

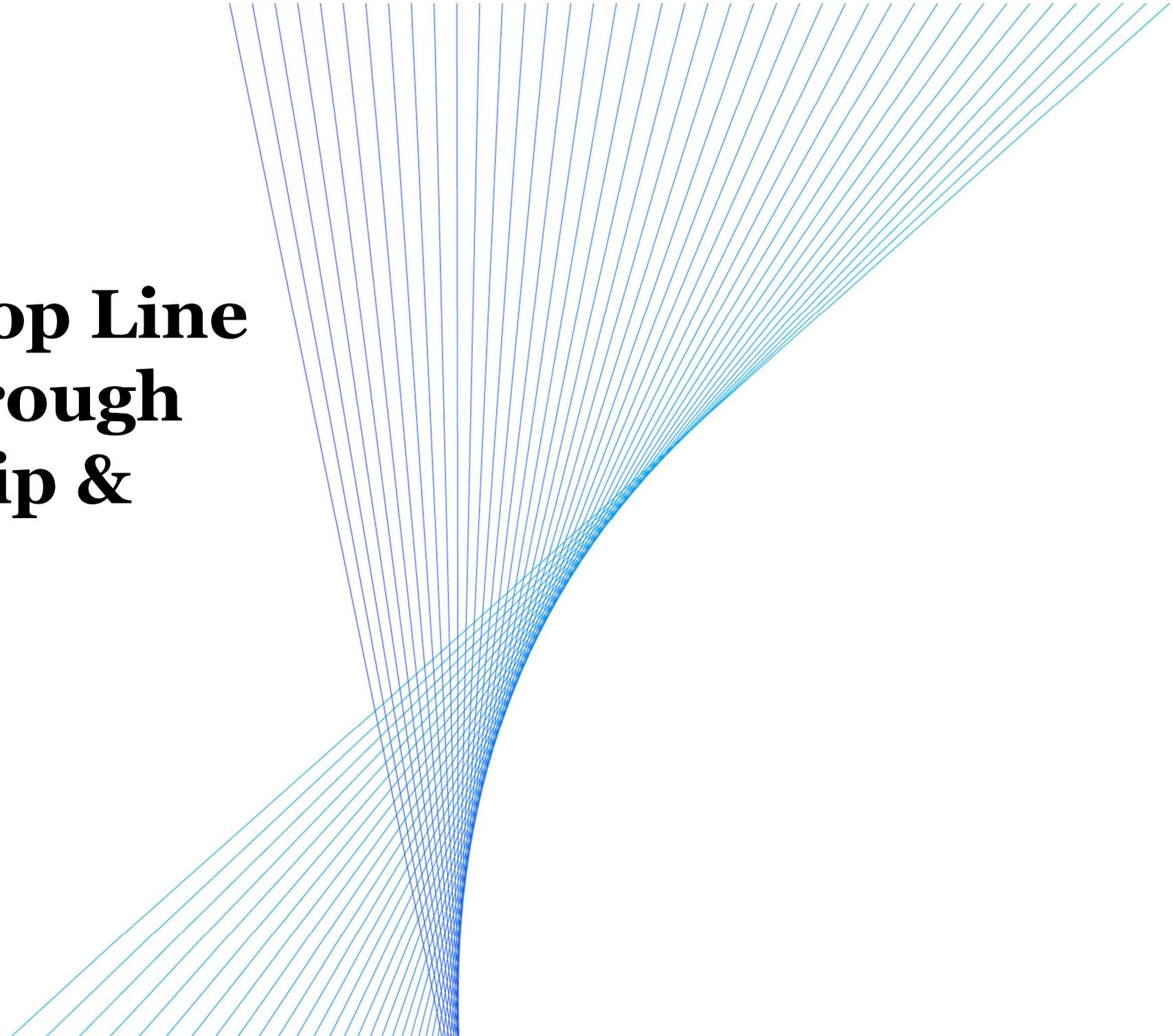
McKinsey
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Re-Energizing Top Line Performance through M&A, Partnership & Diversification

Leadership Institute Roundtable

November 3-5, 2021

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Introduction

Looking back over the last 10 years...

What changes did we correctly predict, and which trends did we not anticipate?



...and looking ahead to 2030

What are the forces that will shape how leading health systems navigate the future?

How should health systems position themselves for success?

Where should providers be bold and disruptive, or risk being disrupted?



Review of our predictions from 2010 ...

Industry consolidation has not happened as quickly as we expected

Anticipated rise of HMOs did not materialize

ACA led to Medicaid expansion but with muted impact on care delivery and pharma

Digital revolution has not yet unlocked significant cost savings and productivity

Adoption of value-based care has been slower than expected

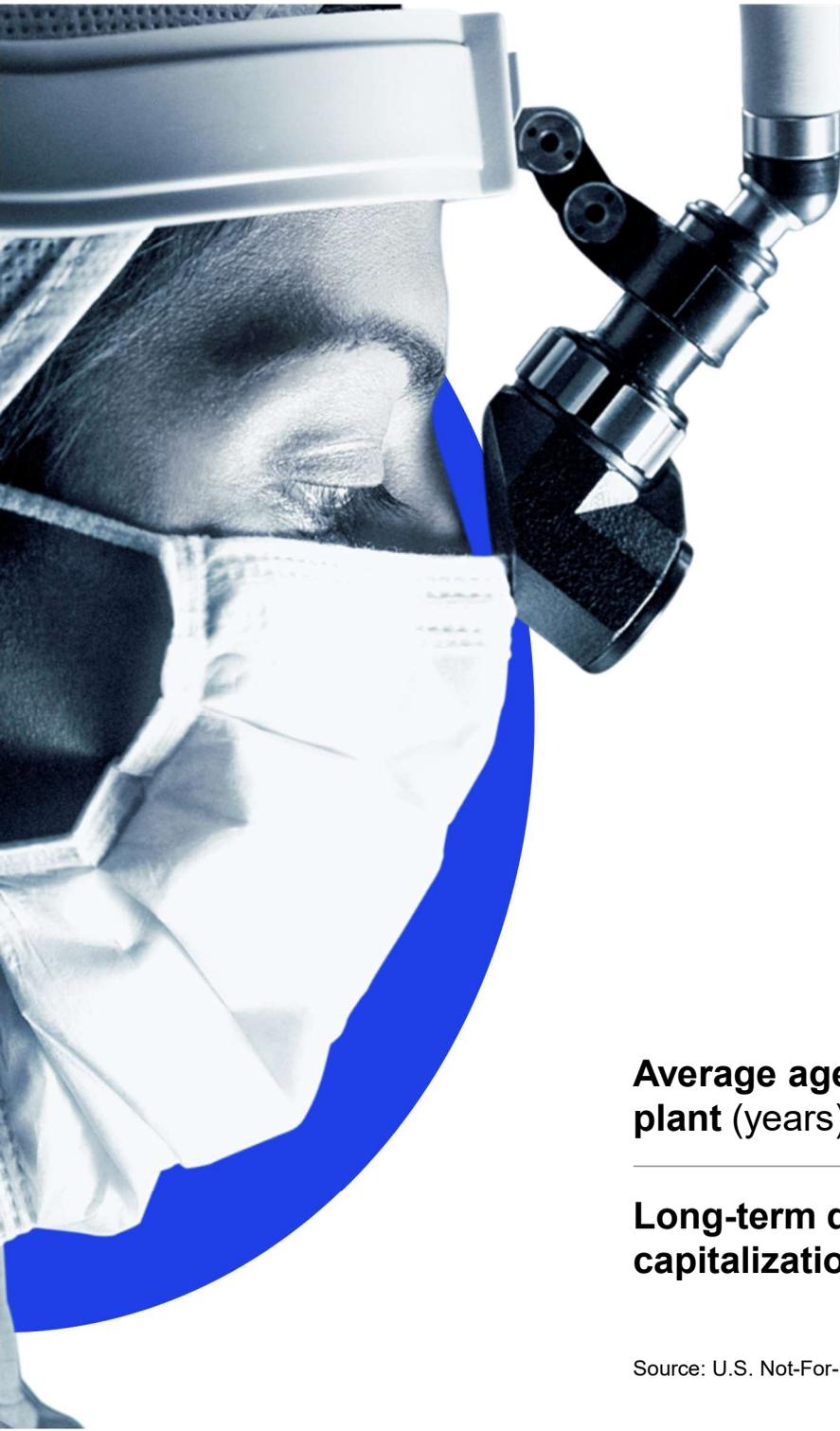
... and some trends that we didn't forecast

