

Leading the Charge for Disruptive Innovation



New health care market entrants and vertical integrators are challenging the traditional business models and operational tactics of hospitals and health systems. This report from the American Hospital Association (AHA) Center for Health Innovation outlines the moves hospitals and health systems can make to convert that challenge into more opportunities to serve the health needs of their patients.

The Time is Now

There's a strategic fork in the road for hospitals and health systems across the country as they contemplate how to respond to the wave of new health care market entrants that are testing their traditional business models and operational tactics as never before.

This report from the [AHA Center for Health Innovation](#) examines why nontraditional health care companies are moving into health care; why traditional sectors of the health care field are coming together in different combinations; how that disruptive behavior may affect hospitals and health systems; and, most importantly, how hospitals and health systems should respond to continue to fulfill their mission of advancing health in America.

The AHA Center for Health Innovation based this report on information and insights taken from a number of sources, including interviews with hospital and health system leaders and other health care experts, surveys of hospital and health system executives, speaker presentations, events and a number of health care reports and research articles. A complete list of sources appears on Page 9 of this brief.

The AHA Center for Health Innovation thanks everyone for their contributions to this analysis.



Understanding the Motivation of New Market Entrants

The disruptive activity prompting hospital and health system leaders to rethink their traditional business models and operational tactics falls into two broad categories:

- **New market entrants.** This activity comes from nontraditional health care business sectors like consumer tech companies and consumer retailers that are expanding into health care.
- **Vertical integrators.** This activity comes from traditional health care business sectors like health insurers, providers and pharmacies that are merging under one corporate umbrella.

The two buckets aren't mutually exclusive as many of the new market entrants and vertical integrators are doing some of both at the same time. The AHA Center for Health Innovation has created an [interactive timeline](#) to track and update all the major activity in both categories.

To know how to respond better to these new market entrants and vertical integrators, hospital and health system leaders first must understand the motivation of the different business sectors that are engaging in the disruptive behaviors.

For new market entrants, the motivation is opportunity. They may be in highly competitive industries that offer little or no future growth for their owners, shareholders or investors. They see inefficiencies and deficiencies in health care delivery and finance. And they believe that they can address them better than legacy players.

New market entrants also see \$3.7 trillion in annual health care spending and a field that represents nearly 20 percent of the country's Gross Domestic Product. If they succeed at addressing inefficiencies, then they will be major players in the health care market. They're not necessarily in it to control costs, expand access or improve quality. But, if they can do any or all of those three things, the new market entrants and their owners, shareholders and investors will benefit financially.



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1,566

Number of health care mergers and acquisitions announced in 2017. The total value of the deals was \$315.3 billion.

Source: Irving Levin Associates, 2018

For vertical integrators, the motivation is sustainability. These corporations and organizations typically enjoy dominant market positions in their sector of the health care field, whether it's inpatient care, ambulatory care, post-acute care, health insurance or pharmaceuticals. Like new market entrants, the growth of vertical integrators also is limited. They see new market entrants as a competitive threat, but the opportunities to merge with or acquire a direct competitor to protect themselves are limited. That could be from a lack of potential merger or acquisition partners or because of regulatory constraints.

Instead, vertical integrators are merging with or acquiring corporations and organizations in another sector of the health care field. They encounter fewer regulatory constraints. They gain entry into a new sector of the field and create new revenue streams. They can scale and reduce their operating costs. They eliminate the transactional costs of doing business with another health care sector. They improve profitability. And they protect themselves from new market entrants.

How Disruptive Activity Affects Hospitals and Health Systems

New market entrants and vertical integrators are engaging in disruptive activities in both the delivery and financing of health care services. That affects hospitals and health systems in two ways:

- First, it can change how hospitals and health systems deliver care.
- Second, it can change how much hospitals and health systems are reimbursed by patients, private health plans, public health-insurance programs, employers and other payers for the care that they deliver.

Most new market entrants and vertical integrators are focusing their disruptive activities on the delivery of health care services, and their goal is to serve the needs of patients better, not the needs of hospitals or health systems.

Hospitals and health systems whose current business models and operating tactics don't make patient care more affordable, coordinated, convenient and closer to home while giving patients more control over their own health data could find themselves on the

losing end of disruptive activity.

Hospitals and health systems can no longer count on patient loyalty by default. Patients are more likely than ever to be attracted to new brands that offer convenience via digital technologies.

