

McKinsey
& Company

Transition Strategies in the Face of Economic Headwinds

Leadership Institute Roundtable

August 2023

CONFIDENTIAL AND PROPRIETARY

Any use of this material without specific permission of McKinsey & Company
is strictly prohibited



Disclaimer

© 2023 McKinsey & Company.

This material contains confidential and proprietary information. Any lessons or other information shared here are not meant to be construed as medical, policy, or regulatory advice. The data, lessons, and insights shared herein are also subject to change over time, and this document may not represent the latest information after publication. Any use of this material without specific permission of McKinsey is strictly prohibited. All rights reserved.

Analysis is focused on economic and business implications and does not address quality and access considerations. References to specific products, companies, or organizations are solely for information purposes and do not constitute any endorsement or recommendation.

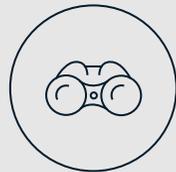
Agenda



Payers' Point of View



Demographics & Engaging an Aging Workforce

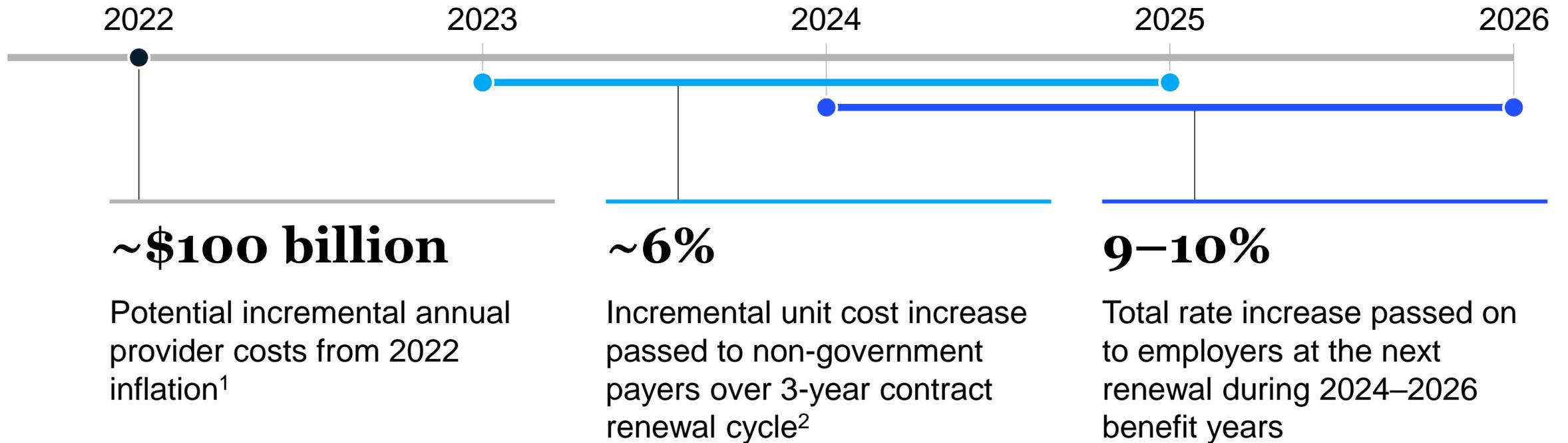


Economic Outlook & Strategic Repositioning



Path Forward

Payers face escalating medical costs – and pressure from employers to limit escalating rates



Specialty Rx is forecast to grow faster than overall healthcare spend (+8% vs. +5% p.a. for '22-25), with new products accounting for ~52% of \$118B expected incremental growth from 2022-2025

1. Based on macroeconomic forecast from McKinsey Global Institute applied to historical profit pools
2. Based on historical provider revenue base from non-government payers and historical payer costs pools across lines of business

Earnings calls speak to impact of rising demand in 1H 2023

“”

...There are some indications that look a little bit like a **pent-up demand or delayed demand** being satisfied...

– CFO, UnitedHealth Group,
Goldman Sachs Global Healthcare Conference
June 2023

“”

...We began seeing **higher-than-anticipated inpatient utilization** diverging from historical seasonality patterns...we made the assumption that **we would continue to experience moderately higher-than-expected trend for the remainder of the year...**

– Humana,
Earning Release, June 2023

“”

...Hospital staffing pressures continue in pockets around the globe and the **patient backlog remains**. **These challenges will likely resolve gradually and be a moderate tailwind** through 2023...