Rising interest from institutional capital, focused on high-value profit pools

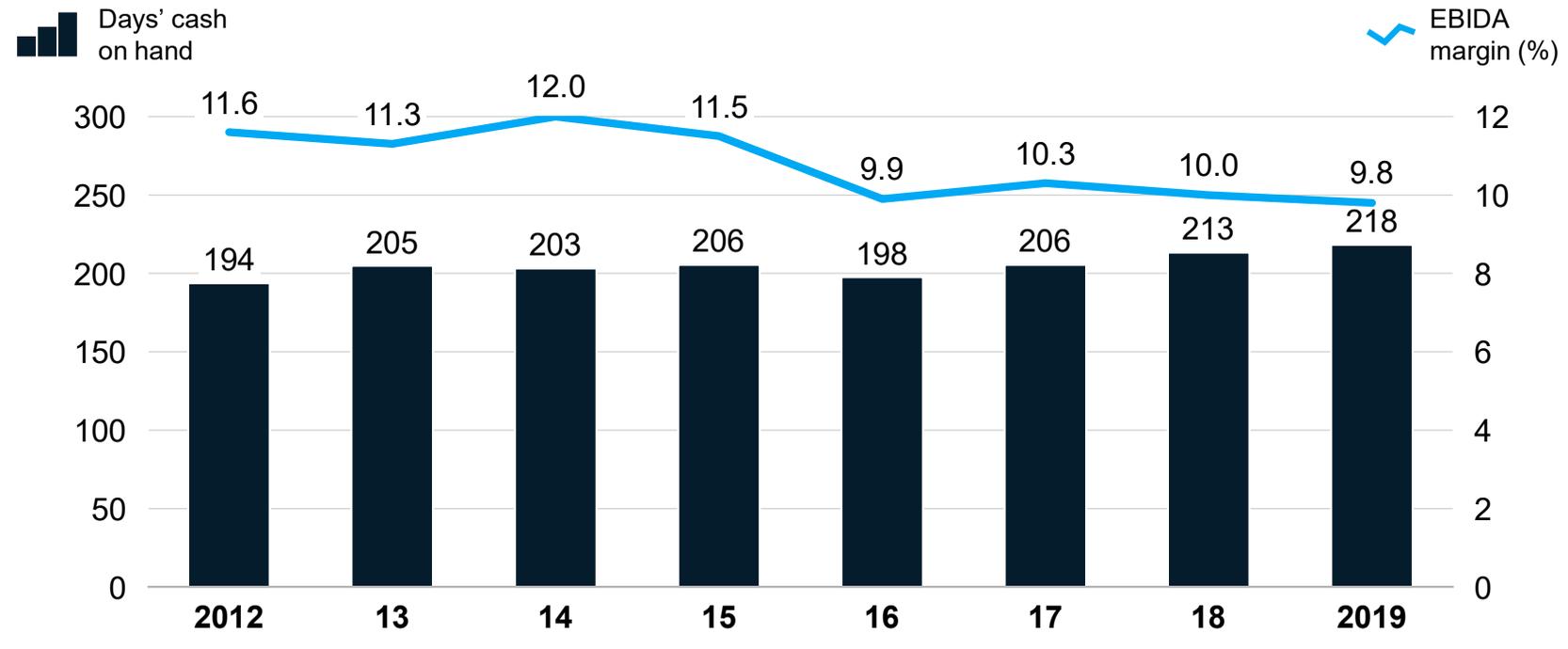
Payers pursuing vertical integration and building ecosystems

Shift of financial burden to consumers, sparking FinTech innovation





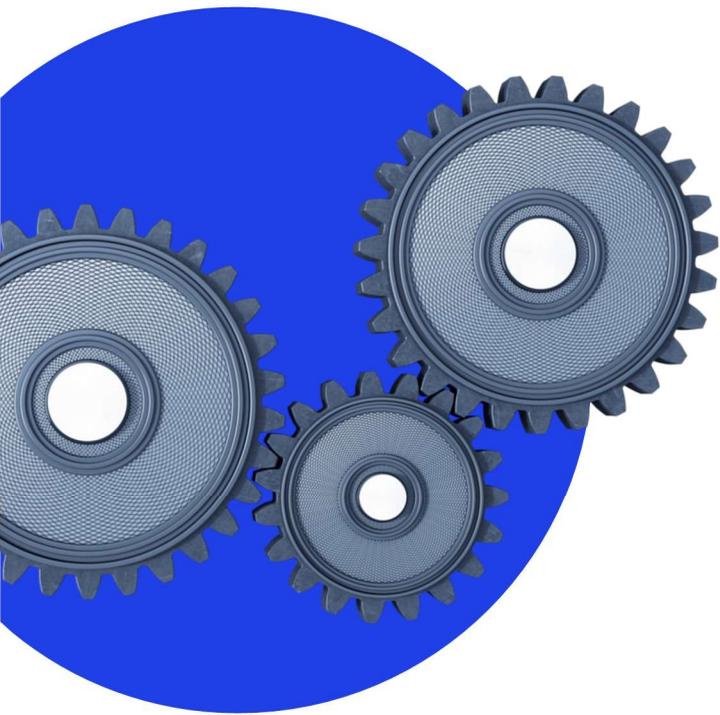
Health system financial performance remains stable



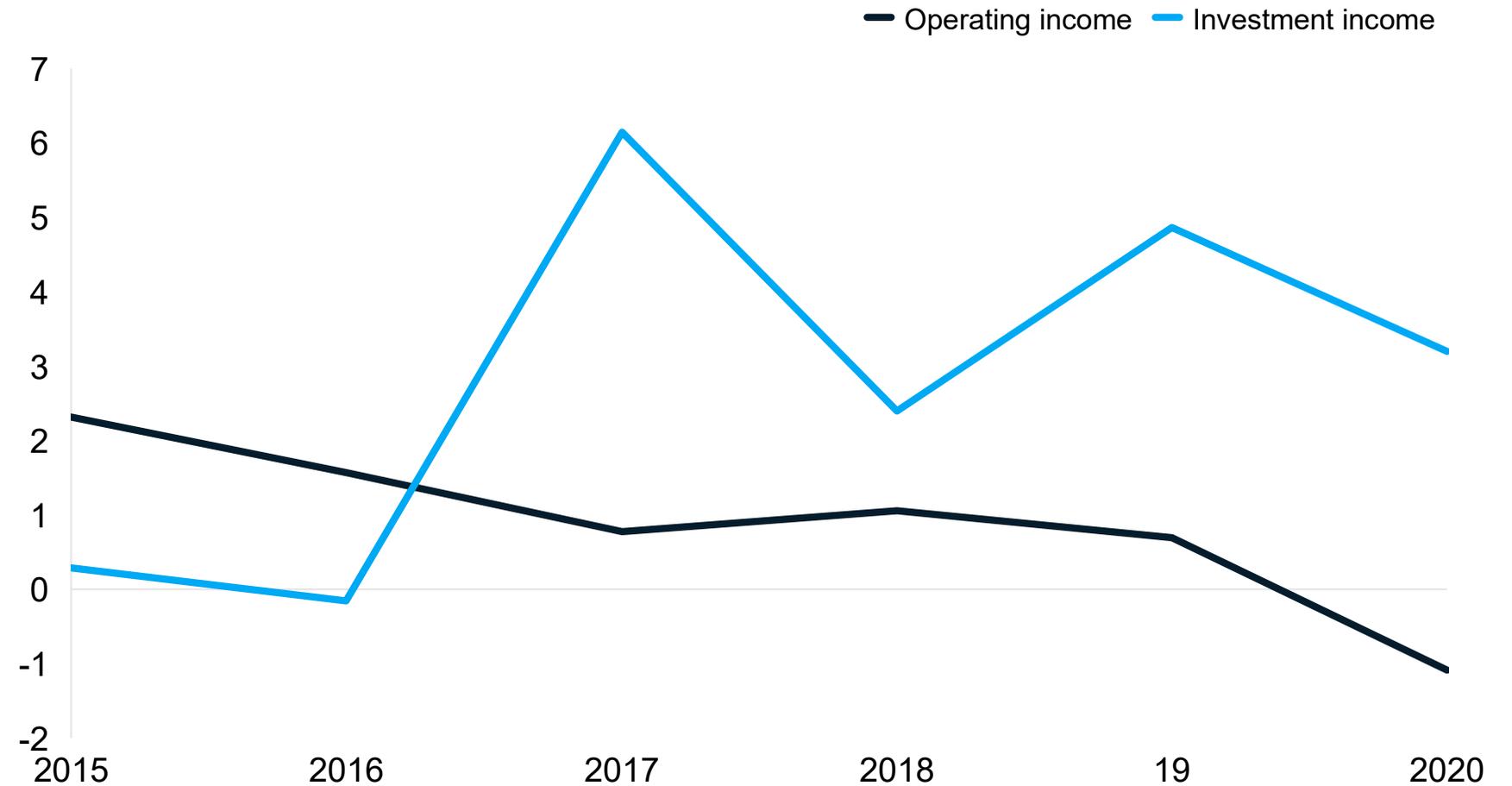
Average age of plant (years)	10.4	11.0
Long-term debt / capitalization (%)	39	32

