The strategist's bookshelf

Porter and Teisberg put health care on the CEO's agenda

Alistair Davidson

Redefining Healthcare: Creating Value-Based Competition on Results
Michael Porter and Elizabeth Olmstead Teisberg (Harvard Business School Press, 2006)

(Pre-publication version of article to be published in Strategy and Leadership magazine)

(bio)
Alistair Davidson, a consultant specializing in corporate growth strategy and technology strategy, is located in Redwood City, California (alistair@eclicktick.com). A Strategy & Leadership Contributing Editor, his article "Managing webmavens: relationships with sophisticated customers via the Internet can transform marketing and speed innovation," co-authored with Jonathan Copulsky, appeared in Vol. 34, No. 3, 2006.

The cost and efficacy of health care is a significant environmental and competitive issue for all American companies. From the point of view of a corporate CEO, healthcare is a time bomb, consuming more and more and more resources, raising the cost of America's products, yet not delivering optimum value. Health care—with its powerful constituencies battling for advantage—does not allow would-be reformers an easy grip, much less an obvious solution. But two of the US's best and brightest strategists, Michael Porter and Elizabeth Olmstead Teisberg, have just completed a revolutionary prospectus for health care reform-- *Redefining Healthcare: Creating Value-Based Competition on Results.* The central message of the book: while some aspects of the American health care system are excellent, overall it is too expensive, offers poor value for money, is inconsistent in its delivery of best practices, and is increasing in cost. So what can be done?

The book's key takeaways are:

1. Business leaders need to link up and actively lobby for dramatic change to the health care system. The prescriptions in *Redefining Healthc*are represent a reframing of how health care should operate in the US and are potentially attractive to both political parties.
2. Fixing the health care system will require reformation of regulation, health care organization, coverage policies, management of treatment delivery, medical record keeping and transparency of treatment outcomes. A key goal of this reorganization is the creation of dynamic competition to

improve the outcome for patients through innovation. Currently, efforts to introduce beneficial innovations are repeatedly stymied by ill-considered regulation and its unintended consequences.

3. The upside for business is lower costs of providing health care coverage, healthier employees and improved competitive advantage relative to other countries with more cost effective health care.

In sum, the book warns that senior managements aren't doing their job if they don't pay attention to the current and future cost of health care. Though US industries are hampered by health care costs to varying degrees, the current problems of the North American car companies can be attributed at least in part to the fact that healthcare contributes about $2,000 to the price tag of each car made here. And if such competitive concerns were not enough, the demographics of health care delivery are going to worsen as the Baby Boomers age and become more expensive to look after.

As with Porter's previous work on strategy (*Competitive Strategy* and *Competitive Advantage*) and on national competitive advantage (*The Competitive Advantage of Nations*), this latest book offers a powerful combination of strategic theory and research-based conclusions.

Healthcare in crisis

Porter and Olmstead begin by presenting data that should convince even the most nationalistic and privileged of American readers that the US health care system is in crisis. Their dispassionate analysis of the facts should convince dissatisfied consumers, business leaders, and policy makers on both ends of the political spectrum that radical change is required.

Their inquiry begins by reviewing the performance of the industry and the many failed attempts at reform of health care. Their conclusions are that, by multiple measure of performance, the system is in trouble:

- US per capita health care expenditures of $5,200 (in 2002) are approximately twice as high as in most developed countries. Between 1990 and 2003, US total expenditures on healthcare rose from $696 billion to $1,679 billion.
- Forty percent of US citizens with health problems did not get appropriate treatment or medication due to the cost of health care in 2004.
- The US has the highest level of dissatisfaction with its health care of major developed countries. Dissatisfaction is highest among low-income patients.
- The US ranks lowest on the relationship between spending and life expectancy in the 29 OECD countries.
- Health systems in the US typically only delivers the best care 55 percent of the time, though with some conditions the rate is as low as 10 percent. In other words, ignoring issues of coverage, the US is currently incapable

of delivering a consistent best practice on a national basis. On a regional basis, there is enormous and inexplicable variation in medical practice and costs.

- Medical errors are a significant cause of death in the US; there are some 200,000 deaths attributed to iatrogenic causes per year.
- Time spent on medical paperwork consumes between 33 percent and 50 percent of medical costs.
- Health insurance premiums are growing dramatically faster than inflation.

