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Healtcare Systems & Services Practice

To succeed in a healthcare transformation, focus on organizational health

In transformations, healthcare providers and payers must attend to their organizational health, not just their short-term performance.

by Gretchen Berlin, Deirdre McGinty, and Stephanie Sherline

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Healthcare organizations across the value chain face continued pressure to perform distinctively in a constantly changing landscape. Providers, especially hospital systems, are experiencing declining admissions and continued growth in costs as they attempt to build the capabilities needed to win in an environment that faces ongoing regulatory reform and new entrants with an eye toward disruption. Over the years, payers have been trying to generate value through vertical and virtual integration, since several large horizontal mergers were blocked. Large and small technology companies alike are innovating in the way healthcare is paid for and delivered. Disruptive forces—for instance, continued consolidation, new forms of vertical integration, heightened consumerism, the persistent potential for regulatory change, and unique partnerships among new stakeholders—are beginning to reshape where and how healthcare providers deliver their services for many Americans.

Margin pressures are growing as well: for example, from 2010 to 2016 inpatient admissions in community hospitals fell by about 5 percent, creating margin pressures on providers.[1] Average monthly premiums from Medicare Advantage are estimated to have decreased by 6 percent from 2018 to 2019, creating margin pressures on payers.[2] To relieve the pressure, many healthcare organizations are exploring one or more transformation approaches, such as increased scale, greater cost efficiency, and innovative business models.

Organizational health is critical to the success of transformation efforts

Comprehensive transformation efforts seek lasting, irreversible change in the way organizations function, but our research persistently shows that less than 30 percent of major transformations succeed.[3] Our research also indicates that one of the most common pitfalls is neglecting to identify and pursue the changes needed for organizational health—how well an organization sets and aligns on a direction, executes priorities, and renews itself over time to sustain its financial and operational results. Good organizational health reflects a company's culture, behavior, and management practices. We measure it through the Organizational Health Index (OHI), which assesses management practices across nine core outcomes: direction, leadership, the work environment, accountability, coordination and control, motivation, capabilities, external orientation, and innovation and learning. Thirty-seven practices support these outcomes (Exhibit 1).[4]

Healthy organizations are not only more agile and resilient but also longer lasting. In fact, an analysis demonstrates that healthy companies generated total shareholder returns (TSR) three times higher than those of unhealthy ones (Exhibit 2).[5] Across the board, different levels of organizational health account for roughly half of all performance differences among organizations.[6]

The relationship between organizational health and performance is just as important for US healthcare organizations as for companies in other industries. In particular, healthcare providers in the top decile of organizational health outperform their counterparts on key measures of patient satisfaction, operational efficiency, and quality (Exhibit 3).

How organizational health is applied matters

US healthcare organizations perform well on overall OHI scores and outcomes (see sidebar "US healthcare organizations have strong organizational health and opportunities to get even healthier"). But organizational-health practices can have somewhat different effects in different industries. Motivation, one of the nine outcomes, is important