Source: U.S. Not-For-Profit Health Care System Median Financial Ratios – 2019 vs. 2018 (S&P Global Ratings; n=146)

Investment income enabled this outcome in recent years



Operating and investment income for ten largest NFP health systems by revenue \$Bs, FY 2015-20 (based on organizations' fiscal years)



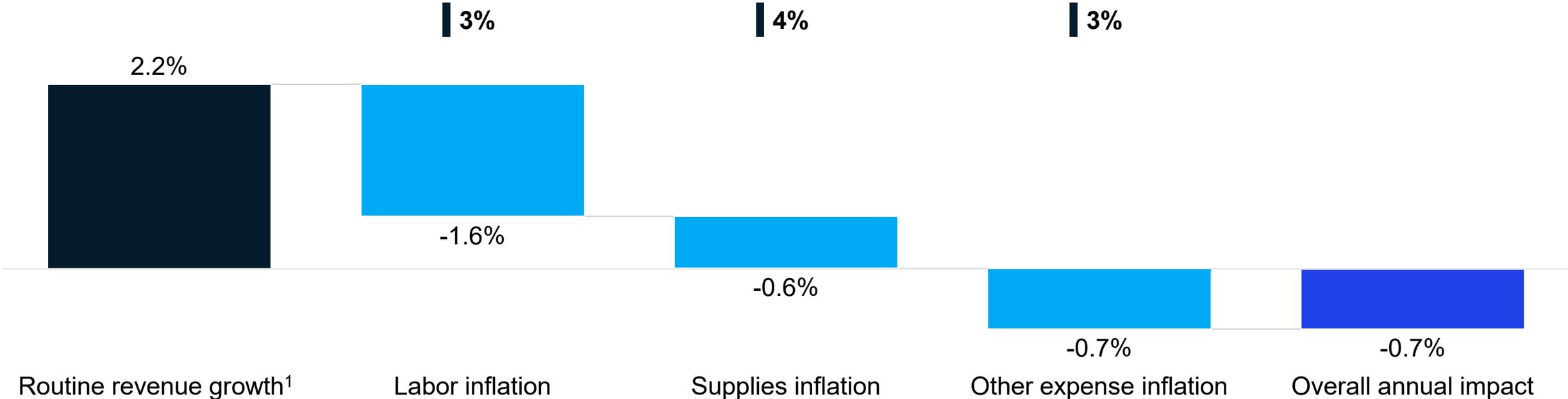
From 2015-2020, cumulative investment income (\$16.7B) exceeded cumulative operating income (\$5.4B) by more than 3x for these health systems

Headwinds from rising costs make core operating excellence a strategic imperative

Cost savings will increasingly come from technology-driven innovation and process redesign, rather than efficiency improvement

Percentage point impact on EBITDA margin (illustrative)

■ xx% Unit cost growth

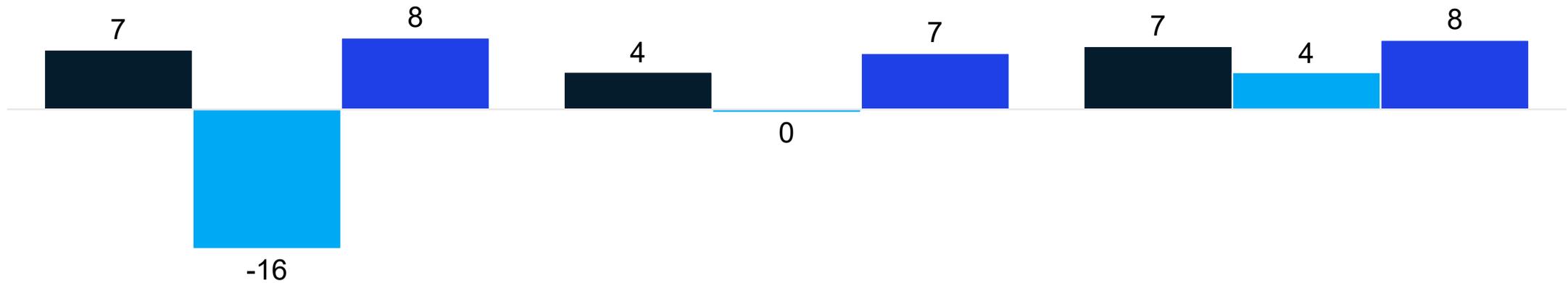


1. Includes steady-state patient revenue and premium growth net of payer-mix shifts

After a turbulent period, growth in core segments should reach or exceed historical trends

2012-2017 2019-2021 2021-2025

Profit pool growth, CAGR %

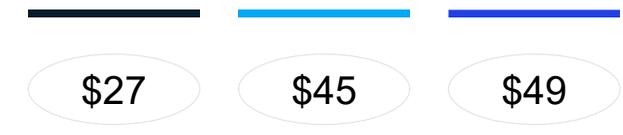
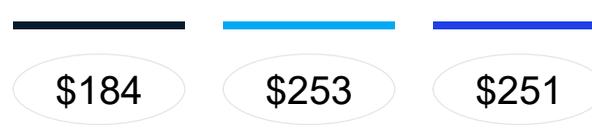
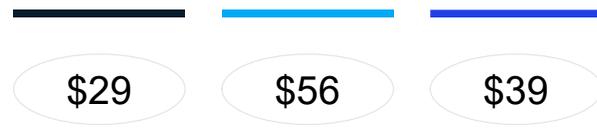


Core payer segments

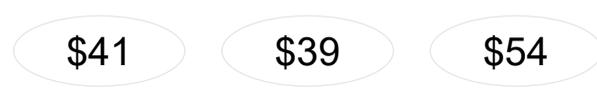
Core provider segments

Healthcare services and technology

EBITDA, \$B
(start year)



EBITDA, \$B
(end year)

