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Innovation and Diversification During Tough Economic Times

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According to the recent press, health care services utilization rates for hospital, physician, and prescription drug usage are on a significant decline[1]. Many posit that these changes are a direct result of the "bad economy" manifested in the emergence of new reimbursement patterns such as Health Spending Accounts (HSAs), the transition to higher-deductible benefit plans, reduced health care benefit offerings to employees, and an expanding unemployment rate resulting in further exacerbation of the growing uninsured population. While the health care industry has seen significant short-term shifts in the demand curve for services in the past, most physicians have never seen the mounting pressures to maintain service volume levels like now. Historically compared to other industries, physician services have tracked along a steeper demand curve signifying strong price inelasticity among patient preferences. However, physicians are now facing a burgeoning price-conscious market consistent with sliding demand for ancillary services considered to be non-essential that require "out of pocket" expenses.

What should health care providers do amidst growing economic turbulence? The least prudent approach would be assuming an entrenchment strategy grounded on "waiting and seeing what happens with the economy" as billions of government dollars are poured into the private sector. Entrenchment would have little to do with thwarting your competitors who are aggressively vying for part of your market share, while in fact, entrenchment would likely erode your brand recognition in the market. As we look at recent bankruptcies of major companies in America and probe more deeply into root causes of their financial disaster, we see that most companies failed in the boardrooms where sound strategy formulation should have been an imperative. Unfortunately, the reality of poor strategic planning and execution is equally as rampant in today's health care environment among physician practices as it has been within other industry sectors. More often, medical practice executives face enormous challenges involved with running day-to-day operations to meet their physician's short-term revenue objectives, the payor requirements, the patients' demands, and the employees' needs while still finding the resources and time to think about and develop strategic initiatives that grow revenues. In the end, most practice managers surrender to fighting the daily fires of running the medical practice while innovation and creative ideas never seem to come to fruition and eventually fade. What results is that they are forced to make recommendations based on inadequate information, incomplete business planning, and intuition. Subsequently, medical practices put their financial viability at risk as service revenues stagnate or fall below expectations.

One effective means to shed light on the difficult question of how to formulate a proper strategy during tough economic times is to retrospectively examine how hospitals reacted during their last major catastrophic event in reimbursement or the infamous implementation of Diagnostic Related Groups (DRGs) in the mid-1980's. I wrote an article in the late 1990's where I compiled results from several published research articles on hospital profitability post-DRG implementation[2], and I firmly believe what was concluded then is applicable to medical practitioners in today's economic earthquake. First in accordance with the work by Miles and Snow[3], hospitals like all organizations typically assumed one of four strategies: Prospector, Analyzer, Defender or Reactor. Briefly, prospectors are most prone to seize market opportunities through aggressively researching and launching new diversified services. A prospector's competitive advantage is based on having "first-mover advantage" in growth markets, building brand awareness, and crafting barriers to entry. Defenders assume a cost-based focus where competitive advantage is grounded on standardization of processes, centralization, and efficiencies. Analyzers, mirroring prospectors and defenders simultaneously, would generally be the second entrant into a new market behind prospectors, invest in limited diversification of new services, and take steps to become more efficient in operations. Reactors simply "flip-flop" among strategies based on the operating climate, and in the end, really have no strategy at all. What has been learned is that hospitals that concentrated on offering efficient core services, in addition to diversifying into limited, related service offerings, were the most successful in surviving the significant upheaval in their operating environments. Finally, it was found that the relationship between being an Analyzer and financial success would be moderated by having adequate internal core competencies and infrastructure. Based on this, the following recommendations are made to medical practice managers:

Recommendation 1: **Assume cautious diversification and prudent economizing in your operations during the tough economic climate. We accomplish this recommendation through:**

"Cautious Diversification"	**"Prudent Economizing"**
Discover untapped needs among your current patient mix	Rebid vendor contracts
Expand into new markets that are overlooked	Address internal processes and eliminate redundancies
Develop points of differentiation in your current service mix	Optimize staffing models and reduce slack resources
Provide highly related and researched ancillary services that complement your core competencies	Divest in non-profitable service offerings
	Evaluate and harvest those service offerings that are eating up precious resources

Recommendation 2: **Develop a thorough and adequate business planning process for your practice for all diversification decisions by deploying the following process:**

Steps for Business Planning to Achieve Cautious Diversification

1. Understand your internal and external environments
    a. Internal assessment (strategic fit, resource capacity, external relationships, and structure)
    b. Patient environment assessment
        i. Market potential forecasting
        ii. Patient profile, decision criteria, brand perceptions, switching propensity and price elasticity (measured via primary research)
    c. Channel partnership criteria involving strategic alignment, decision drivers, feature preference, past experience, future intentions for referrals (measured via primary research)
    d. Competitor assessment regarding performance, competencies and shortfalls, marketing strategies, targets, and reactions
    e. Other environmental factors pertaining to technology, legal, regulatory, and payor/reimbursement
2. Set objectives
    a. Specificity
    b. Measurement
    c. Attainable (actionable)
    d. Responsible Party
    e. Timeline
3. Assume strategy formulation
    a. Service development (Features must link to the Solutions to a Problem)
        i. Diversification decisions must be supported by the research (evidence)
        ii. Options include acquisitions, strategic alliances, outsourcing, internal service development, and franchising
        iii. Considerations include licensing, liability implications, process and quality protocols, infrastructure, financial management, technology, and staffing & skill acquisition
    b. Pricing is centered on the preferences among payors and reimbursement practices
        i. Cost-based pricing
        ii. Patient-based pricing
        iii. Competition-based pricing
    c. Geographical Expansion
        i. Convenience
        ii. Branding recognition
        iii. Global access to new markets
        iv. Referral relationships
        v. Strategic alliances
        vi. Unsaturated markets
    d. Promotion – Develop your points of differences
        i. Relevance
        ii. Distinctiveness
        iii. Believability
        iv. Feasibility
        v. Communicability
        vi. Sustainability
4. Financial Analysis
    a. 3-5 year proforma

    b. Break-even analysis
    c. Pay back period
    d. Net present value
    e. Internal rate of return
5. Tactical Launch Plan – spreadsheet plan of activities and recording of occurrences
    a. Task definition
    b. Start and completion dates
    c. Budget versus actual costs
    d. Responsible Parties
    e. Status and comments
6. Formal controls
    a. Control Variables
        i. Resource allocations
        ii. Training and professional development
        iii. Compensation and rewards
        iv. Capital outlays
        v. Infrastructure support
        vi. Internal communication
    b. Measurement
        i. Branding (awareness and recall)
        ii. Revenue growth
        iii. Market share changes
        iv. Patient satisfaction results
        v. Referral source feedback
        vi. Process improvement results

7. Take-aways
    a. Avoid entrenchment strategy
    b. Allocate resources to innovation and new ideas
    c. Seek expert advice (you pay for what you get)
    d. Build on facts not intuition
    e. Measure, measure, measure
    f. Assess the efficacy of your planning using multiple measurement methods

Footnotes:

1. Flick, Eileen M. (2008), "Moderating health care costs could signal trouble ahead", *BenefitNews.com Employee Benefit News*, December, p. 48-9.

2. Westbrook, Kevin W. (1997), "Assessing the Strategy-Performance Paradigm: Implications for Organizational Adaptation in Discontinuous Environments for Home Health Care Providers" *Health Marketing Quarterly*, 14, (4), 27-44.

3. Miles, Raymond E., and Charles C. Snow (2003), <u>Organization Strategy, Structure, and Process</u>, Stanford University Press, Stanford, CA.