[1] *TrendWatch chartbook 2018: Trends affecting hospitals and health systems*, American Hospital Association, aha.org.
[2] "Medicare Advantage premiums continue to decline while plan choices and benefits increase in 2019," Centers for Medicare & Medicaid Services, September 28, 2018, cms.gov.
[3] Scott Keller and Bill Schaninger, *Beyond Performance 2.0: A Proven Approach to Leading Large-scale Change*, Hoboken, NJ: John Wiley, 2019.
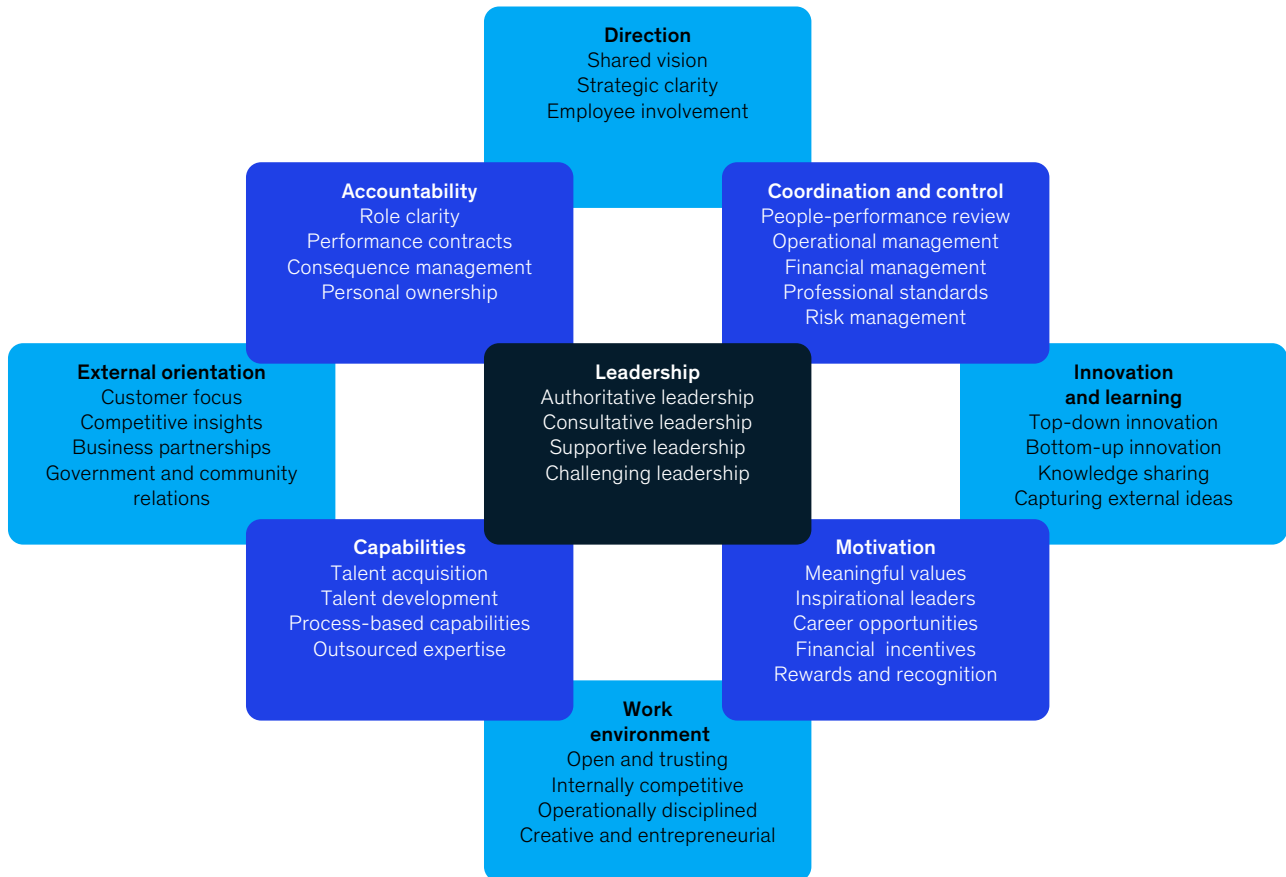[4] For more information, see "How OHI works," McKinsey.com.
[5] For additional information on the link between organizational health and performance, see Chris Gagnon, Elizabeth John, and Rob Theunissen, "Organizational health: A fast track to performance improvement," *McKinsey Quarterly*, September 2017, McKinsey.com.
[6] Simon Blackburn, Carolyn Dewar, Elizabeth Irons, Scott Keller, Mary Meaney, Anders Bruun Nielsen, Garrett Ulosevich, and Carter Wood, "How do I transform my organization's performance?," June 2011, McKinsey.com.

Exhibit 1

Thirty-seven practices are 'what you do'–the behavior that drives each outcome.

9 health outcomes

Direction
Shared vision
Strategic clarity
Employee involvement

Accountability
Role clarity
Performance contracts
Consequence management
Personal ownership

Coordination and control
People-performance review
Operational management
Financial management
Professional standards
Risk management

External orientation
Customer focus
Competitive insights
Business partnerships
Government and community relations

Leadership
Authoritative leadership
Consultative leadership
Supportive leadership
Challenging leadership

Innovation and learning
Top-down innovation
Bottom-up innovation
Knowledge sharing
Capturing external ideas

Capabilities
Talent acquisition
Talent development
Process-based capabilities
Outsourced expertise

Motivation
Meaningful values
Inspirational leaders
Career opportunities
Financial incentives
Rewards and recognition

Work environment
Open and trusting
Internally competitive
Operationally disciplined
Creative and entrepreneurial

no matter what kind of organization you strive to be, for example. But the practices for each outcome should be interpreted and acted upon with thoughtfulness, taking into account the industry context—for example, financial incentives alone may make some organizations (such as sales-focused ones) successful but can have unintended results in others. As a recent article[7] has indicated, in clinical practice financial incentives may not be the best way to improve clinical results.