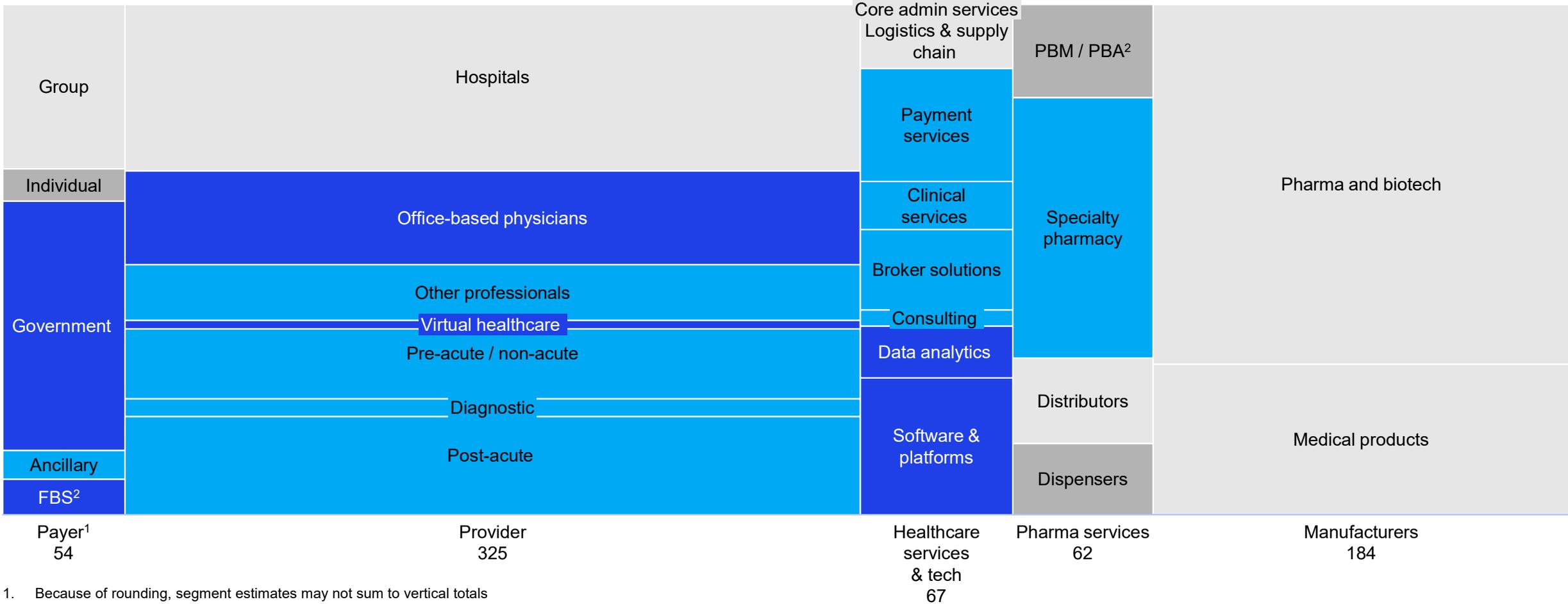


Profits in government insurance, physician offices, and services segments are predicted to grow fastest

Distribution of projected healthcare EBITDA across healthcare segments¹, 2025, \$B

2021-2025 growth rates

■ = <0% ■ = 0 - 5% ■ = 5 - 10% ■ = >10%



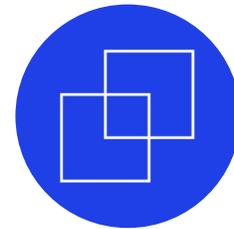
1. Because of rounding, segment estimates may not sum to vertical totals
 2. FBS = fixed-benefit and supplemental; PBM / PBA = pharmacy benefit administrator / pharmacy benefit manager



We see three emerging strategic archetypes



Organic growers focused on acute care excellence (supported by further investments in key capabilities, e.g., digital and analytics)



Scale seekers who see value in the capabilities and growth vectors it unlocks (e.g., enabling success with population-based payments)

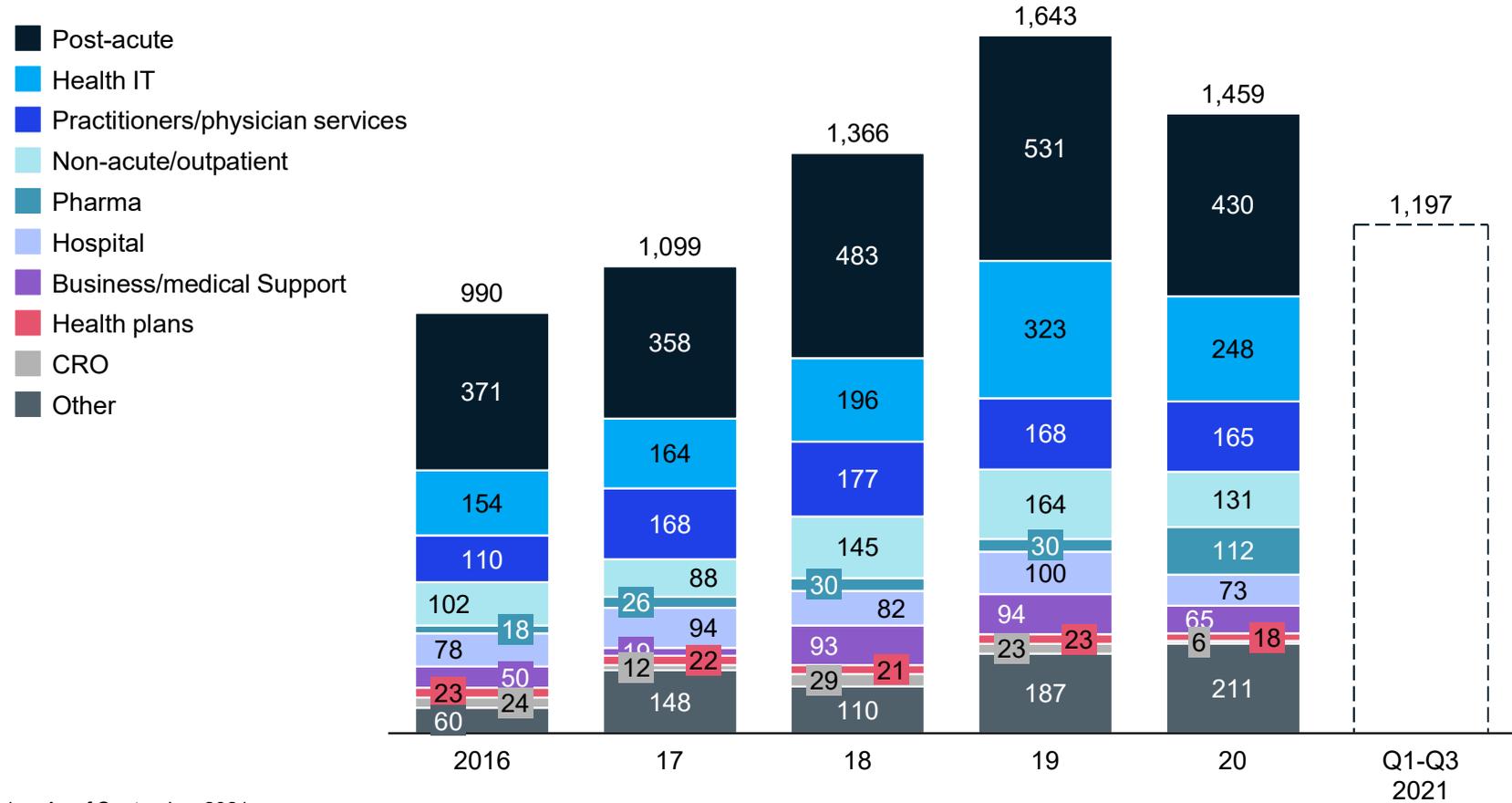


Diversified players focused on services and technology to deliver capabilities and margin back to the mission

Each archetype can be successful – and will require superior execution

M&A deal volume has continued to grow during the pandemic, along with institutional funds flows