– VP, Investor Relations, Stryker
Earnings Call, May 2023

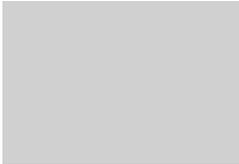
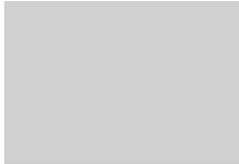
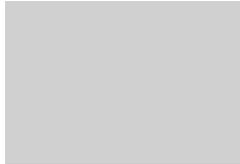
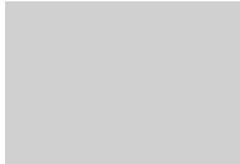
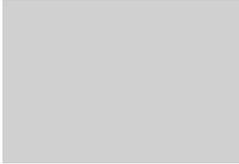
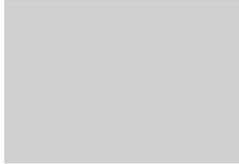
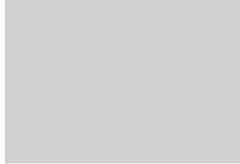
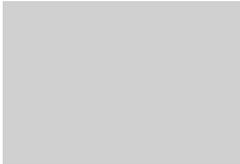
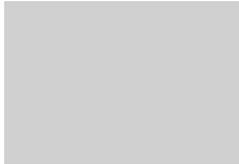
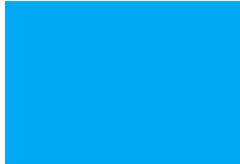
“”

...While there is uncertainty surrounding the duration of this **utilization spike**, our 2023 guidance now prudently assumes that these **medical cost trends will remain elevated for the rest of 2023...**

– CFO, CVS/Aetna
Earnings Call, August 2023

Regulatory changes are also shifting landscape, especially for MA rates and Medicaid enrollment

Lower impact    Higher impact

Select Policies	Medicare	Medicaid	Commercial Individual	Highlighted Impact	
Rate setting					CMS proposed a 2.27%¹ MA net payment decrease for 2024 , the first negative change since 2015 and shift from 5% increase for 2023
Risk adjustment					CMS will remove or reweight conditions in Part C to reconcile deviations in MA and FFS
Stars					New methodology may make it more challenging for MA plans to maintain Stars rating²
End of PHE regulatory flexibilities and financial support					8-24M members may lose Medicaid coverage following PHE wind-down ; many of these individuals are likely to shift into Individual marketplace

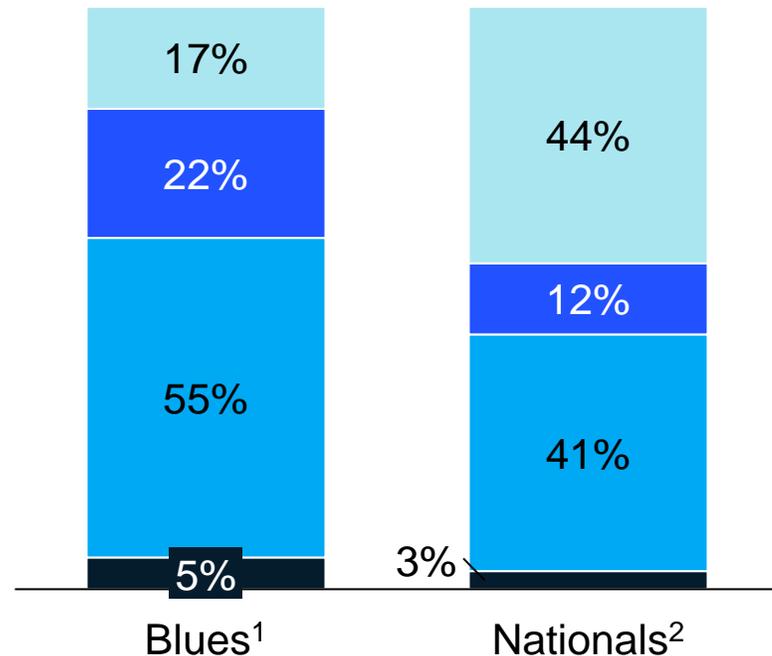
1. CMS Announced Rates, not including adjustment for underlying coding trends