Since financial incentives are an imperfect practice for building motivation in this sector, organizations in it should consider the full breadth of practices connected with that outcome. Our research suggests that in healthcare, other practices may be more effective motivators. The Organizational Health Index survey uses employees' responses to determine the scores for the 37 practices. These responses reflect the employees' perceptions of, for example, financial incentives and career opportunities at their companies. In our OHI data set, we have found that US healthcare organizations, despite their high overall organizational-health rankings, score at the global benchmark on the practice of financial incentives (Exhibit 4). For these organizations, the other four practices—meaningful values, inspirational

[7] Robert Pearl, "The deadly consequences of financial incentives in healthcare," *Forbes*, January 28, 2019, forbes.com.

US healthcare organizations have strong organizational health and opportunities to get even healthier

McKinsey's Organizational Health Index Global Database shows that US payer and provider organizations significantly exceed global cross-sector and industry norms for organizational health. More than half of these organizations in our sample enjoyed top-quartile health, and a quarter of healthcare providers scored among the top 10 percent in our Organizational Health Index Database. US healthcare organiza-tions rank among the healthiest 25 percent of companies in four key outcomes (exhibit).
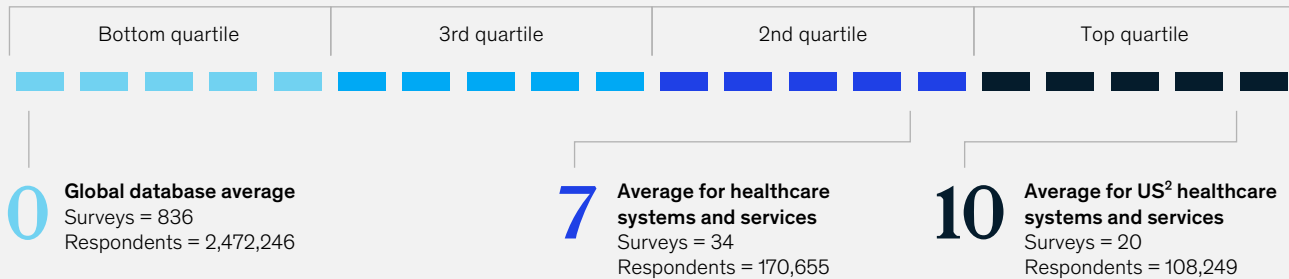
Nevertheless, the organizational health of these companies still has room for improvement—and their weaknesses hinder their efforts to respond to continued uncertainty. As payers and providers alike embark on major efforts to deliver break-out growth, manage operating expenses, achieve scale, build new capabilities, and explore diversified margin opportunities, they would be wise to understand and improve the practices that make orga-nizations fit for performance. The most successful transformational efforts invest heavily in organizational health at the start of the transformation, both to understand the current state and to identify mind-sets and behavior that must be overcome.

Exhibit

US healthcare organizations significantly exceed global cross-sector and industry norms for organizational health.

Organizational Health Index,[1] average score, %

Bottom quartile	3rd quartile	2nd quartile	Top quartile

0 **Global database average**
Surveys = 836
Respondents = 2,472,246

7 **Average for healthcare systems and services**
Surveys = 34
Respondents = 170,655

10 **Average for US**[2] **healthcare systems and services**
Surveys = 20
Respondents = 108,249

