

Strategy Pivots in the Time of COVID

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Aligning Organizational Strategy With COVID's Unpredictable Path

- The virus has moved from pandemic to endemic back to pandemic
- After nearly a year of fighting the virus, high levels of uncertainty persist
- The success of vaccination efforts remains to be seen
 - Thirty-seven percent of Americans don't plan on getting vaccinated, Gallup reports
- *Hospitals need to tackle COVID as a pandemic, an endemic, and a chronic situation*

"We will be dealing with this virus forever. We're not going to be vaccinating our way out of this..."

—Michael Osterholm, PhD
Center of Infectious Disease
Research and Policy
University of Minnesota

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What we are facing now
is not business as usual,
but disruption of uncertain
intensity, duration, and effect.

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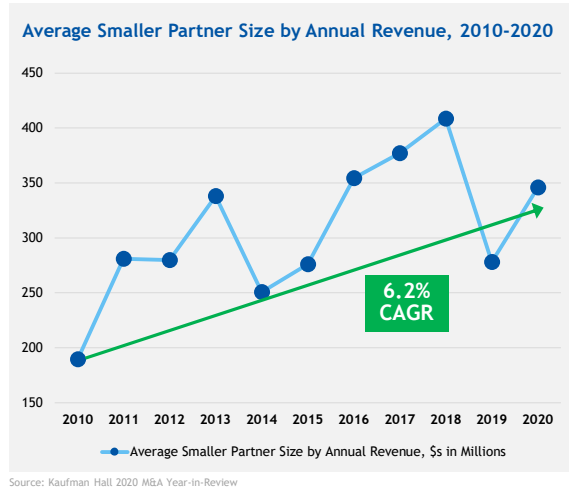
This Crisis is Different

- COVID-19 has produced a level of uncertainty that previous healthcare market changes did not
- The pandemic is a clinical, economic, and social crisis that will continue to alter the normal course of business
- Intensifying the tumult are a contentious political climate, louder calls for health equity, and changes to health policy
- Each of these factors can emerge at a different time, exist for a different duration, affect specific populations differently, and hit with varied intensity
- Hospitals have relatively little control over these threats—and must outwit the uncertainty

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Consolidation is Heightening

- More than ever, scale is a priority: the size of smaller partners in M&A transactions is growing (right)
- We are seeing signs that health systems are moving beyond their geographic tradition
- The pandemic has accelerated the need to transform care delivery models and reimagine health system configuration
- Systems are restructuring their portfolios to monetize or exit underperforming assets and strengthen their financial viability
- Where do these shifts leave organizations of various sizes, levels of financial strength, and competitive positions?



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Needed: Vertical Alignment and Readiness for Value-Based Care

- The financial challenges brought on by COVID-19 will increase the need for vertical alignment and readiness for value-based care
- Health plans and providers will have a greater incentive to integrate
- This may involve expanding existing relationships or developing new partnerships to increase the number of covered lives across the most profitable lines of business, such as commercial and Medicare Advantage plans

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COVID-19 May Accelerate Payer-Provider Partnerships



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Consumer-Oriented Care Models Are Taking Off

- The tech sector's economic dominance has accelerated
- Verticals with a face-to-face orientation (retail, hospitality, live entertainment) have been devastated by COVID-19
- The more tech is winning, the more the nature of economic competition changes
- To what extent will nature of competition in healthcare be based more on technology and less on face-to-face care delivery?

- Apple, Amazon, Google, and Facebook now account for almost 20% of the S&P 500 market cap
- Apple's market cap is hovering at \$2 trillion
- Amazon's revenue was up 40% in Q2 2020, and its profitability was over \$5 billion for the quarter

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Consumer-Oriented Care Models Are Taking Off *(continued)*

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The Biden Administration's Priorities Are Taking Shape

Expand coverage under the Affordable Care Act

- Implement a “public option” to compete with commercial health plans on individual health plan marketplaces
- Increase tax credits to lower premiums and extend coverage

Reduce disparities in health outcomes

- Provide premium-free access to a public option for eligible individuals
- Expand nationwide a California program that has reduced maternal mortality rates
- Double the federal investment in community health centers

Heighten scrutiny of healthcare mergers and acquisitions

- Continue the current, more aggressive posture of FTC and Department of Justice toward healthcare M&A activity

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In 2006, California health officials noticed a troubling rise in maternal deaths

The California Maternal Quality Care Collaborative set out to improve the quality of maternal healthcare by:

- Creating a Maternal Data Center offering real-time benchmarking for 200 participating hospitals that account for 95 percent of the state’s births
- Launching and scaling statewide, data-driven quality improvement efforts
- Researching the cause of state maternal deaths to identify gaps and launch new efforts

California’s maternal mortality rate fell 55 percent by 2013, reaching parity with Western Europe even as overall U.S. rates worsened

President-Elect Biden supports replicating the initiative nationwide

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The Potential Impact on Hospitals and Health Systems

Initiative	Outcome	Change from Trump Administration?	Impact on Hospitals & Health Systems
Expanded ACA coverage	Uncertain (highly dependent on new legislation and additional funding)	Yes	Positive, but the benefits of expanded coverage may be offset by erosion of commercial payer mix.
Reduced health disparities	Likely to the extent federal agencies and task forces can act without additional legislation in tightly divided Congress	Yes	Positive, especially for systems that have moved into population health and risk-based contracting.
Heightened merger scrutiny	Likely	No	Negative; will make mergers more cumbersome without addressing underlying issues driving consolidation.