2. Enrollment-weighted average contract rating was 4.37 Stars in 2022, an all-time high in the program's 12-year history; technical changes to Stars methodology include removal of performance outliers using Tukey method and reductions in disaster provisions

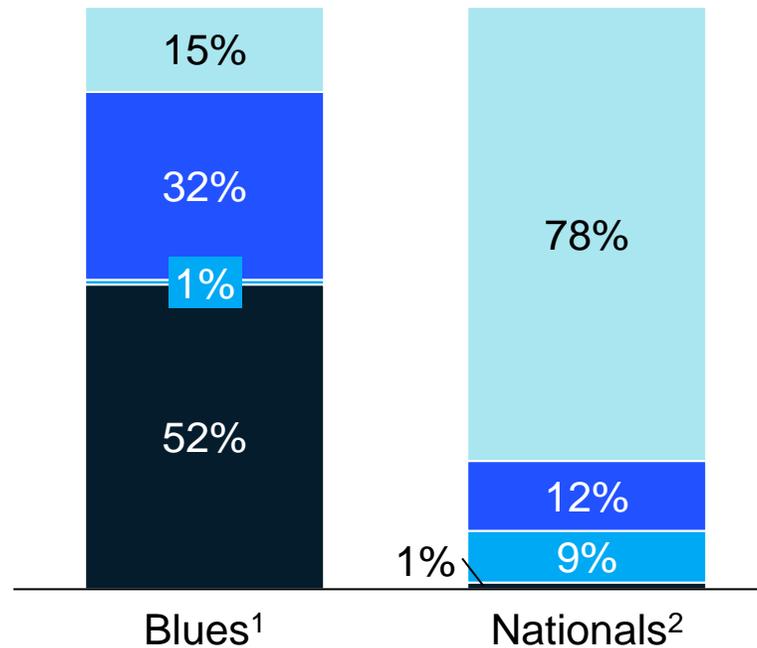
Membership and earnings profiles of Blues and Nationals differ by LOBs

■ Individual ■ ASO ■ Group Fully Insured ■ Government

Membership by LOB, 2021



Op. margin allocation by LOB, 2020, 2021³



1. Including Elevance Health – Lives excludes AmeriHealth Caritas for Medicaid
 2. Includes CVS/Aetna, Centene, Cigna, Humana, UnitedHealth Group, Molina
 3. Margin allocation is average margin for 2020 and 2021, Blues value is the normalized median margin mix across segments
 4. -3% p.a. small Blue fully insured membership decline 2013-2022; similar trends seen for large regional Blues (-1%) and Nationals (-1%)
 5. Includes Blue plans with <1M members in 2022

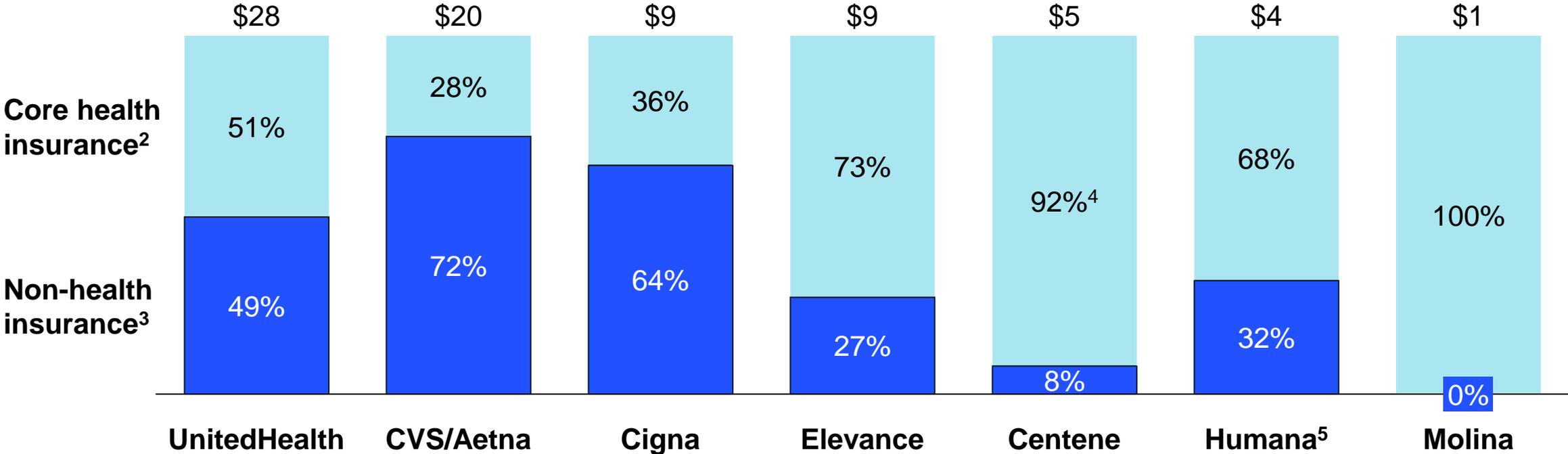
Blues have greater margin allocation in **declining fully insured membership** (-3% p.a. 2013-2023⁴)