M&A deal volume
number of deals, 2016–21YTD¹



Annual PE deal growth
CAGR %, 2014–20

Healthcare sector



17%

US industry average



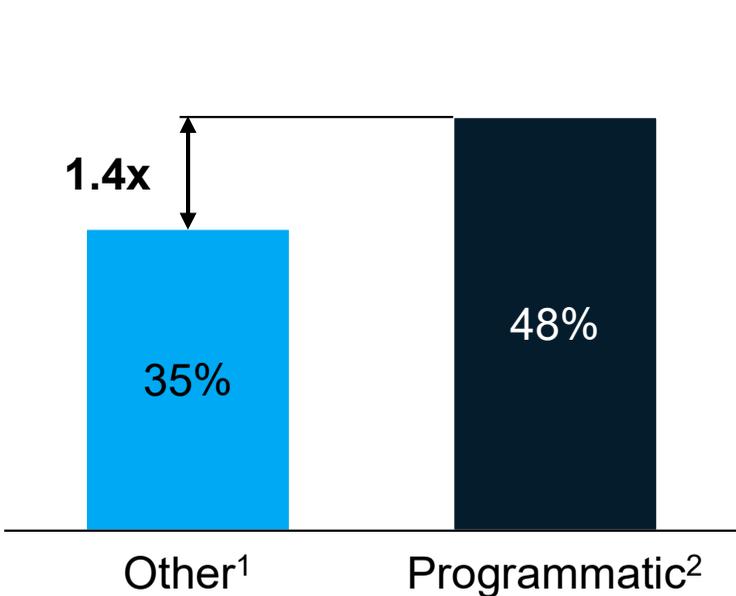
0.3%

1. As of September 2021

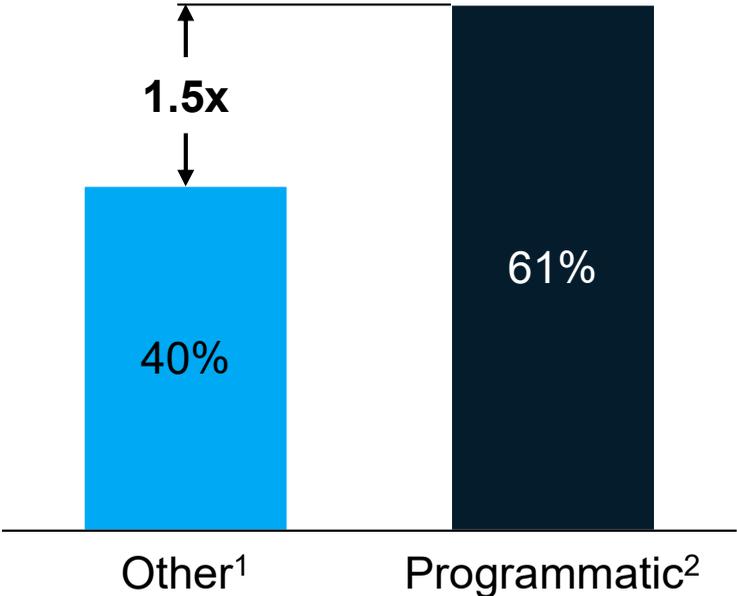
Most organizations do not have a clear M&A strategy

Share of respondents who strongly agree with a given statement, %

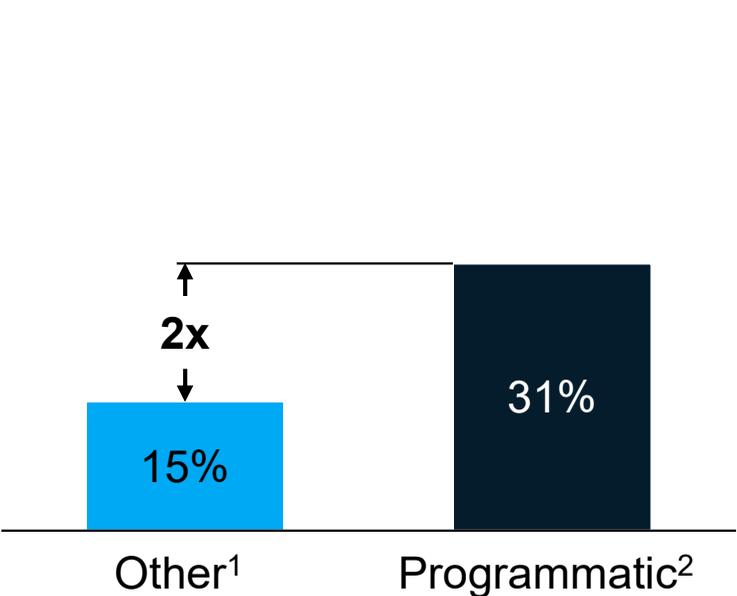
Company is aligned on the industry and/or market trends they want to pursue via M&A



Company has a clear understanding of sources of competitive advantage in the markets where it is pursuing M&A



Company regularly reallocates capital to potential M&A opportunities that align most closely with its overall strategy



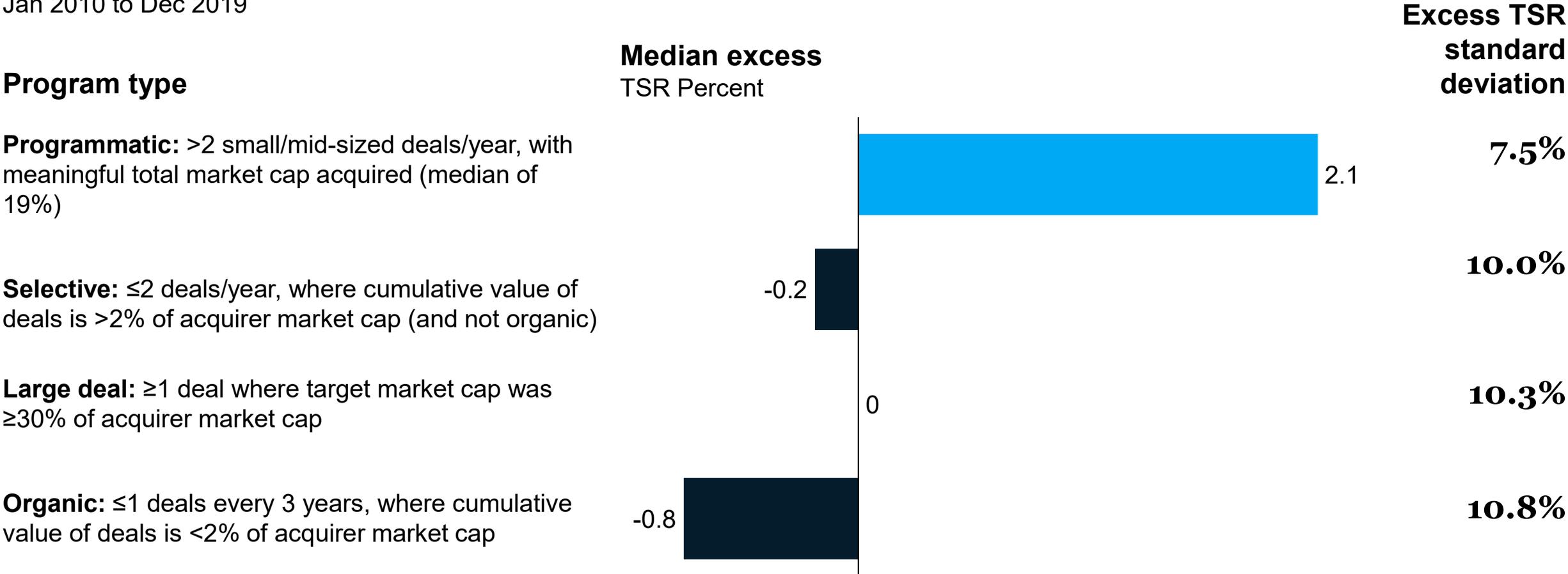
1. Less than 2 or more deals closed per year, in the past five years (n = 584).

2. More than 2 or more deals closed per year, in the past five years (n = 134).

Programmatic strategies generate highest total shareholders returns (TSR) with lowest risk

Global 2000¹ median excess TSR by program type

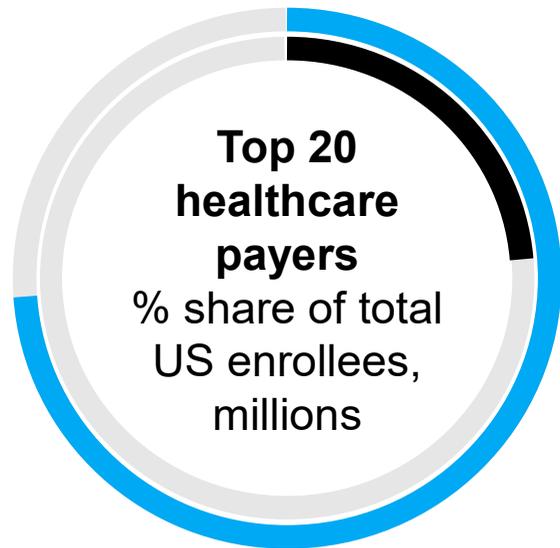
Jan 2010 to Dec 2019



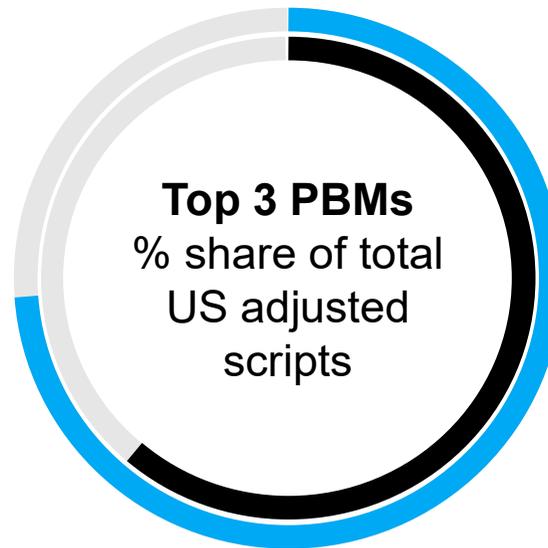
1. Companies that were among the top 2000 companies by market cap at December 31st, 2009 (>\$2.0bn) and were still trading as of Dec 31st, 2019; Excludes companies headquartered in Latin America and Africa

Health systems remain fragmented compared to payers and PBMs...

