediatrics
- Diagnostic Radiology
- Womens’ Health
- Neurology
- Ophthalmology
- General Surgery
- Behavioral Health
Hospitals must carefully select the service lines they will play in by taking into account mission, market, margin, and likelihood of success

### Key factors to consider

<table>
<thead>
<tr>
<th>Hospital mission</th>
</tr>
</thead>
</table>
| ▪ Patient care: secondary, tertiary, quaternary  
▪ Types of education  
▪ Types of research |

<table>
<thead>
<tr>
<th>Market growth</th>
</tr>
</thead>
</table>
| ▪ Market growth by service line  
▪ Payor mix by service line  
▪ Ability to feed into other key profitable service lines  
▪ Ability to partner with payors / employers and shift share |

<table>
<thead>
<tr>
<th>Margin</th>
</tr>
</thead>
</table>
| ▪ Payor mix by service line  
▪ Impact of reimbursement changes  
▪ Ability to partner with physicians to control costs |

<table>
<thead>
<tr>
<th>Likelihood of success</th>
</tr>
</thead>
</table>
| ▪ Necessary investments (e.g., physician recruitment, capital expenditures)  
▪ Internal and competitor capabilities |
We have built a highly granular 6-layer model to help hospitals predict demand.

Projection of future market volumes

1. Demographics
2. Population growth
3. Payor changes / impact of reform
4. Long term systemic trends (e.g. increased OP disease management)
5. 1 day surgeries → outpatient / Observation bed growth
6. Recession impact and recovery

Granularity

- Age, DRG, ED/Non ED, payor, region
- Age, county, payor
- Age, sub-service line
It incorporates behavioral economics-based modeling of how healthcare reform will impact coverage.

Demographic & geographic data
- County (state)
- Age
- Current coverage
- Income
- Race/ethnicity
- Legal status
- Employer size
- Smoking status

Medical costs
- US distribution
- Adjustments by
  - State
  - Age
  - Smoking

Employer offer decisions
- ESI eligibility
- Employer subsidies/penalties

Government decisions
- Medicaid eligibility

Payor decisions
- Premium levels across all five products for every state

Personal decision engine
- Medicare participation decision
- Military participation decision
- Medicaid participation decision
- ESI participation decision
- Individual participation decision
  - Individual subsidies
  - Individual penalties

Product financials

Model outputs by product and geography
- Revenues
- Costs

Coverage landscape
- Members by product
- Medical expenses

Results in year 1 determine pricing in year 2

SOURCE: McKinsey MPACT model
We project orthopedics to be the fastest growing service line in most U.S. counties in this decade.

<table>
<thead>
<tr>
<th>Service line</th>
<th>Rankings (1=highest growth, 5=least growth)</th>
<th>U.S. CAGR Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orthopedics</td>
<td>2,540</td>
<td>2.0</td>
</tr>
<tr>
<td>Hematology/Oncology</td>
<td>514</td>
<td>1.7</td>
</tr>
<tr>
<td>Neurosciences</td>
<td>31</td>
<td>0.7</td>
</tr>
<tr>
<td>General Surgery(^1)</td>
<td>8</td>
<td>0.4</td>
</tr>
<tr>
<td>Cardiovascular</td>
<td>1</td>
<td>-0.2</td>
</tr>
</tbody>
</table>

\(^1\) Includes oncology surgery

SOURCE: Objective Health Market Volume Explorer
Turning to profitability, service lines across hospitals and geographies show ‘clusters’ of performance.

### Contribution margin per case, 2010

<table>
<thead>
<tr>
<th>Service line</th>
<th>Percent of hospitals in Objective Health database</th>
<th>Rankings (1=highest CM/case, 5=lowest CM/case)</th>
<th>Avg CM/case $ Thousands</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Orthopedics</td>
<td></td>
<td>0%</td>
<td>20%</td>
</tr>
<tr>
<td>Hematology/Oncology</td>
<td></td>
<td>0%</td>
<td>10%</td>
</tr>
<tr>
<td>Neurosciences</td>
<td></td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>General Surgery</td>
<td></td>
<td>100%</td>
<td>0%</td>
</tr>
<tr>
<td>Cardiovascular</td>
<td></td>
<td>0%</td>
<td>70%</td>
</tr>
</tbody>
</table>

1 Database filtered for hospitals with high quality cost accounting and revenue data (includes 10 hospitals)
2 Includes oncology surgery

SOURCE: Objective Health client data
What’s your specialty?

Service line strategy to remain competitive in the evolving healthcare environment

- Context
- Our approach to service line strategy
- **Case study**
- Conclusion
Now let’s look at how one of our clients prioritized service lines using granular local data

**Background**
- 400+ bed tertiary hospital
- Not-for-profit
- Urban market

**Challenges they faced**
- Heavy Medicare payor mix
- Highly competitive market
- Lower projected operating margin = less resources to invest going forward
- Historically provided services in all service lines (i.e., no focus)
Bucking the larger trend, Cardiovascular was growing fast and Neurosciences was not, but several service lines were ‘on the bubble’

What to do with General Surgery and Oncology?