Quartiles for US provider sample, average outcome

Direction

Accountability

Coordination and control

External orientation

Leadership

Innovation and learning

Capabilities

Motivation

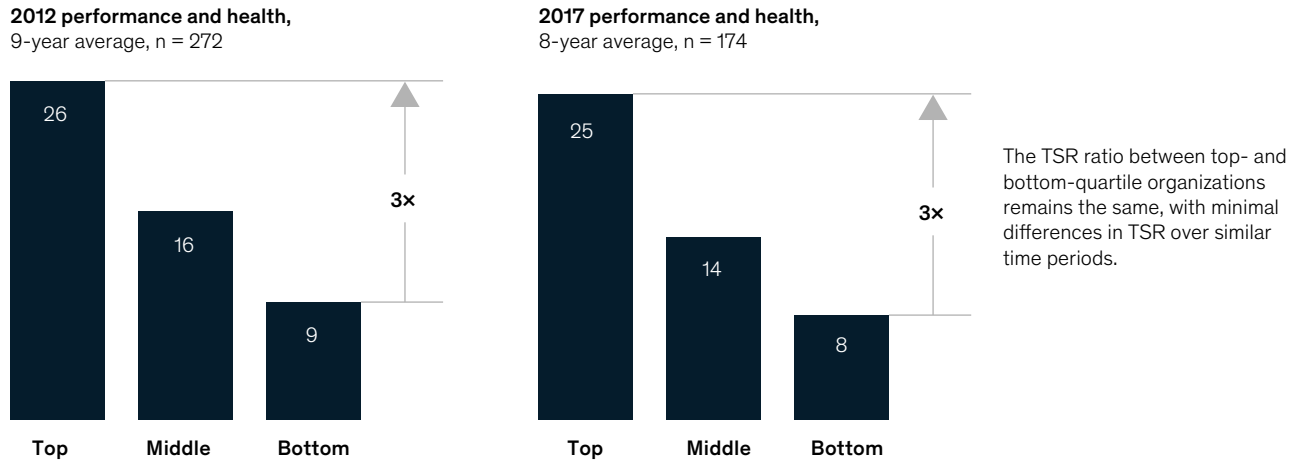Work environment

[1] Average of the 9 health outcomes.
[2] Significantly different from global and healthcare industry average, statistically significant with a P value (calculated probability) of <0.05.

Source: US healthcare sample: surveys = 20, respondents = 108,249; global-survey database, Organizational Health Index by McKinsey: surveys = 836, respondents = 2,472,246

Exhibit 2

The powerful relationship between performance and health, found in 2012, remains robust in 2017 research.

Total shareholder returns (TSR), by health quartile, %

2012 performance and health,
9-year average, n = 272

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Top     26
Middle  16
Bottom  9
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3×

2017 performance and health,
8-year average, n = 174

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Top     25
Middle  14
Bottom  8
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3×

The TSR ratio between top- and bottom-quartile organizations remains the same, with minimal differences in TSR over similar time periods.
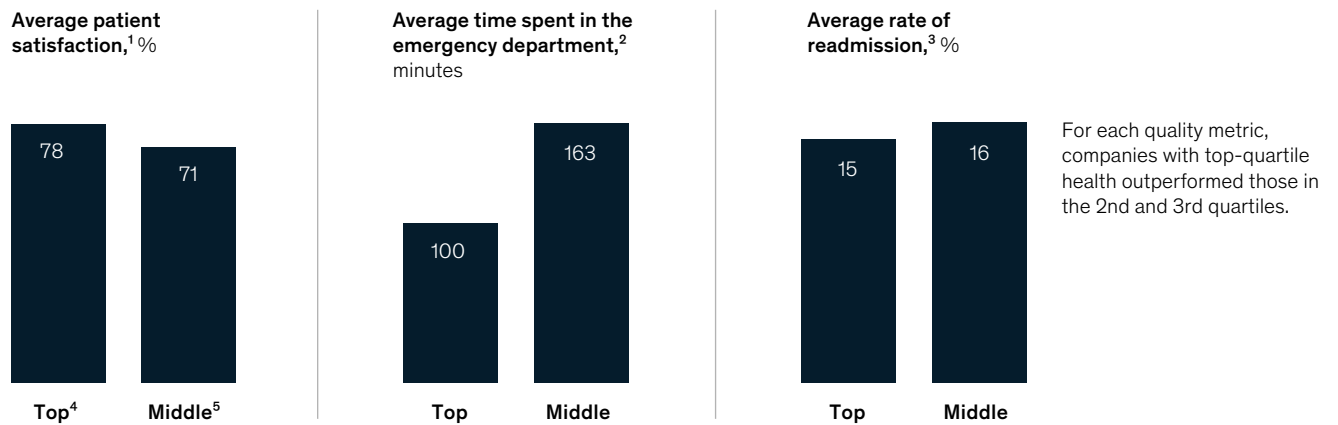
Source: For health scores, global-survey database, Organizational Health Index by McKinsey; for financial data, Corporate Performance Analytics by McKinsey

Exhibit 3

Stronger organizational health is correlated with stronger performance in quality.

