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Delivering bold performance in an ever-changing healthcare landscape

Bede Broome, MD, PhD; David Bueno, PhD; Brandon Carrus; Deirdre McGinty; and Drew Ungerman

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Best-practice approaches to transformation and turnaround

The odds are stacked against healthcare organizations as they pursue sustained growth and differentiated performance. Six strategies can help them achieve successful transformations at scale.

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"What got you here won't get you there." This tried-and-true adage perfectly sums up the challenges facing many healthcare organizations today. Executives across the industry acknowledge that regardless of how healthcare reform proceeds, expectations on performance and growth are rising dramatically. On the provider side, the average US health system will see EBITDA performance fall by 1.5% to 2% by 2019, leaving small and midsize health systems in a particularly vulnerable position.[1] The payor market is rapidly shifting, and growth is expected to come primarily from lower-margin government segments. The services sector is grappling with similar factors, including customer consolidation, rising input prices, and disintermediation.

The dual challenges of rising performance expectations and increasing uncertainty are affecting virtually all companies in the industry, and in many ways, addressing these challenges is even more difficult for well-established healthcare incumbents. Scale economies have not fully settled in for most players,[2] and legacy assets, technology, and mindsets persist, making transformative change extremely difficult. The odds are stacked against even the highest performers.

Most players in the industry are seeing rising administrative, supply, and labor costs while experiencing uneven results from their growth strategies. Despite considerable effort, few organizations seem to have mastered the ability to create consumer- and patient-focused experiences. In short, most providers, payors, and health services companies demonstrate at least a handful of "symptoms of distress" (Exhibit 1).

Amid continued uncertainty and growing margin pressures, many institutions are exploring one or more approaches to relieve the pressure, such as increased scale, cost efficiency, business model innovation, and horizontal integration. Yet all too often, these organizations undertake relatively familiar, business-as-usual approaches to improve performance with the unrealistic expectation of delivering uniquely transformative results.

Executives searching for a better way should be heartened by the evolution of other industries. Airlines, mining, and telecommunications all faced a similar disruptive landscape (regulation, technology revolution, and mass consolidation). These disruptions were followed by a wave of transformations that enhanced not only performance but also growth and innovation. For example, the airline industry's trajectory from 2000 to 2015—a period marked by turnarounds, megamergers, and proactive transformations—provides a provocative comparison. In the early 2000s, low-cost air carriers increased competition

[1] Greenfield M, Khanna G, Malani R, Repasky C, White M. Midsize healthcare systems: Pathways to succeed. McKinsey white paper. March 2017.
[2] Coe E, Singhal S. The next imperatives in US healthcare. McKinsey white paper. November 2016.

on legacy carriers. At the same time, industry cost structures were challenged by the economic slowdown caused by a combination of the September 11 attacks, skyrocketing fuel prices in the mid-2000s, and unsustainable labor and pension obligations.

Airlines inevitably took action, whether in a proactive or reactive manner. From 2000 to 2015, the US airline industry saw six bankruptcies and six mergers that resulted in the emergence of four primary carriers. Consolidation alone was not enough to guarantee success, however. The true winners were airlines that pursued aggressive but balanced growth targets while working to make the underlying organization healthier. Everything was on the table during these transformations, whose scope and pace pushed the airlines well beyond their comfort zone. On the top line, the airlines fundamentally transformed their revenue models through new pricing strategies, unbundling of services, increased ancillary fees, and higher passenger loads. In parallel, the organizations captured significant cost savings through a

EXHIBIT 1 **Providers, payors, and other healthcare companies face varying "symptoms of distress"**

1 Fundamental changes to the market	• Consolidation across the value chain • Changes to the regulatory environment • Shrinking margins across the industry • Evolving customer preferences • Demographic shifts in key markets • Technological advances
2 Leading operational indicators	• Shifts in patient volumes and/or payor mix • Rising administrative costs • Declining productivity and rising input costs • Elevated churn in key customer segments
3 Organizational indicators of distress	• Accelerating employee turnover • Declining patient satisfaction • Eroding quality performance • Negative media coverage • Difficulty attracting key talent
4 Material financial realities	• EBITDA/operating margin erosion • Declining risk-based capital • Rising days in accounts receivable and/or fallings days in accounts payable • Declining days of cash on hand • Bond ratings downgrades

portfolio of performance-focused efforts—from advanced fuel management practices to lean ground operations, increased automation, and targeted outsourcing (for example, maintenance). Delta rode such a balanced approach to record profits in 2016, nine years after emerging from bankruptcy.[3]

Altering an organization's trajectory is difficult but imperative given these uncertain times. Unfortunately, there is no one-size-fits-all, foolproof playbook to spur performance, growth, and innovation. However, in working with hundreds of healthcare organizations across the value chain, we have identified six strategies that are crucial to achieving successful transformations at scale.