Specifically, new market entrants and vertical integrators are targeting areas in which they believe hospitals and health systems fall short: affordability, care coordination, convenience, customer service, digital acumen, transparency and virtual care.

The following six areas receiving the most funding from venture-capital firms, according to a recent report from Rock Health, reveal where new market entrants and vertical integrators are placing their bets:

- On-demand health care services
- Fitness and wellness
- Diagnosis of disease
- Consumer health information
- Monitoring of disease
- Treatment of disease

In short, patients want high-quality care that is convenient and affordable, and it's that need that new market entrants and vertical integrators seek to fulfill.

The Rise of the Vertical Integrator

Hospital and health system leaders interviewed for this report said they see vertical integrators that offer immediate and low-cost, primary care services to patients as perhaps the biggest challenge to their organizations' traditional business models and operating tactics.

Examples of this type of disruptive innovation include health insurers merging with physician practices or retail pharmacy chains with in-store clinics merging with health insurers.

In each case, health insurers control both the financing and delivery of

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\$1.27 Billion

Amount of venture capital invested in on-demand health-care services through the first nine months of 2018.

Source: Rock Health, 2018



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“Companies all around us, in and out of health care, are developing replacements for hospitals and health systems. They’re not here to help us. They’re here to be us.”

primary care services. They can steer enrollees to their own sites of care and set the prices for those visits substantially lower than what enrollees might have to pay for visits to other practices or practices affiliated with hospitals and health systems.

In fact, many leaders identified health insurers and other payers as the sector that will have the greatest impact on disrupting the current models of care delivery in their services areas — even more than will consumer tech companies and consumer retailers. Rather than underwriters of risk that negotiate with hospitals for payment, insurers increasingly appear to see themselves as competing providers.

That may be particularly troubling as payer consolidation gives health plans more market share in their respective service areas. A recent American Medical Association analysis said one carrier controlled at least 50 percent of the health insurance market in 169 out of 389 metropolitan statistical areas in the U.S. in 2016. If the same dominant health plans start to control more providers, it could doubly impact hospitals and health systems.

Disruptive Impacts by Hospital Type

Disruptive activities by new market entrants and vertical integrators will affect all types of hospitals and health systems. The type of disruption will affect each type of hospital and health system differently. No hospital type will be immune from consumer- and patient-driven innovations in its market regardless of whether the innovations target affordability, care coordination, convenience, customer service, digital acumen, transparency or virtual care. For example:

Academic medical centers. Academic medical centers and their inherent high-cost structures may not be able to reduce their costs and subsequent prices for services to the point of being competitive with new market entrants and vertically integrated delivery systems.

Community hospitals. Community hospitals may lack the health and wellness capabilities to support a comprehensive population health-management program that new market entrants and vertically integrated delivery systems can execute from anywhere through new technology.

Critical access hospitals. Critical access hospitals may struggle with

care coordination and the ability to invest in innovation.

Metropolitan hospitals. Urban and metropolitan hospitals may have issues with convenience because of their locations, congestion and available parking. New market entrants and vertical integrators don’t have physical limitations to when and where they deliver care.

Small or rural hospitals. Small or rural hospitals may have workforce issues because their labor or talent pools may be limited. New market entrants and vertical integrators understand the value of great customer service and know how to replace humans with technology.

Large health systems. Hospitals that are part of larger systems can benefit from the scale of the system. Individual hospital innovations can scale across markets. But complex organizational structures can slow wide-scale adoption. Often, new market entrants and vertical innovators can move and scale faster than legacy system-based hospitals.

Yet, achieving scale alone won’t position hospitals and health systems better when faced with challenges to their traditional business models. All the things that hospitals and health systems do that new market entrants and vertical integrators want to disrupt are still there, there are just more of them.

Hospitals and health systems that join together must aggressively pursue clinical and financial integration as well as seek economies of scale to reduce their operating costs. They also need to use their collective strength to launch scalable innovations in care delivery and financing in an environment where patients have more options, particularly for their ambulatory care needs.

Historically, most hospitals and health systems, regardless of their type or size, have tried to be all things to all people in their communities. They are the centers of health and medical care in their markets. That has made them good at everything, but not necessarily great at everything. Those are the weaknesses that new market entrants and vertical integrators seek to exploit.