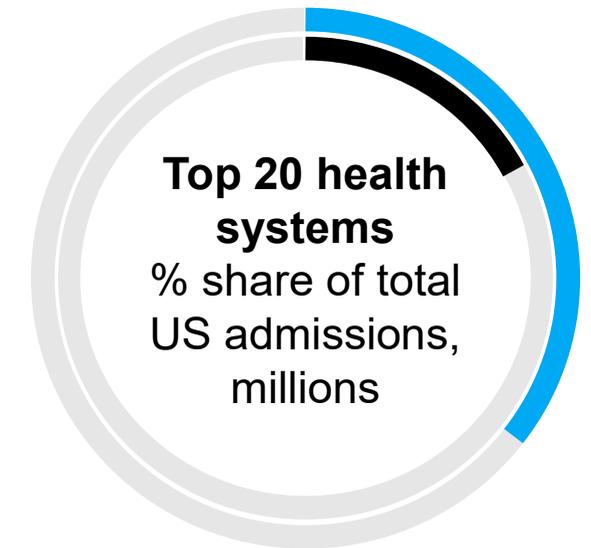
If the top 20 health systems had the same share as the top 20 payers, each would average 1.3M admissions and \$35B NPSR annually



1994 21%
2019 74%



2003 54%
2019 74%



1993 18%
2019 33%

...and payers' strategic themes also increasingly mirror providers' priorities

Theme					
	<p>Digital offerings and services: Accelerating offerings in virtual care, remote monitoring, digital biometrics, and automation (e.g., claims processing)</p>	<p>Medicare as a continued driver of growth: Focus on member acquisition, improving Stars rating performance, and expanding value-based care arrangements</p>	<p>Heightened focus on integration of medical care and specialty services: Continuing expansion of specialty services offerings (e.g., pharmacy, care coordination) and integration with medical care and offerings, particularly for those with chronic conditions</p>	<p>Continued expansion of value-based care: Expanding especially within government programs that favor increased risk (e.g., Direct Contracting), including new enabling capabilities</p>	<p>Inorganic growth used to build and expand capabilities into new areas: Strategically deploying capital to drive growth expected to continue</p>
<p>Payor(s) placing greatest emphasis on theme</p>					

Source: Investor day presentations, annual reports, annual conference books

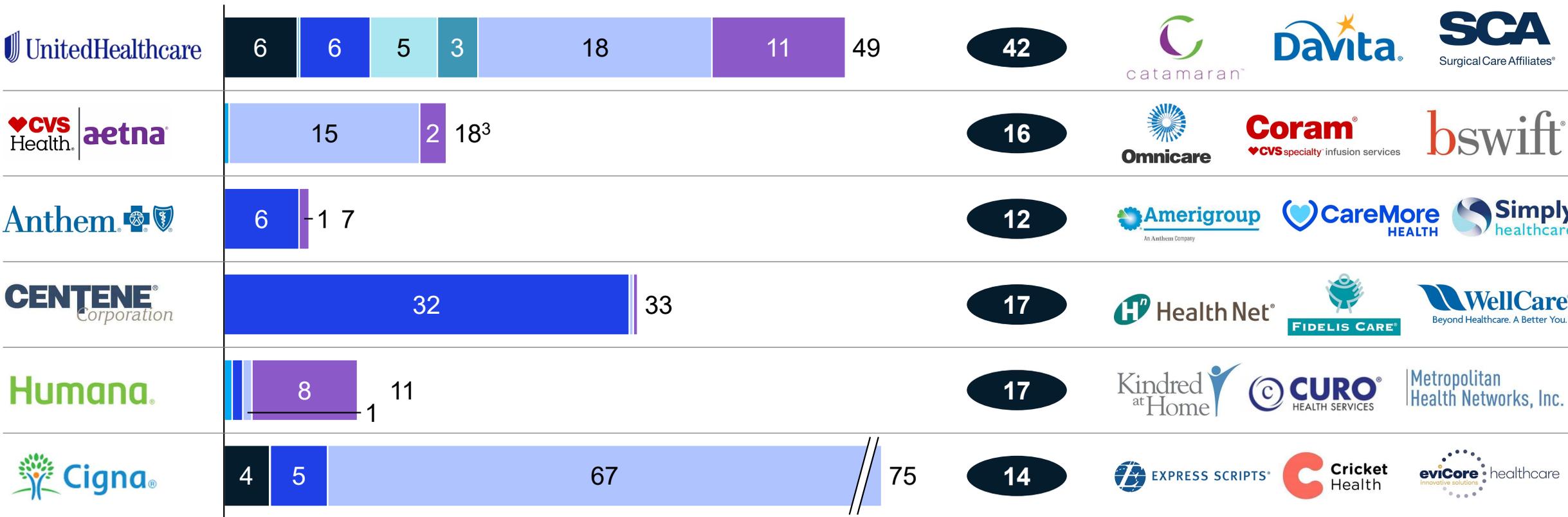
National payors are building on their scale to create “mega entities” of healthcare services

■ Business / Medical Support
 ■ Health IT
 ■ Health plans
 ■ Hospital
 ■ Other
 ■ PBM and pharmacy
 ■ Non-acute care delivery assets

Major payors’ acquiring behavior 2012-2020, \$B value of transactions¹

Deal count
of deals²

Selected examples of major transactions



1. Not exhaustive – deal value is not publicly disclosed for several transactions; includes major investments in total deal count and dollar value
 2. Deal count includes all deals, even those without publicly disclosed transaction values
 3. Does not include CVS / Aetna deal

Meanwhile, health systems are increasingly engaging in a wider range of partnerships as means to access scale

← Particularly sensitive to governance questions →



Several contemplated not-for-profit horizontal M&A deals have run into challenges given:

- Lack of alignment on Board governance and management control
- Resistance among physician community and cultural misalignment
- Federal and state regulatory review

Several players have focused on expanding along the continuum and on diversification, including via JVs and partnerships with PE/VC, to invest in at-scale platforms, access capabilities, and pursue diversified financial returns

We focus on four lessons for organizations developing approaches to scale and partnerships

-  **1** Clearly define your strategic intent for the partnership and therefore understand the type of organization with which to partner — do not “seek shelter in scale”
-  **2** Clearly articulate value levers, double down on synergy estimation, and use that to anchor the fundamentals of the deal (from initial structure to integration management)
-  **3** Calculate the resourcing need and double it – the amount of leadership bandwidth required to manage integration and realize full synergies is meaningful
-  **4** Never underestimate the impact of culture – it is routinely cited as one of the most important factors in realizing the full aspiration of the strategy and synergy potential

Aligning with Boards on “red-line” issues upfront is essential and often under-emphasized

While partnerships are easier for Boards to understand and approve, **multi-lateral deals often add disproportionate time and complexity** with each additional party

Discussion Questions



How clearly defined is your organization's growth agenda? How does inorganic growth fit into the overall approach, and how strong is your capability to develop your strategy and support deal execution and integration?



Have you decided on the archetype of where and how you want to play across inorganic opportunities? Where are you focused on deploying resources and attention today?



What is the appetite for you and among your leadership team and Board to pursue inorganic growth? Are there a limited range of deals you can pursue as a result, and how does this map to what you believe is needed to succeed in 2030 and beyond?