MA grew ~11% p.a. for **Nationals²** over last decade vs. ~1% for **small Blues⁵**

Nationals are re-entering Individual; consumers had access to >2 carriers' products in 87% of counties in 2023 (vs. 46% in 2018)

Nationals' capital and scale has helped them diversify, moderating risks to core health insurance business

FY 2022 operating profit¹ by segment, 100%=total operating profit, \$ Billion

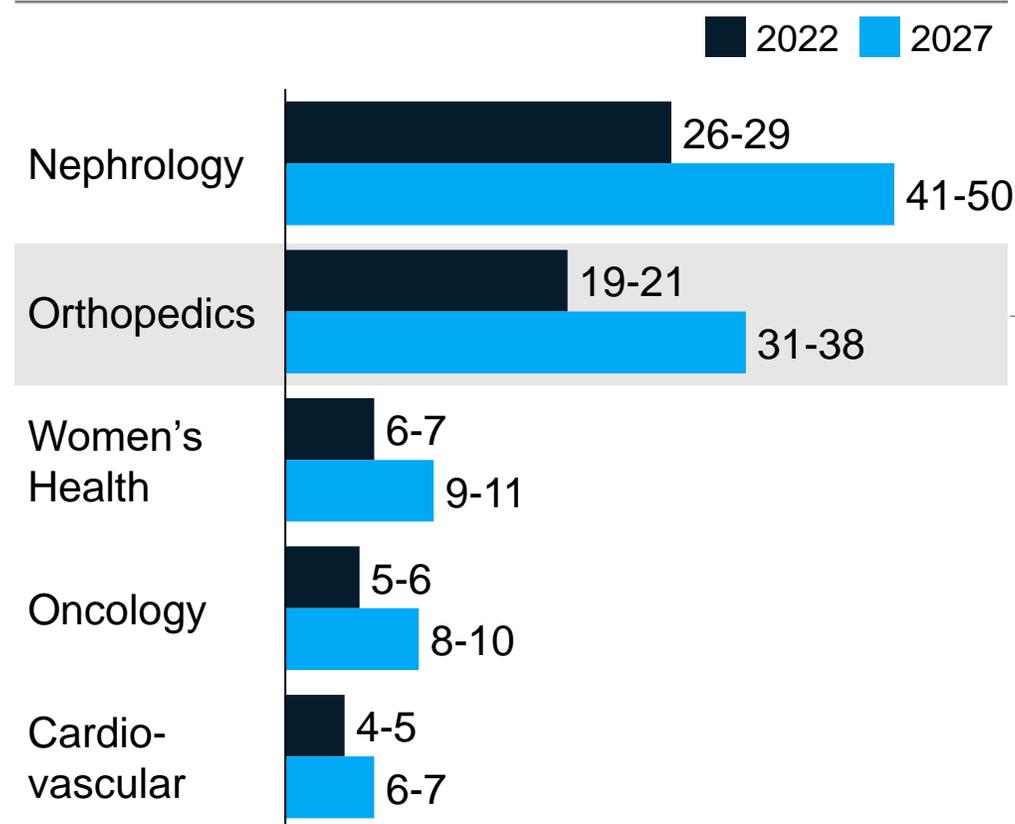


Divested non-health insurance assets

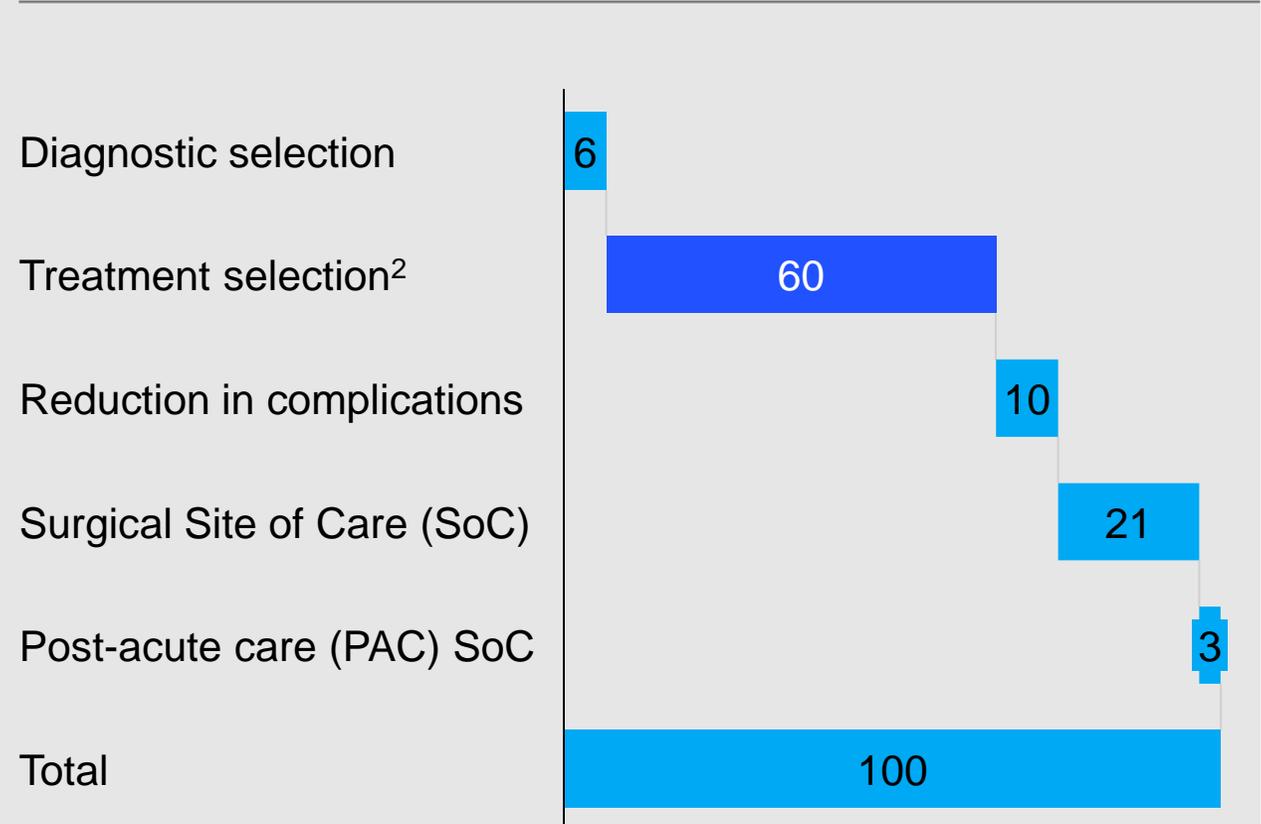
1. Excludes net investment income and corporate and other operations losses
 2. Includes all payer (commercial, specialty, and government businesses)
 3. Includes PBM, provider, and other diversified businesses (e.g., retail, long-term care)
 4. Includes ~\$.8B in operating profits from core health insurance assets that Centene divested
 5. Q42022 Humana completed realignment of reporting segments. Core health insurance contains Retail and Group and Specialty and Pharmacy Benefit Manager. Non-core health insurance includes payor-agnostic healthcare services offerings

Increasing attention may go to specialty VBC models, including focus on influencing physicians' treatment selection

Lives in specialty VBC models,
% of lives in each specialty in VBC contracts



Potential sources of value and savings in non-traumatic orthopedic specialty care¹, %



1. Est. total savings for non-traumatic orthopedic lives in VBC arrangements
 2. Main identified source of value for providers (est. 15-20% in potential upside for orthopedists)

Priorities for non-National payers in response to headwinds



Operational efficiency & technology adoption to improve administrative cost position



Portfolio repositioning, including strategies in **high-growth products and services** (e.g., specialty VBC, TPA)



Vertically-integrated capabilities that advance diversification and enhance ability to manage medical costs (e.g., post-acute care)