INSIGHT

“If patients can get an on-demand primary-care visit for less than \$50 that includes labs and radiology, we’re going to be hard-pressed to attract them to our hospital.”



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64%

Percentage of CIOs at 40 large health systems who cited culture or organizational structure as the biggest barrier to innovation.

Source: Health Management Policy and Innovation, 2018

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65%

Percentage of senior leaders at the 100 largest health systems who said they are willing to self-disrupt in response to a disruptive market.

Source: H2C, The Health Management Academy, 2018

12 Cultural Attributes of the Innovative Hospital or Health System

The motivations of new market entrants (opportunity) and vertical integrators (sustainability) are clear. The picture of how their actions will test the traditional business model and operating tactics of hospitals and health systems is emerging. As a result, hospitals don't have to just be reactionary. Hospitals and health systems can be innovators themselves and lead, rather than follow, disruption.

As with any successful transformation, change starts at the top, and that's no different for those who lead the nation's hospitals and health systems.

The AHA Center for Health Innovation asked the expert panel assembled for this analysis as well as researched reports, surveys and other literature to identify the characteristics of executives and cultural attributes of the organizations they lead that, when combined, will give birth to hospitals and health systems that thrive on disruptive innovation.

The following characteristics and cultural attributes are essential to making hospitals and health systems the disruptors, not the disrupted.

1. Be comfortable and competent in blurring the lines between two or more traditional health care business sectors.
2. Be willing to partner with nontraditional health care business sectors to pursue innovative solutions that solve a critical job to be done.
3. Be comfortable and competent running two operating models—one based on volume and the other based value—at the same time.
4. Be willing to move quickly to make the necessary changes and innovations that lead to better patient-focused outcomes.
5. Be willing to believe what the data is saying about what patients want instead of relying on instinct and experience alone.
6. Be willing to base strategic business decisions on what patients and communities need rather than what financial needs dictate.
7. Be willing to accept that change will be difficult but necessary to succeed in the new health care economy overflowing with new market entrants and vertical integrators.
8. Be willing to take risks if they present genuine opportunities to more effectively serve patients and communities.
9. Be comfortable with revenues and margins coming from new and different places instead of inpatient volume.

10. Be willing to re-examine traditional objects of capital investments and redeploy capital in different ways.
11. Be willing to embrace new digital health technologies and create a fully informed, patient-centered digital health strategy.
12. Be willing to build a sustainable innovation infrastructure that's well-supported by budget, talent and processes.

The 12 characteristics and cultural attributes describe a hospital or health system whose top executives recognize that disruptive innovation is here now, and that this is how things will be from now on.

They describe a hospital or health system whose top executives are ready, willing and able to make the changes necessary to lead disruptive innovations in their markets, because they see themselves as advocates for their patients and communities. They're not in it to expand their businesses or preserve their market shares. They want their hospitals and health systems to remain relevant because their patients and their communities need them to remain relevant.

Wresting Control of Disruptive Innovation from New Market Entrants and Vertical Integrators

How do those 12 characteristics and cultural attributes manifest themselves into actions that respond to the disruptive activities of new market entrants and vertical integrators? The AHA Center for Health Innovation's research for this analysis identified four practical steps that hospitals and health systems around the country can take.

1. Know what you want to become

A recent report from the PwC Health Research Institute recommended that hospitals and health systems should no longer try to be all things to all people. Instead, hospitals and health systems should "evolve into one or more distinct models to stay relevant." The four models are:

- **Product leader** that delivers the most advanced care and best outcomes.
- **Experience leader** that achieves the greatest customer satisfaction.

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"We need hospital and health system CEOs who will roll up their sleeves and innovate around the jobs to be done today, not CEOs who will spend all their energy arguing to preserve the current system."



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- **Integrator** that has the greatest scale and scope.
- **Health manager** that improves the health of entire populations.

Other experts and sources referenced for this report agreed that hospitals and health systems will have to assume distinct identities to be successful in the future. The identities tend to fall into three buckets:

- An academic-focused specialty hospital that provides high-cost, high-acuity care to patients
- A community hospital that serves as a hub to primary and secondary ambulatory care sites closer to patients' homes
- A local hospital that serves as a hub for neighborhood or home-based resources that provide basic health and wellness services to patients

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84%

Percentage of 325 CEOs who said their hospitals or health systems will be collecting standardized data on patients' social determinants of health in their communities by 2023.