Workforce Deep-Dive

Critical challenges impacting the healthcare workforce



Structural workforce shortages

COVID-19 accelerated existing labor shortages in the demand for clinical talent and the educational pipeline is constrained by limited classroom spots and an aging educational workforce



Attrition and churn

In a February 2021 survey, 22% of frontline nurses indicated they were likely to leave direct patient care roles in the next year, up from an industry average of ~15-17%. Many are leaving for roles outside healthcare



Mental health needs and provider burnout

The physical and psychological pressures of the past year have enhanced an existing need to provide mental health support to frontline healthcare workers



Evolving skill needs

Shifts to new care models require a different mix of skills: team-based, socio-emotional, technological

Demand for talent is rising

Select occupations in US healthcare sector	Percent increase in employment, post-COVID-19 scenario, 2018–30	Absolute change, '000s
Home health aides	84	679
Surgeons	71	25
Mental health & substance abuse social workers	70	66
Software developers	61	8
Speech-language pathologists	60	49
Training and development specialists	60	23
Ophthalmic medical technicians	60	32
Pharmacists	56	56
Licensed practical & licensed vocational nurses	53	338
Emergency medical technicians & paramedics	48	90
Dental assistants	47	163
Physical therapists	38	84
Receptionists and information clerks	-7	-34
Billing clerks	-11	-25
Medical assistants	-15	-101
Medical secretaries	-17	-96
Office clerks	-20	-75
Medical transcriptionists	-23	-8

Source: McKinsey Global Institute analysis

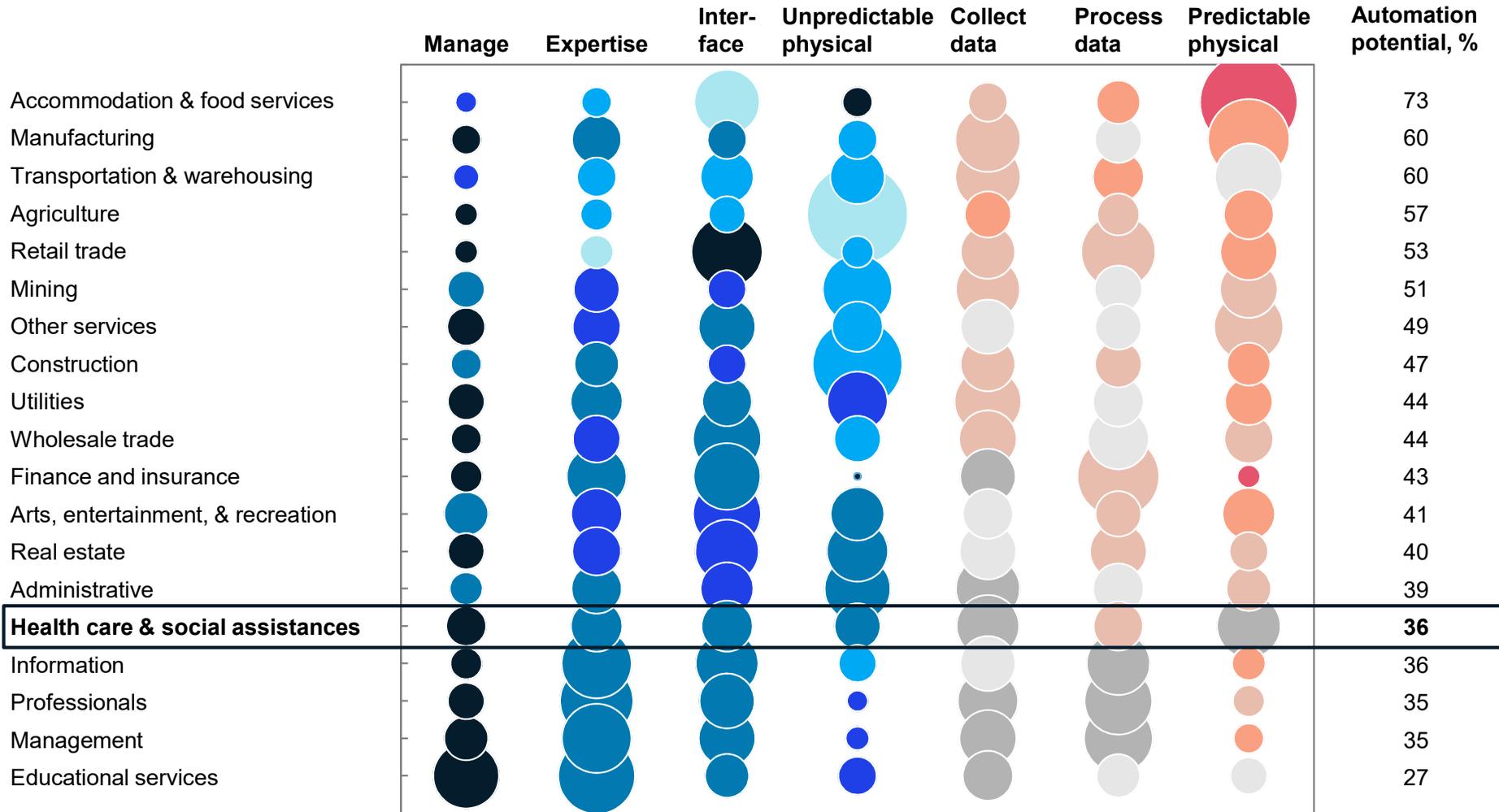
30%
total sector job growth

1.4M
net new jobs created

600k
workers may need
new occupations

Healthcare has constraints on its potential for automation

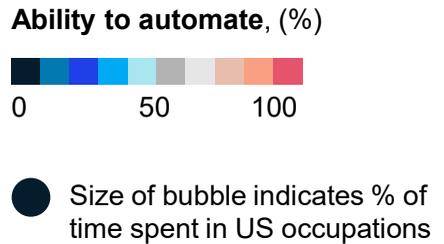
Sectors by activity type



36%

of activities have potential for automation, even with pre-pandemic technologies

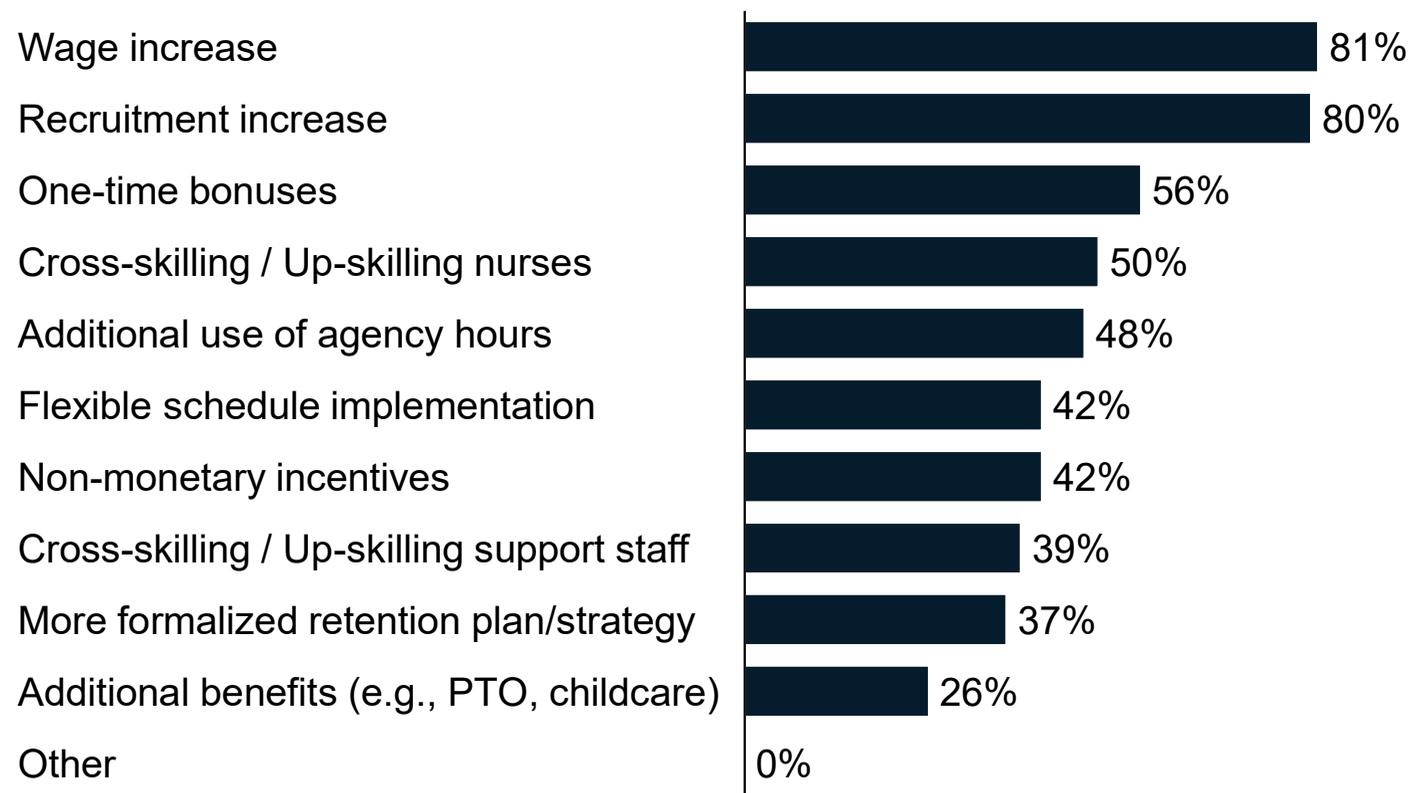
Care giving and technology roles may rise, while admin roles may decline



Source: US Bureau of Labor Statistics; McKinsey Global Institute analysis

Health systems are using several tactics to maintain their nursing staff, with wage and recruitment increases being most common

Tactics your hospital has deployed over last 3 months to maintain a strong nursing workforce, % of respondents¹



Nursing turnover rate in past 12 months²

17.6%

Percentage change in Q3 2021³

+6.0 p.p.