From functional management to disease life cycle management

The authors' fundamental arguments are consistent with theories of competitive advantage and selective value creation that Porter has espoused throughout his career. The authors propose:

- Management of disease life cycles rather than functional (departmentally organized) management of patient relationships. Clearly, interventions to prevent diabetes produce both lower costs and better healthcare outcomes that having to deal with the treatment of diabetes and its side effects.
- Performance improvement though publicly reporting of benchmarked risk adjusted patient health outcomes. In New York city, reporting of heart surgery outcomes has caused a general improvement in results.
- Empowering consumers. As with many proposals on reforming government or government-regulated sectors, they argue for letting customers select the most effective producer of good outcomes for individual diseases. More successful providers will attract more customers and grow their revenues while innovating and driving down costs.

  "The fundamental problem in the US health care system is that the structure of health care delivery is broken. That is what all the data about rising costs and alarming quality are telling us. And the structure of health care delivery is broken because competition is broken. … All of the well-intended reform movements have failed because they did not address the underlying nature of competition.

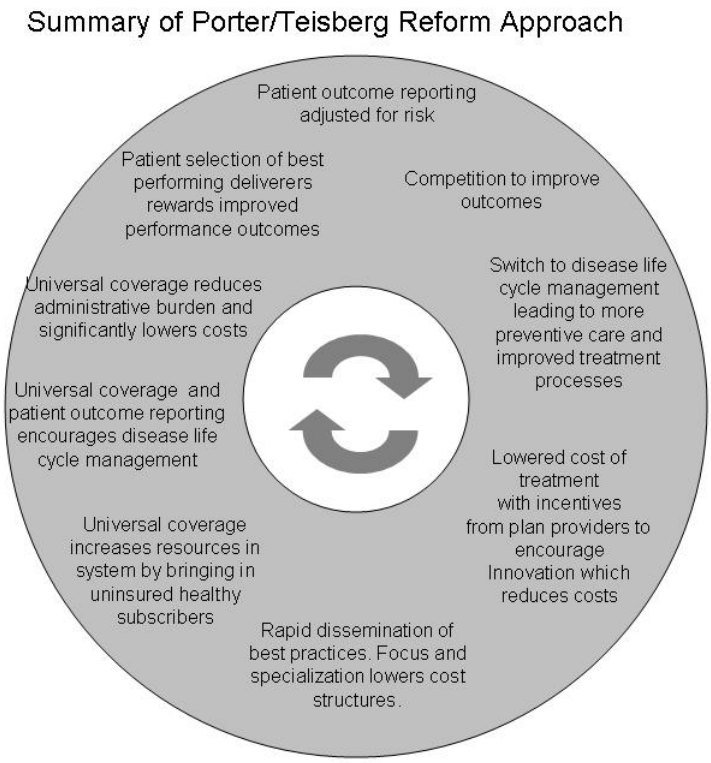
  In a normal market, competition drives relentless improvement in quality and cost. Rapid innovation leads to rapid diffusion of new technologies and better ways of doing things. Excellent competitors prosper and grow, while weaker rivals are restructured or go out of business. Quality adjusted prices fall, value improves and the market expands to meet the needs of more consumers. This is the trajectory of all well functioning industries…

  Health care competition could not be more different. Costs are high and rising…Quality problems persist. The failure of competition is evident in the large and inexplicable differences in cost and quality for the same type

of care across providers and across geographic areas.” p.3

In brief, they argue that:

- Healthcare reform in recent years has largely involved the transfer of costs between funding sources (government, insurance companies, consumers), healthcare delivery organizations and medical professionals. Often, what has been sold as reform has merely been an attempt to transfer costs between participants.
- Hospitals simultaneously experience too much and too little competition. Competition tends to be based upon on breadth of service in local markets rather than on the disease specific outcomes. Improvement is not normally based upon regional, national and international comparisons.
- Current revenue models in healthcare tend to be based upon transactions (such as those that offer doctors incentives to over-service patients) or on capitation (per capita) revenue models (that tend to cause the average American to receive non-optimum treatment).
- Best practices in healthcare disseminate extremely slowly, leading to poor outcomes and higher costs and high variability in implementation of best medical practice.
- Perverse incentives in the system encourage under-specialization, low levels of utilization of equipment, under treatment of disease and failure to invest in preventive healthcare. A startling example: Health Savings Accounts can have damaging consequences because, to preserve their savings, some account owners postpone early treatment and diagnosis of diseases, leading to higher downstream treatment costs.
- From the point of view of plan providers, marketing medical coverage is more about avoiding patients with high healthcare costs rather than spreading risk across populations. From an equity and efficiency perspective, Porter and Teisberg argue for universal coverage to increase resources available to the healthcare system and to avoid the problem that younger, healthier people do not contribute to the overall costs of the system until they need healthcare.