Patient journeys, by health quartile, %

Average patient satisfaction,[1] %

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Top[4]     78
Middle[5]  71
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Average time spent in the emergency department,[2] minutes

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Top     100
Middle  163
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Average rate of readmission,[3] %

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Top     15
Middle  16
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For each quality metric, companies with top-quartile health outperformed those in the 2nd and 3rd quartiles.

[1] Patients who gave their hospital rating of 9 or above (out of 10), on scale from 0 (lowest) to 10 (highest).
[2] Time patients spent in emergency department after being admitted as inpatient and before leaving emergency department.
[3] Rate of readmission after discharge from hospital (hospital wide).
[4] Surveys = 7, respondents = 19,388.
[5] Surveys = 3, respondents = 79,184.

Source: American Hospital Directory; McKinsey analysis

leaders, career opportunities, and rewards and recognition—contribute to successful motivational outcomes to a much greater extent, pushing up the overall scores. In our experience, nonfinancial incentives have a particularly strong impact motivating provider organizations to improve their performance and the care they give patients.

No company we know excels at all 37 practices assessed in the OHI, and attempting to do so is likely to produce across-the-board mediocrity. High-performing organizations focus instead on a few critical practices that work together as a winning "recipe" to create a coherent, effective management system fully supporting the strategic imperatives. They aim to be "good enough" at all 37 practices but to excel only at those few—often, about ten.

We have found four winning recipes, which we call leadership factory, market shaper, continuous-improvement engine, and talent and knowledge core. Each reflects different core beliefs about how to create value and make organizations successful (Exhibit 5).[8] Our research has shown

Exhibit 4

US healthcare organizations significantly outperform the global benchmark in most motivation practices but are comparable in financial incentives.

US healthcare performance in motivation practices compared with global benchmark,[1] median point difference

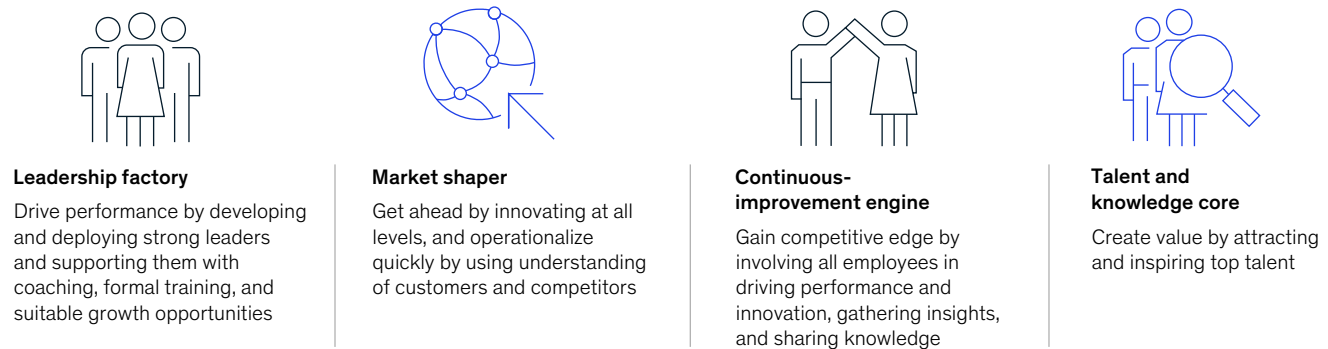| Meaningful values	Inspirational leaders	Career opportunities	Financial incentives	Rewards and recognition
13% or greater	**11%** or greater	**8%** or greater	**4%** difference	**9%** or greater

[1]Statistical significance is defined by differences (higher or lower) that fall outside of the 95% confidence interval for chance error. All of the percentages in this exhibit are statistically significant except the financial-incentives metric.

Source: US healthcare sample: surveys = 20, respondents = 108,249; global-survey database, Organizational Health Index by McKinsey sample: surveys = 836, respondents = 2,472,246

Exhibit 5

Our research reveals four successful 'recipes' for organizational health.

