Innovation in the Age of Obamacare

A conversation about how the Affordable Care Act is changing healthcare

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The Patient Protection and Affordable Care Act of 2010, commonly called “Obamacare” or the ACA, continues to be a highly charged political issue. Most of the law’s provisions survived a Supreme Court ruling, and thus far, the ACA has withstood dozens of attempts at legislative repeal. It remains a hot-button issue politically, has been widely discussed as a factor in each election since its inception and is expected to figure prominently in future elections.

The law has been rolled out to consumers unevenly, partly because of the rocky launch of the federal healthcare exchange website, and partly due to state healthcare exchanges that vary in quality and functionality. Another factor affecting the consumer launch is the individual states’ acceptance of the Medicaid expansion portion of the law. All of these elements have profoundly influenced perceptions of the ACA and how it functions for individuals and governments.

Much of the commentary about the law has focused on how the ACA’s provisions affect consumers and the political fallout, and there are important, ongoing developments on both fronts that are worthy of discussion. But it’s also crucial to analyze how the ACA is changing the way providers deliver care and how the law is affecting innovation in the healthcare sphere.

ACA provisions like the medical device tax and the shift away from fee-for-service business models and toward outcomes-based reimbursement have caused fundamental changes in the way companies invest and innovate. Product and medical device manufacturers are reacting to the changes. Healthcare services and solutions providers are evolving their approaches.

Operating in this changing landscape calls for a different set of leadership skills. When traditional avenues to profitability are no longer viable, the companies that succeed will be those that adapt and compete under the new rules – keeping in mind that the rules are always subject to change. This paper explores some of the factors that are driving the current evolution in healthcare, including:

- New product and medical device manufacturer operating parameters and the impact on investment
- New reimbursement models and emerging mobile technology’s effect on healthcare delivery
- Turmoil in the industry, including consolidations and layoffs, R&D budget reductions and new partnership models
- New paths to innovation, including fresh investment strategies, offshore manufacturing and launch and different delivery systems
- Changing perceptions of healthcare delivery, including a focus on the retail aspects
This paper is intended to advance a discussion of these issues, exploring the ways the ACA has already changed the way the industry approaches innovation, examining the methods that companies on the product and delivery sides of the healthcare continuum are responding to an evolving landscape and investigating a more consumer-oriented approach.

Since its inception, the ACA has been viewed with alarm by those in the life sciences, medical device manufacturing and healthcare delivery sectors, and not without ample justification. For life sciences companies like pharmaceutical firms, it’s not yet clear how the ACA will affect spending on medications over the long haul.

But the shift away from fee-for-service models toward performance-based reimbursement is already prompting pharma developers to eschew products designed to deliver short-term gains in favor of “Hail Mary” projects – products with the potential to dramatically affect outcomes rather than deliver incremental improvements. This is a fundamental shift with far-reaching implications for how the life sciences industry approaches innovation.

On the medical device manufacturer side, the ACA’s 2.3 percent excise tax on clinical medical device product sales has drawn criticism from politicians on both sides of the aisle and inspired pessimism and worse among device manufacturers, who contend that the ACA will stymie innovation. A Deloitte study projects that the US medical device market could decline by more than 10 percent, partly as a result of ACA provisions that give hospitals and patients greater influence in purchasing decisions. This has broad implications for medical device industry innovation.

With margins expected to decline and buyers becoming increasingly cost-focused and results-oriented, many medical device companies are rethinking their marketplace strategy. Product development is shifting to areas where value can be more clearly demonstrated and toward products that can help accountable healthcare organizations meet compliance goals. Investment in new medical technologies remains steady; overall declines preceded the passage of the ACA and were in line with the general trajectory of investments in other sectors during the economic downturn that began in 2007.

On the healthcare delivery side, the ACA as well as Medicare and Medicaid reimbursement reductions are prompting hospitals and healthcare groups to shift their focus from volume to value. Leading insurers are following suit, emphasizing transparency as they move away from the fee-for-service payment model for doctors and hospitals. At the Forbes Healthcare Summit 2013, leaders from UnitedHealth Group, Humana and a number of Blue Cross and Blue Shield plans confirmed that their new reimbursement models emphasize rewards for keeping patients healthy rather than pay for delivery of services, just as ACA protocols for government payers do.
By design, the ACA built in a focus on technology, including incentives for providers to demonstrate meaningful use of healthcare IT assets, such as electronic medical records systems. And just as new communications platforms and the explosion of data analytics have transformed the way customers connect with businesses and companies manage performance, the mHealth revolution holds great promise as an innovation tool that can help healthcare providers control costs while delivering personalized, high quality care.

A Transition Marked By Turmoil

The ACA and related healthcare reform measures adopted by the private insurance industry are transforming the way medicine is practiced in the US, and the transition has been marked by turmoil, including acquisitions, consolidations and layoffs. In just one of many examples of consolidation, Aetna purchased Coventry Health Care for $5.7 billion, a move that added the five million Coventry members to Aetna’s 36.7 million enrollees. A Jefferies & Co. analyst described Aetna’s strategy as follows: “The regulatory limitations on their margins mean that to drive profitability, they need to get leverage on [sales, general and administration]. In order to do that, they need to be bigger.”

Leading medical device maker Covidien announced layoffs in September 2013 as a cost control and asset management measure that would enable a new market strategy. The move was accompanied by a boost in the device maker’s quarterly dividend share. Company executives cited the need to create long-term efficiencies and improve Covidien’s cost structure in the regulatory filing that announced the layoffs. Among the expected long-term benefits are significant reductions in corporate costs, increased reliance on outsourcing, a shift to lower-cost locations and further consolidation in manufacturing and distribution operations.