Source: Futurescan 2018–2023: Healthcare Trends and Implications, 2018

Regardless of the model, the message is clear: Hospitals and health systems will become what their patients and communities need them to become. One size will not fit all.

2. Be a new market entrant or vertical integrator yourself

If nontraditional health care businesses can enter the health care space, why can't hospitals and health systems move into other areas as well? As hospitals and health systems address social determinants of health to improve outcomes and manage the health of their patient populations, many are doing just that.

For example, some hospitals and health systems are growing their own food or opening up their own grocery stores to manage their patients' food insecurity. Others are delving into the housing and the real estate market to manage their patients' safe-housing requirements. Still others are getting into the transportation business to ensure that their patients can keep scheduled appointments with their physicians and other clinicians.

Hospitals and health systems are partnering directly with new market entrants like consumer tech companies and consumer retailers to test the application of their digital technologies on the delivery of health care services. Others have formed their own venture-capital companies to finance startups that develop disruptive health care products and services. Yet other hospitals and health systems are sponsoring or joining different accelerators and incubators across the country to get in on the ground floor of potentially transformative innovations in care delivery for their patients and communities.

In addition to becoming their own new market entrants, hospitals and health systems can become their own vertical integrators. The classic example of this behavior is provider-sponsored health plans, which are owned in whole or in part by hospitals or health systems. However, provider-sponsored plans aren't the only way hospitals can integrate vertically. A new example arrived on the scene earlier this year when several prominent health systems announced that they were forming their own generic drug company, Civica Rx.

3. Create and execute your own digital health strategy

Patients are not comparing their online customer service experiences with another hospital or health system. They're comparing them with those of a retail company in another field. And patients are wondering why hospitals and health systems can't yet do what they've come to expect from retail companies in other industries.

The rise of digital health technologies in many ways is disconnecting patients from their hospitals and health systems. Without speaking to another human being, patients can do everything from managing their own chronic illnesses, scheduling appointments with their doctors, checking their latest lab results and refilling prescriptions to paying medical bills and accessing their own medical records.

The responsibility of hospitals and health systems is to make all those tasks as easy as possible for their patients. That's what patients expect. And the hospitals and health systems that can deliver on those expectations will be in a better position to fend off competitive threats from new market entrants and vertical integrators.

4. Support your workforce as it shifts to a new type of workforce

As hospitals and health systems make life easier for patients in response to the disruptive activities of new market entrants and vertical integrators, life will become more complicated for the caregivers and staff who work at hospitals and health systems.

Caregivers and staff will have to change how they deliver care to pa-

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71%

Percentage of senior leaders at the 100 largest health systems who said that they are investing in digital health technologies.

Source: H2C, The Health Management Academy, 2018



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71%

Percentage of 325 CEOs who said their hospitals or health systems will have acquired and repurposed offsite retail or office space for outpatient services in their communities by 2023.

Source: Futurescan 2018–2023: Healthcare Trends and Implications

tients. They will have to learn new technologies and incorporate those technologies into their workflows. Effective training, education and support will be essential to the success of that transition.

New and disruptive technologies will extend beyond clinical documentation and administrative tasks. More and more hospitals and health systems will turn to analytics, artificial intelligence (AI) and machine learning to support everything from clinical decision-making and supply-chain management to revenue-cycle management. The learning curve will be steep and stressful for caregivers and staff before Big Data, AI and machine learning mesh seamlessly with their human users at the high-tech hospitals and health systems of the future.

Caregivers and staff also will have to change where they deliver care to patients. That could be in a patient's home, in retail or office space that's been repurposed into outpatient care space, in a retail clinic

that's part of a joint venture with a pharmacy chain or it could be virtual care via a computer screen that's part of a new telemedicine program.

Adequate staffing and the right skill sets will be essential to maintaining the safety and quality of patient care while at the same time meeting patients' growing customer-service expectations and avoiding staff burnout and turnover.

By adopting the 12 characteristics and cultural attributes of an innovative hospital or health system and putting them into practice, hospitals and health systems across the country can lead the patient-driven innovations in care delivery that are happening in their communities.

In doing so, they can effectively respond to the new market entrants and vertical integrators that are challenging their traditional business models and operating tactics.

Expert Panel

The AHA Center for Health Innovation thanks the following individuals for their time and insights in making this analysis report possible:



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