Leadership factory
Drive performance by developing and deploying strong leaders and supporting them with coaching, formal training, and suitable growth opportunities

Market shaper
Get ahead by innovating at all levels, and operationalize quickly by using understanding of customers and competitors

Continuous-improvement engine
Gain competitive edge by involving all employees in driving performance and innovation, gathering insights, and sharing knowledge

Talent and knowledge core
Create value by attracting and inspiring top talent

[8] For more information, see "How OHI works," McKinsey.com.

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that across industries, organizations that rely on any of these four recipes are five times more likely than others to be healthy and to sustain strong performance than organizations with no alignment on recipes.[9] Only about one-third of the US healthcare organizations in the sample were strongly or very strongly aligned with one of the four recipes—the market-shaper recipe, in particular (Exhibit 6). The practices aligned with it include top-down and bottom-up innovation, a focus on customers, and the ability to capture external ideas. These practices are generating positive results in an ever-changing and more complex industry.

Meanwhile, traditional players are assuming new value-chain roles in an increasingly blended landscape of payers, providers, and service companies. To know how an organization will align, execute, and renew itself in the new context (see sidebar "Applying lessons learned"), the management teams of healthcare organizations would therefore be wise to spend significant time on their recipes for success.

US healthcare organizations that were strongly or very strongly aligned with one of four 'recipes' improved their chances of achieving top health.

Probability of top-quartile health in US,
by strength of recipe alignment, %

50
Weak or moderate
14 companies

67
Strong or very strong
6 companies
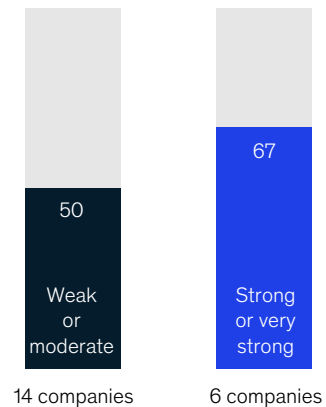
Note: We have found 4 winning recipes, which we call leadership factory, market shaper, continuous-improvement engine, and talent and knowledge core.

Source: US healthcare sample, surveys = 20, respondents = 108,249; global-survey database, Organizational Health Index by McKinsey, surveys = 836, respondents = 2,472,246

Applying lessons learned

The recent experiences of a provider system highlight the importance of emphasizing performance and health equally in an enterprise transformation.

A large regional provider sought to reposition itself in highly competitive markets while ensuring sustainable financial performance through the transition. Six months into the launch of a comprehensive enterprise-wide transformation that touched everything from labor to supplies to the profitability of health plans, the provider recognized that the foundations for a lasting performance improvement were not in place. The provider scored in the second quartile of the Organizational Health Index (OHI) but

had third-quartile performance in two key renewal outcomes: external orientation and innovation.

The top team invested significant time to align on a health aspiration and determine how existing mind-sets impeded the breakthrough performance the organization wanted. For example, seeking to understand how better to tap into the best ideas inside and outside the organization, the leadership uncovered a pervasive view that employees did not feel safe to fail. Similarly, the OHI pointed to gaps in the way employees understood the organization's expectations. That discovery led to candid discussions about the need to craft role descriptions

that accurately reflected responsibilities and performance accountabilities.

Through this seeming "administrivia," the leadership team recognized that addressing such gaps was critical to engage the organization's broad base with the changes required to meet the aspirations. The leadership team turned these and several other health imperatives into discrete initiatives incorporated into the regular rhythm of the transformation office and tracked regularly for progress and impact. Over the subsequent 18 months of the transformation, the system expanded its operating margin from 0.0 percent (trending down) to 2.7 percent.

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[9] Aaron De Smet, Bill Schaninger, and Matthew Smith, "The hidden value of organizational health—and how to capture it," *McKinsey Quarterly*, April 2014, mckinsey.com

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US healthcare organizations cannot afford to wait out the continual uncertainty enveloping the industry. Many are embarking on major programs to redefine how they will grow and operate in the new environment. US payers and providers are healthier, on average, than many global companies. Yet healthcare leaders would be wise to build on that strong foundation while their companies embark on the performance transformation needed for a truly lasting impact.

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