Act before the brink of crisis

Among executives, one of the most common (and dangerous) default modes is failing to recognize, downplaying, or ignoring indicators that change is needed. Such blind spots delay necessary action. In a survey of global executives who led turnaround efforts, just 13% kicked off transformations at scale before performance dropped markedly.[4] Another one-third commenced a transformation program as an immediate reaction to declining returns. More than 45% reacted only after the performance decline had become widely evident or threatening. Unsurprisingly, the perceived success and impact of the transformation efforts were significantly higher among the executives who took early action (50%) than among those who described their actions as late (25%).

This myopia is often caused by executives who fail to regularly reassess and adapt their business plans. After all, no one wants to call their own baby ugly. Across the healthcare industry, three- and five-year plans for growth and performance abound, but far too many of these plans are written and then disregarded. Organizations frequently fail to define and revisit signposts of performance and health (for example, operational efficiency, market share, returns on major investments, basic financials, and cash flow) that can confirm whether the current path is the right one.[5]

Numerous cautionary tales can be found across all sectors of the healthcare industry. In each of these cases, players have made incomplete or insufficient attempts at changing their trajectory before their challenges became full-blown crises (see sidebar "Too little, too late?"). Thankfully, some successful organizations can also provide positive points of reference (see sidebar "Transformation before desperation"). These successful organizations acknowledged their problems early and reacted by launching aggressive, comprehensive efforts focused on improving all aspects of their business, including costs, revenues, and overall organizational health (Exhibit 2).

Establish a bold mandate

Simply put, rapid and comprehensive transformations will not thrive without a clear, compelling, and actionable change story that moves beyond "what's possible" aspirations. Such change stories are even more critical when employees don't perceive the organization as distressed. For example, a successful healthcare provider had recorded relatively stable performance and grown to become the largest in its region. The company returned solid margins but faced market pressures

[3] Durant M. Delta Air Lines announces December quarter and full year 2016 profit. Delta News Hub. January 12, 2017.

[4] Jermin M. Rising stars 2013: Turnarounds—How to execute a turnaround. McKinsey survey. March 2013.

[5] Yakola D. Leading companies out of crisis: Ten tips from a veteran turnaround artist. McKinsey on Finance. Winter 2014.

EXHIBIT 2 **Before hardship strikes, healthcare organizations should target growth, innovation, and performance as part of an enterprise transformation**

Growth	Innovation	Performance
• Product and service design • Go to market • Access and outreach • Physician engagement	• Digital enablement • Consumer and patient experience • Network design • Total cost of care and population health	• Medical cost management • Clinical operations • SG&A/support functions • Strategic sourcing

on its business model. The CEO knew he needed to take bold action and act from a position of strength, and so he launched a comprehensive transformation anchored on a patient-centered change story incorporating customer centricity, community health, digital innovation, and a balance of growth and performance.

Being clear is only half the battle; setting aggressive aspirations is also critical. In our experience, companies typically pursue targets that are a fraction of the potential value at stake. What's more, our research found little relationship between the scale of the target and the likelihood of success: organizations that sought to improve their operating margin by more than 20 percentage points were nearly as likely to achieve or exceed their target (68% of the time) as organizations that targeted improvements of only 10 percentage points (74%).

A leading healthcare services provider reinforces this insight. The company initially aspired to boost operating income by about $100 million over three years—an aggressive target at an accelerated pace. When an in-depth diagnostic phase identified and confirmed that the company could capture twice that amount, executives revised their projections upward and significantly compressed the timeline. For example, they opted to immediately launch initiatives worth more than $60 million annually instead of waiting a year to do so.

Being bold not only signals that the transformation effort will be a fundamentally different endeavor but also forces leaders to adopt a new mind-set that challenges what is possible while rethinking how to create value.

Address all performance levers

The most successful leaders of transformations recognize that achieving sustainable impact from an enhanced operating model requires equal emphasis on performance, growth, innovation, and culture. Superficial "slash and burn" actions may produce short-term results but very often fail to take root in the organization. Moreover, executives too often believe they are leading a transformation while in reality they are focused only on a narrower subset of value creation levers. If the aspiration is to reach a new level of performance, relying on targeted improvement efforts or protecting sacred cows won't cut it. Long-term improvements to an organization's growth, performance, and health begin with rapid action to identify, challenge, and definitively address the root causes of inefficiency.

For example, one payor's proactive enterprise transformation included efforts focused on growth (e.g., pricing, new product development, sales force effectiveness), performance (e.g., medical value, administrative cost), and innovation (e.g., digitization of customer journeys, new business development), and major culture and capability improvements.

Truly transformative efforts are exhaustive in approach—no option is off the table until it is proved to yield no value or be truly infeasible.

Proceed in a structured manner

The pace of a successful turnaround, when done well, should be uncomfortable, with radical transparency and meaningful accountability. Aspiring to deliver impact over a time horizon longer than 18 to 36 months undermines the sense of urgency, allows for distractions to creep in, and increases the temptation to delay the tough calls that have likely been avoided for some time already. Similarly, relying upon existing team structures and governance bodies often has the unintended consequence of reverting to the mean. Put another way, it is difficult to bake a different cake following the same recipe you have always used.

Take the recent example of a midsize nonprofit health system. Although the provider had revenues in excess of $1 billion,

Too little, too late?