Healthcare reform is driving another effect in the healthcare delivery ecosystem: business process outsourcing that is reminiscent of the cost-cutting measures that have long been a part of the retail and manufacturing landscape. Group purchasing organizations like Parallon Business Solutions, an HCA subsidiary, aim to change the way hospitals and healthcare systems conduct business by establishing more efficient logistics and warehousing processes and using economies of scale to drive down prices on supplies.

On the medical device side, an Ernst & Young report shows that the medical device tax could cut R&D spending by as much as 29 percent across the industry. While this is obviously cause for concern on the innovation front, the report also notes heightened interest in acquisitions and joint ventures: Companies that are reducing R&D are seeking to acquire startups with strong patent portfolios. And in some cases, established industry players are working together in new ways: General Electric and Microsoft launched a 50-50 joint venture in 2012, forming Caradigm to deliver a technology platform and clinical applications to address population health management solution demands driven by healthcare reform.
Finding New Ways to Innovate

The significant industry turmoil resulting from healthcare reform, including measurable reductions in R&D, layoffs and consolidations across both the medical device and healthcare delivery sectors, has led some observers to conclude that innovation is dead. But like a stream whose path is altered by a dam, innovation continues along different courses in the age of Obamacare. The companies that are carrying innovation forward are led by executives who display maximum agility in response to change and a willingness to shift focus from one set of core competencies to another as new demands emerge.

Stuart Karten, principal of California-based medical product design specialist Karten Design, described the new mindset in a radio interview late in 2013: “When you put constraints or barriers around anything it causes innovation and things to pop up,” Karten said. He noted that while healthcare reform is adversely affecting big businesses with existing products, the increased number of healthcare consumers as more people gain access to coverage will ultimately expand opportunity: “It’s short-term versus long-term thinking.”

US-based device makers are also looking beyond national borders to identify new opportunities. Exports to China are up, with $1.7 billion in US devices sold in 2012, and companies are looking to China and other markets as environments to manufacture and launch new products with fewer constraints. GE Healthcare invested $2 billion to promote medical device innovation in China. Stryker Corp. acquired Trauson Holdings and rolled out manufacturing locations in China. The company also signaled its interest in China as a device market by establishing surgeon education centers.

Other companies are pursuing new paths of innovation by creating services and products that meet the new ACA standards and help healthcare providers conform with new expectations that emphasize managing population health rather than filling hospital beds and delivering services. An overview of trends indicates that the larger, less agile companies with an established product portfolio are taking a hit with the implementation of the ACA while smaller, more nimble companies that capitalize on the new requirements are poised to grow.

The Innovation Executive – New Rules

- In today’s rapidly evolving healthcare market, the most successful executives will display the following traits:
  - Ability to form collaborative joint ventures and partnerships to spread risk and potentially broaden product development portfolios
  - Expertise in co-sourcing and supply chain optimization to deal with unwinding issues and an increasingly global supplier model as opposed to in-house manufacturing
  - The ability to navigate change and uncertainty – the Explorer model – showing leadership to respond to any potential path rather than pursuing a specific path that the market may render obsolete with no warning
  - Customer and market insight capability – based on the shift to preventative medicine, new systems and outcomes-based payment models
New Conversations About Healthcare Delivery and Related Products

So what’s the bottom line on how the ACA is affecting innovation in healthcare? It’s too early to draw many firm conclusions, but some big-picture trends have emerged, including a more retail-oriented, consumer-focused approach to healthcare delivery. Like their retail business counterparts, hospitals and healthcare systems are focusing on cultivating patient satisfaction and measuring performance more closely, thanks in part to the fact that the ACA explicitly ties reimbursement to overall population health management rather than volume.

As is the case in other industries when new factors overturn long-established ways of doing business, the healthcare delivery and medical product design and manufacturing sectors are undergoing a period of uncertainty as they try to adjust to rapid changes. Companies are reassessing their roles in the marketplace and looking inside and outside the US for new opportunities. Some are reacting to new regulatory and financial pressures by reducing costs, ramping up outsourcing resources and exploring new markets. Others are building products and service models to support operations in the new healthcare landscape.

Some examples of these shifts are the redirection of medical device R&D dollars to portfolio acquisition, which can allow companies to acquire the high-value, next-generation innovations that will generate profits in a transformed healthcare environment. The new partnerships between healthcare systems and group purchasing organizations and business process outsourcers also illustrate an adaptation within the industry to changing expectations, as does the emphasis on products and services that promote health rather than treating diseases, including mHealth innovations.

While some say that the Affordable Care Act is an innovation killer, the picture that is emerging as healthcare reform progresses is much more nuanced. Clearly opportunity is still out there, both on the healthcare delivery side and the medical device development front, as companies that are growing rapidly in the new environment demonstrate. Now the question is how healthcare providers and product developers can adapt to meet changing circumstances. The uneven response across the industry mirrors in some degree the evolving rates of acceptance of the ACA in the political and consumer realms. In the age of Obamacare, this much is clear: New leadership skills and core competencies within established organizations are required to navigate the changes – and seize the opportunities.

It’s becoming clear that executives will need to develop new skillsets to thrive within this rapidly evolving environment. An ability to collaborate to launch joint ventures and form partnerships is becoming a must-have skill. Expertise in supply chain optimization is increasingly important. An ability to handle rapid change and uncertainty is key, as is the capacity to respond to emerging customer and market insights. In the age of Obamacare, this much is clear: New leadership skills and core competencies within established organizations are required to navigate the changes – and seize the opportunities.
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