“Double-down”

Re-invigorate or cut losses

SOURCE: Objective Health Hospital Economics Simulator
... so they looked at additional factors beyond analytics to help them decide, including their capabilities ...

<table>
<thead>
<tr>
<th>Internal capabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Key service offerings or limitations</td>
</tr>
<tr>
<td>▪ Facility and service capacity</td>
</tr>
<tr>
<td>▪ Performance on key quality metrics</td>
</tr>
<tr>
<td>▪ Physician perception of service line performance</td>
</tr>
<tr>
<td>▪ Public perception of service line performance</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Client situation</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ CON-driven restriction on outpatient radiation therapy</td>
</tr>
<tr>
<td>▪ Excess OR and bed capacity</td>
</tr>
<tr>
<td>▪ US News “Top 50” hospital for CV</td>
</tr>
<tr>
<td>▪ Excess surgeon capacity in some sub service lines but not all; outmigration in colorectal cases</td>
</tr>
</tbody>
</table>
...as well as their competitors’ capabilities…

### Key factors
- New competitor market entry or expansion
- Competitor offerings of new key feeder services or specific services within service line
- Aggressive marketing by competitors
- Physician perception of competitors

### Client situation
- Teaching hospital competitor was clear market leader in Neurosurgery—commanding market share, aggressive marketing and full suite of services
- Significant capital investment required to compete in Oncology
… and the state of physician partnerships in that service line

**Key factors**

- Shifts in physician availability (e.g., physician retirement, physician departure from market, physician employment)
- Physician recruitment by competitors (both within current market and from other markets)
- Shifts in physician referral sources

**Client situation**

- Client recently recruited boarded vascular surgeon
- 50% of market physicians are employed
- Competitor recently lost key colorectal group to smaller regional hospital
Using a balanced scorecard, they decided to prioritize Orthopedics, Cardiovascular and General Surgery.

<table>
<thead>
<tr>
<th>Service line</th>
<th>Hospital Vision</th>
<th>Volume growth</th>
<th>CM/case</th>
<th>Likelihood to succeed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orthopedics</td>
<td>🟦</td>
<td>🟦</td>
<td>🟦</td>
<td>🟦</td>
</tr>
<tr>
<td>Oncology</td>
<td>🟦</td>
<td>🟥</td>
<td>🟦</td>
<td>🟦</td>
</tr>
<tr>
<td>Cardiovascular</td>
<td>🟦</td>
<td>🟥</td>
<td>🟦</td>
<td>🟦</td>
</tr>
<tr>
<td>General Surgery</td>
<td>🟦</td>
<td>🟥</td>
<td>🟦</td>
<td>🟦</td>
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<tr>
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<td>🟦</td>
<td>🟥</td>
<td>🟦</td>
<td>🟦</td>
</tr>
</tbody>
</table>

*Strategic areas of growth*
Finally, they dove deep into each prioritized service line’s recent performance, the key drivers of that performance, and potential initiatives to grow (1/2)
Finally, they dove deep into each prioritized service line’s recent performance, the key drivers of that performance, and potential initiatives to grow (2/2)

<table>
<thead>
<tr>
<th>Commercial inpatient market share in PSA¹</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% = 36</td>
<td></td>
</tr>
<tr>
<td>Avg. IP Mkt share</td>
<td></td>
</tr>
<tr>
<td>Fracture</td>
<td>14</td>
</tr>
<tr>
<td>Back / Connective Tissue</td>
<td>29</td>
</tr>
<tr>
<td>Joint</td>
<td>451</td>
</tr>
<tr>
<td>Fracture</td>
<td>105</td>
</tr>
<tr>
<td>Joint</td>
<td>209</td>
</tr>
<tr>
<td>Sports</td>
<td>53</td>
</tr>
<tr>
<td>Back</td>
<td>147</td>
</tr>
<tr>
<td>Spinal Fusion</td>
<td>477</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Orthopedic Medicine</th>
<th>Orthopedic Surgery</th>
</tr>
</thead>
<tbody>
<tr>
<td>Client 2019 CM/case Dollars</td>
<td>$3,001</td>
</tr>
<tr>
<td></td>
<td>$1,195</td>
</tr>
<tr>
<td></td>
<td>$12,810</td>
</tr>
<tr>
<td></td>
<td>$5,522</td>
</tr>
<tr>
<td></td>
<td>$5,446</td>
</tr>
<tr>
<td></td>
<td>$6,293</td>
</tr>
<tr>
<td></td>
<td>$24,534</td>
</tr>
</tbody>
</table>

SOURCE: Client market data; Objective Health Hospital Economics Simulator
What’s your specialty?
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Conclusion / Summary of key points

- The changing reimbursement environment and massive secular trends are pushing hospitals to define and defend a real value proposition.
- Hospitals can’t afford to be caught in the “murky middle” – trying to be all things to all people.
- Focus brings risk (the risk that comes with choosing to not focus on some things) – granular data analysis is key.
- Data analytics aren’t 100% sufficient though – you still need to understand some important qualitative factors like internal capabilities, competitors’ capabilities, and the physician landscape.
- Even these can be tackled in a rigorous way.
Q&A

What’s Your Specialty?

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