Many healthcare organizations ignore underlying issues for years or even decades until they simply must be confronted. Take the case of one large, US-based hospital operator: over the 1990s and 2000s, the company executed an acquisition-driven growth strategy to evolve from a small hospital operator to a major multistate system. However, over time financial performance began to falter, with earnings misses punctuated by surprise year-end operating losses. For several years, external communications on business strategy and performance remained consistent, suggesting a business-as-usual approach to improvement with minimal urgency. In hindsight, many of the problems cited by the company for its deteriorating performance—including operational, capital, and managerial issues—were addressable or could have been mitigated with targeted actions. Instead, the losses continued unabated, accompanied by rising uncertainty and a credit downgrade. The company has divested many of its hospitals and announced plans to continue to shed assets as it works to ensure a sustainable future.

it was hemorrhaging physicians, and patient volume and cash flow were in freefall. A loss of more than $100 million served as the trigger for action. The turnaround, once started, set the goal of achieving a positive EBIDA within two years. Teams were formed to simultaneously address back-office labor, union relations, clinical labor, revenue cycle, physician strategy, clinical program growth and rationalization, supplies and services expenditures, and the productivity of clinical operations.

The health system established a strict cadence of rapid iterations on key business processes, and the interim COO leading the turnaround held weekly comprehensive progress reviews. Within seven months, the organization had generated $50 million in revenues through clinical improvements, revenue cycle productivity, and reductions in labor and nonlabor costs. Today, the system is well on the path to profitability.

Install the right leadership

For a transformation to be successful, organizations must ensure they have the right leaders in place from day one. More often than not, executives have a clear sense of which leaders will adapt and thrive both in a rapid turnaround and the desired end state. Yet they still struggle to make the tough calls.

A regional provider embarked on a comprehensive effort to boost growth, stabilize underperforming assets, and innovate in care delivery. However, its CEO quickly concluded that the executive leadership team, both in structure and membership, was not up to the task. While difficult to think about dismissing long-tenured leaders and trusted colleagues, the CEO knew rapid action was in the best interest of the system. Once the top team was restructured, leaders who were previously reluctant to participate in the transformation began stepping up.

Transformation before desperation

A sober-minded performance assessment can help executives realize that a change in course is required to right the ship before an organization passes the point of no return. A case in point: one of the largest Blues payors, with more than 2 million covered lives and annual revenues of more than $10 billion, recognized in the early 2010s that it was not optimally positioned to navigate the challenges and uncertainty that lay ahead. The organization embarked on a journey to become a “multi-dimensional” health solutions company, with the triple aim of spurring consumer-centric innovation in its business model, reducing costs, and accelerating speed to market. The payor completed a substantial amount of work to increase efficiency among supporting functions; fundamentally restructure its cost base; establish new, segment-focused business units; and simplify decision making. Today, the company enjoys high pretax margins (as a share of premium) and is one of the few payors to demonstrate growth in risk-based capital, a key measure of payor health.

Few turnarounds can be successfully executed without at least some change in the top ranks. But waiting to take decisive action on struggling talent not only impedes performance but also broadly undermines an organization's health and commitment to pursue bold change.

Focus on organizational health

Comprehensive transformations and turnaround efforts are powerful "unfreezing" moments that, by definition, seek to create lasting change in the way an organization functions. Yet one of the most common pitfalls for leaders is neglecting to identify and pursue changes needed to address and improve organizational health, which is an enterprise's collective capacity to achieve superior financial and operating performance over the long term. Key dimensions of organizational health include leadership, climate, accountability, coordination, external orientation, innovation and learning, capability building, and motivation. Most successful transformations invest heavily in organizational health initially, both in understanding the current state and identifying mind-sets and behavior that must be overcome. For example, in the planning stages of a major transformation, a leading healthcare services company recognized that enterprise performance was adversely affecting efforts to disseminate its strategic vision and develop talent. Leaders subsequently launched an intense series of communications, engagement, and capability-building efforts to address the issue and improve organizational health.

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US healthcare organizations today cannot afford to wait out the continual uncertainty enveloping the industry. Whether an organization is a sector-leading performer or truly distressed, hundreds of case examples tell us that they need to act early and boldly. Structuring and delivering programs to sustainably improve growth and performance is never easy and, when done correctly, will stretch the organization well beyond its comfort zone. In our experience, organizations must undertake all six transformation strategies to be successful. An uncompromising focus on each is the key to building a viable future for challenged organizations.

Bede Broome, MD, PhD *(Bede_Broome@mckinsey.com) is a partner in McKinsey's Southern California office.* ***David Bueno, PhD*** *(David_Bueno@mckinsey.com) is an associate partner in the Atlanta office.* ***Brandon Carrus*** *(Brandon_Carrus@mckinsey.com) is a senior partner in the Cleveland office.* ***Deirdre McGinty*** *(Deirdre_McGinty@mckinsey.com) is an expert associate partner in the Southern California office.* ***Drew Ungerman*** *(Drew_Ungerman@mckinsey.com) is a senior partner in the Dallas office.*