Nursing vacancy rate in past 12 months⁴

15.3%

Percentage change in Q3 2021⁵

+5.9 p.p.

1.q29: What tactics has your hospital deployed over the last 3 months to maintain a strong nursing workforce?

3.q31: By what percentage has your nursing turnover rate changed in Q3 2021?

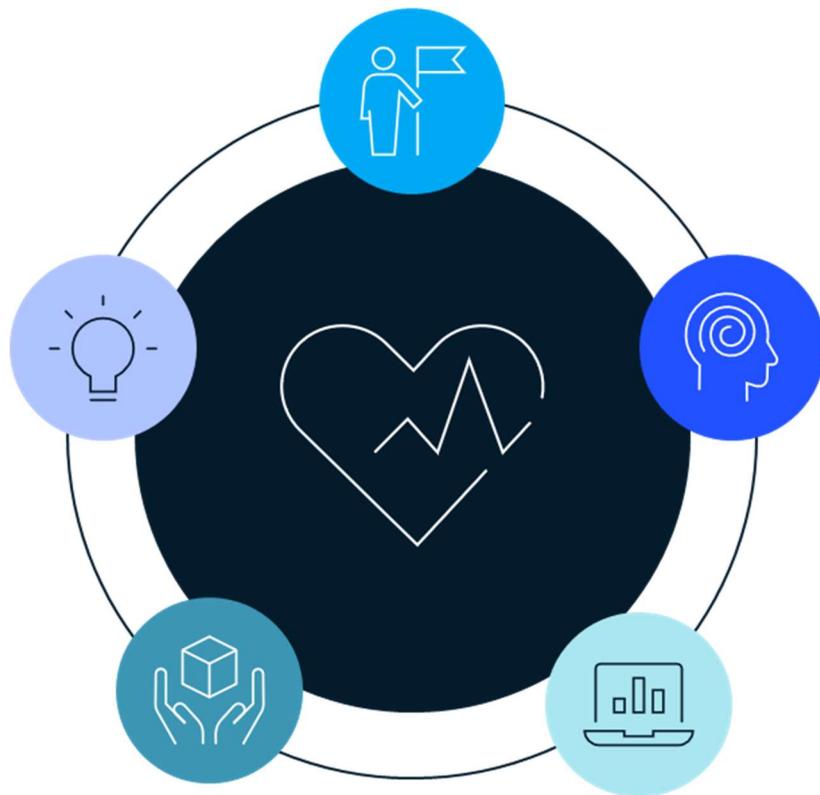
1.q33: By what percentage has your nursing vacancy rate changed in Q3 2021?

2. q30: What was the turnover rate for your nursing workforce in the past 12 months (e.g., 15%)?

4. q32: What is your current nurse vacancy rate (e.g., 10%)?

How can health systems, academia, and government respond?

Levers to retain and excite the healthcare workforce



Enhance leadership support

Clear communication from leadership providing recognition, support for breaks, and introduction of new assets to improve on-the-job support (e.g., technology)

Provide mental health support

Addressing the demonstrated need for mental health or well-being support for frontline healthcare workers impacted by COVID-19

Leverage digital

Utilizing digital tools and innovations to streamline processes and improve quality of care

Deliver increased flexibility

Retaining flexibility in scheduling and staffing introduced by the pandemic and identify ways to continue delivering flexibility going forward

Build out talent pipelines

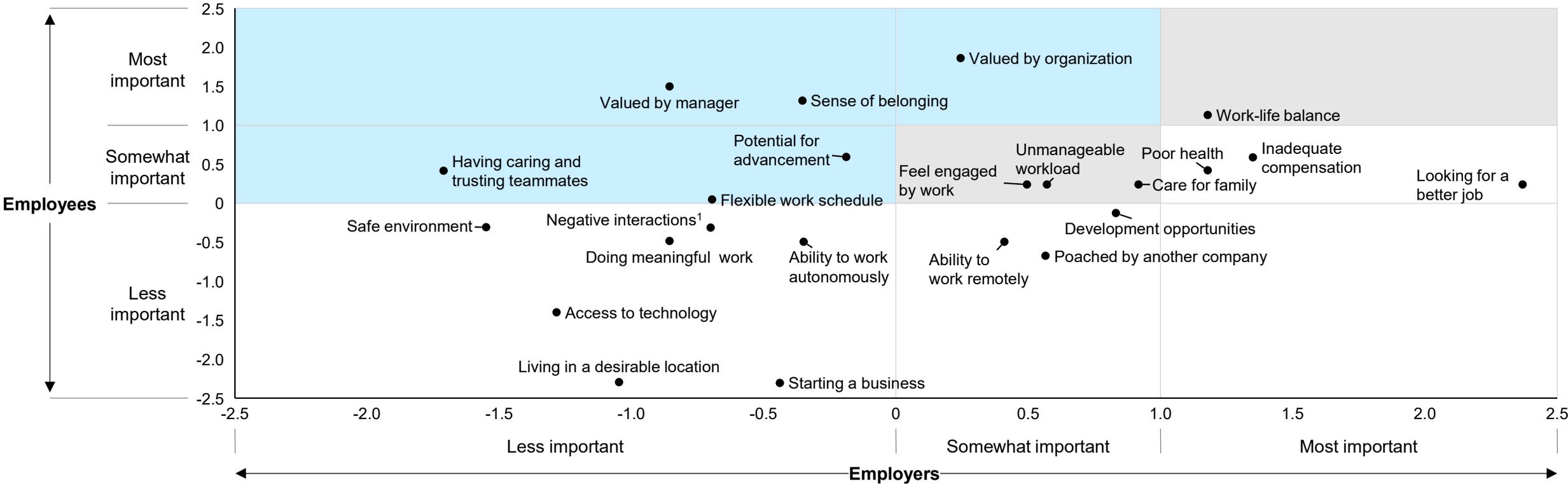
Recruiting, training and hiring hard-to-fill clinical positions and building community support for nursing as a profession to ensure a stable workforce

Employers do not fully understand why employees are leaving

Factors that are important to employees versus what employers think is important

More important to employees than employers appreciate
As important to employees as employers think
Employee views
Employer views

Employers seem to overlook the relational elements that are key drivers for why employees are leaving, such as lack of belonging or feeling valued at work



1. Includes client, customers, patients, and students
 Note: Standardized scores are reported for both employee and employer perspectives. Employees were asked to respond to the following question: To what extent did the following factors impact your decision to leave your last job? (Not at all, slightly, moderately, very much, extremely); employers were asked to respond to the following question: Why do you think employees are choosing to leave your organization now? (select all that apply)

Elements of workforce management reimaged for the future

What if your organization could ...

Reduce your time to fill by 50%?

1

Recruiting and on-boarding

A broader and more diverse set of talent is more rapidly identified, assessed, and prepared to assume critical roles

Move 25% of your clinical workforce to virtual?

2

Tech-enabled care delivery

Technology is further embedded in care model through COVID-19 accelerated innovations, supporting patient outcomes and improving patient and staff experience

Reskill 30% of your workforce in next 3 years?

3

Professional development and skill building

Learning infrastructure evolves to support both near and long term development. Skills are built through geographic, site of care, and topical opportunities and curriculums evolve to address socio-emotional and technological skills.

Achieve 10% nursing turnover?

4

Engagement and retention

Employee experience and well-being is measured and acted on more proactively, with increased personalization.

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