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The COVID Strategy Pivot



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Keep Your Organization Afloat

- Each hospital's new cost structure will depend on the slope of its revenue recovery curve
- Hospitals will need to know how its total cost of care compares with its competition
- Hospitals will need to make major changes to operations in order to adjust to a loss of revenue whose exact level remains unknown
- What will the resulting healthcare delivery system need to look like?
- At this point, executives have only a hazy idea of what their new cost structure will need to be

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Rethink the Far in a Post-COVID World

- An organization's future success depends on how well it responds to customer needs at "purchasing events"
 - When employees select health plans
 - When consumers with non-acute issues decide where to access care
- Access on demand is a new requirement for success
- Virtual health can address this need for immediacy while breaking down geographic hurdles to access
- Competitive differentiation requires a robust payer strategy, built in part on meaningful payer-provider partnerships
- Integrated health systems have an advantage, particularly if they view their health plans as a dominant future revenue source

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Aggressively Pursue "No Regrets" Strategies

- COVID-19 has illustrated the shortfalls of fee-for-service
- Organizations that employ population-based models are faring better
 - Their revenues, costs, and margins depend on covered lives, not patient volumes
 - They realize their profit pools today may not be the same in the future

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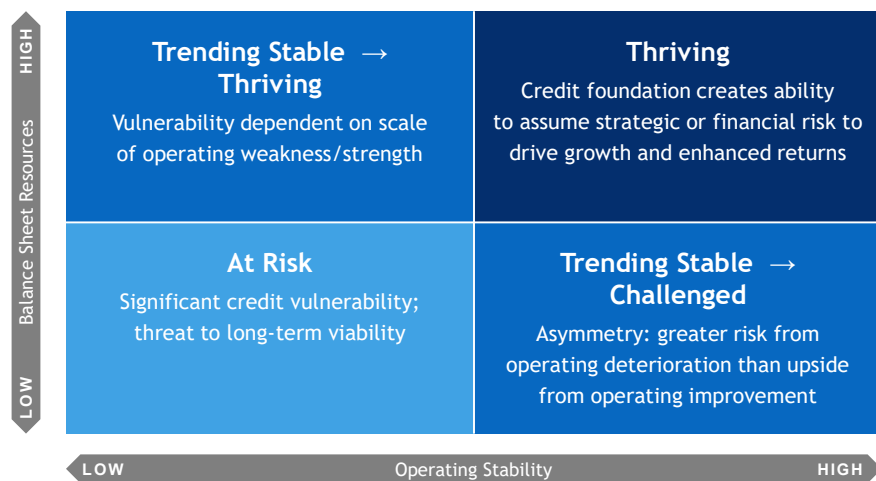
Potential “No Regrets” Strategies

- Maximize performance in value-based arrangements, a growing proportion of total revenue
- Explore payer-provider partnerships with the potential for strategic growth
- Review lines of business and explore how payer mix and revenue mix might shift
- Develop targeted performance improvement/cost reduction initiatives
- Rebalance asset allocation across the service delivery system
- Mitigate operating risk to the greatest extent possible

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Risk vs. Resiliency

- **Balance sheets** will be an anchor
- **Operations** will be a credit variable



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While External Risk Is High, Hospitals Need to Focus on Internal Risk

TWO KINDS OF RISK

1 OPERATING RISK
Risk internal to the organization

2 EVENT RISK
Risk external to the organization

Economic rule of thumb: When event risk is high, reduce operating risk

ACTIVE RISK MITIGATION

Convert short-term financing (lines of credit) to permanent financing. Do this now while capital markets are operating within a normal range.

Scrub your operating model for accumulated assets that have increased operating risk but are not positively contributing to operating performance.

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Pre-COVID State and COVID Impact Will Influence Future Strategic Financial Planning

Heavily Affected

- Weak Capitalization Pre-COVID
- Short- and Long-Term Post-COVID Viability Concerns



- Create consensus on situation
- Establish partnership goals
- Identify potential partners
- Execute structured evaluation process

Moderately Affected

- Median Pre-COVID liquidity, leverage, and profitability
- Short-Term Post-COVID Operating Pressures
- Long-Term Strategic and Operational Options



- Re-establish targets and control methods
- Reinvigorate the operating model
- Actively pursue "Deals" in the environment

Lightly Affected

- Strong Capitalization Pre-COVID
- Limited Balance Sheet and Operating Damage
- Continued Stability and Broad Options



- Determine objectives aligned with vision of "far"
- Allocate capital and leadership to pursue options
- Seize the "once in a generation" opportunity

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At this point, we have more questions than answers. However, there are some observations that encourage a positive strategic outcome.

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What We Know – Three Very Important Things

Organizations with strength are in the best position to lead

- A strong balance sheet, scale, and revenue diversification help weather uncertainty

Math has never been more important

- Highly sophisticated monitoring, predictive modeling, and analysis are more necessary than ever to understand current position and future scenarios

Multi-taskers will have the broadest options

The ability to simultaneously:

- Take on COVID as a chronic condition
- Recover financial stability
- Reimagine strategic position

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For more than 30 years, Mark Grube has worked with healthcare organizations of all sizes and types to improve market position and financial performance in highly competitive environments. He leads Kaufman Hall's healthcare strategy services, where his signature engagements have included helping hospitals and health systems to achieve growth opportunities, assess partnership options, and establish consumer strategies.

In addition to his consulting experience, Mark served as an executive with one of the nation's largest health systems. He has an M.B.A from the University of Chicago.