Universal coverage and value creation

As one of the US's most respected researchers and consultants, Porter cannot be dismissed as an unrealistic utopian. He and Teisberg, a specialist in innovation, argue convincingly that competition and market forces are powerful and effective, and that they should be the basis for pursuing dynamic improvement in the health care system.

If this doesn't sound revolutionary then consider that, in most cases, the current system doesn't reward institutions that devise ways to prevent disease or lower the cost of treatment by making patients healthier. In fact it punishes them, by reducing their revenues. In an ideal system, the most successful disease managers should be able to sell their services regionally, nationally and internationally and reap the benefit of their superior treatment outcomes. The authors argue that to support rapid innovation and specialization, universal coverage is required.

As with any radical new strategy, the secret to reform is reconceiving value creation. The book proposes healthcare delivery around an unbundled approach to individual disease management. Competition, they argue, should be based upon outcomes over the full life cycle of the disease (e.g. diabetes, heart disease, high blood pressure, transplants, etc.). An ideal system should reward providers that prevent disease, not just cure it at a higher rate.

Eight principles guide the authors' policy advice:

1. The focus should be on value for the patient, not just lowering costs.
2. Competition must be based upon results.
3. Competition should center on medical conditions over the full cycle of care.
4. High quality care should be less costly.
5. Value must be driven by provide experience, scale and learning at the medical condition level.
6. Competition should be regional and national not just local.
7. Results information to support value-based competition must be widely available.
8. Innovations that increase value must be strongly rewarded.

(Table 1: p.98)

Challenges to reform

The most likely objection to the authors' recommendations will come from readers who (1) don't understand the powerful benefits of competitive innovation to achieve orders of magnitude improvement in effectiveness and cost, and (2) don't realize that the US has already effectively created universal healthcare access (anyone can get health care at an emergency room); but this care is provided in the most expensive, most bureaucratic and ineffective way imaginable.

The prescriptions of *Redefining Healthcare* should be acceptable to almost the entire spectrum of stakeholders. Universal coverage will appeal to those who believe in social responsibility. Competition to improve performance should appeal to those who believe in market forces. Customer choice should appeal to those who believe in the power of markets to reallocate resources to those most efficient at delivering good healthcare outcomes. Rewarding best practices should please health care professionals. The insight that universal coverage is the glue required for performance improvement is a powerful proposition.

But the unanswered question, as with all strategies, is how to get there. It is in this area that the book is at its weakest.

A looming budgetary crisis is likely to make the ideas in this book increasingly attractive. But without strong pressure from business leaders, the innovative transformation promoted by the authors will likely be difficult to achieve or will emerge slowly. Coverage cutbacks will be the first option chosen by many state governments and most businesses, but they will not solve the problems of the system.

Anticipating skeptics and pessimists, the authors argue that we already can point

to instances where focusing on disease treatment outcomes has dramatically improved patient outcomes (heart surgery outcomes in NY City hospitals, transplants nationally). They have identified organizations that have centralized medical record keeping and obtained better dissemination of best practices (Kaiser, Veterans' Administration). They have identified organizations (Cleveland Clinic) that have specialized and changed their "retail strategy" by establishing feeder providers (community hospitals). So their argument is that the healthcare industry demonstrates how their reform proposals work on a small scale.

Next steps

While the recent reforms proposals in Massachusetts (universal mandatory coverage) don't fully embody all the recommendations of Porter and Teisberg (they don't encourage competition on the basis of life cycle disease outcomes), they do indicate that leading decision makers and healthcare consumers are beginning to recognize that radical rather than incremental change is needed.

This first example of reform is encouraging because American business is clearly being damaged by today's ponderous and stumbling health care system. The authors estimate the cost of America's inefficiency at 3-7 percent of GDP, by any measure, a huge burden on the US economy. (Imagine the positive impact of a tax reduction equivalent to 7% of GDP.) It's up to America's CEOs to start the country on a path to a new system, one based on enlightened self interest, market forces and sound strategy. Porter and Teisberg deserve credit for blazing the trail.