Emphasis on brand, local ties, and network quality for differentiation



Strategic partnerships to add scale and fill capability gaps cost effectively

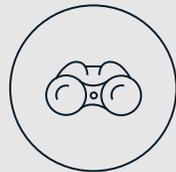
Agenda



Payers' Point of View



Demographics & Engaging an Aging Workforce



Economic Outlook & Strategic Repositioning



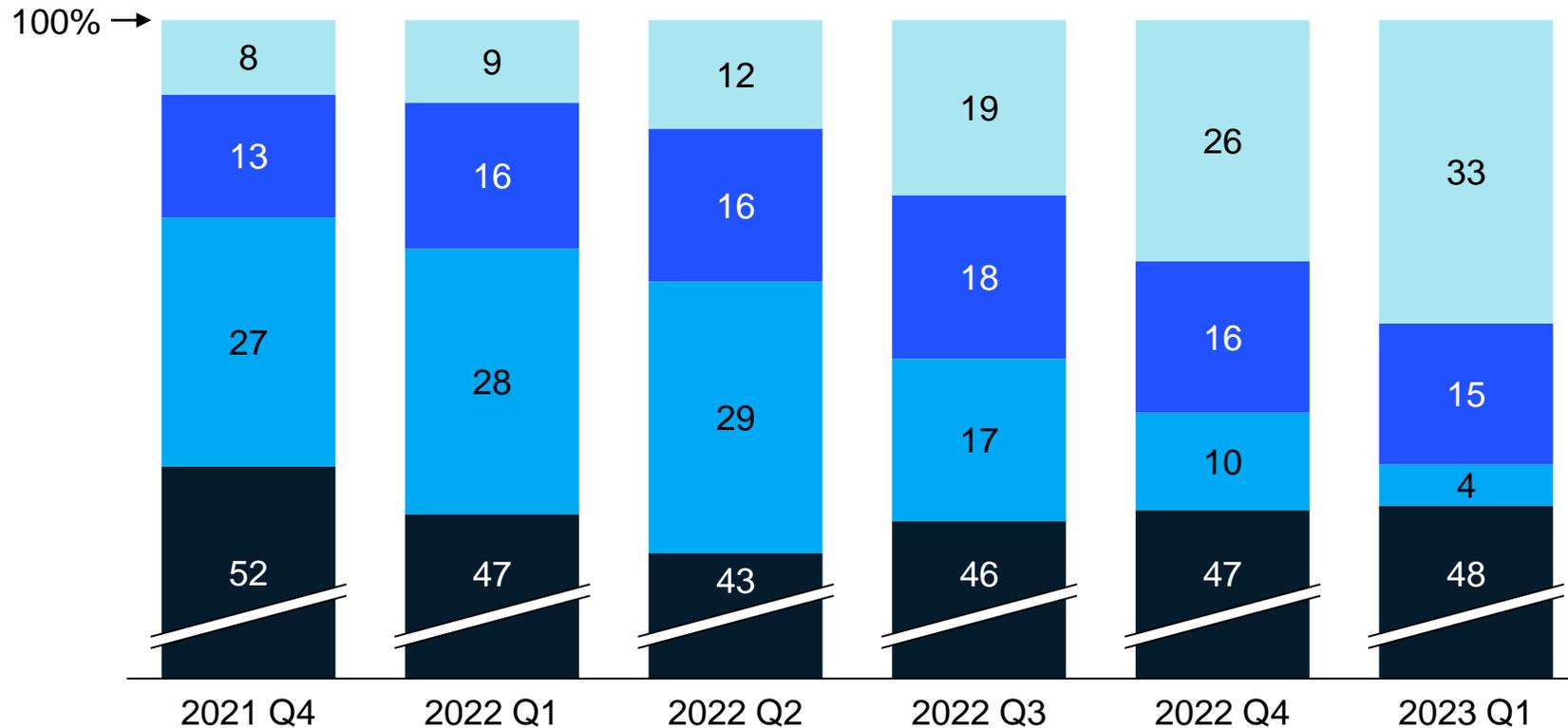
Path Forward

Labor is now a primary driver of inflation

■ Cyclical demand & wage pressure
 ■ Material input costs
 ■ Commodity & supply chain shocks
 ■ Long-term expected inflation and other factors

Drivers of cumulative US consumer price inflation¹

% contribution, Q4 '21 - Q1 '23



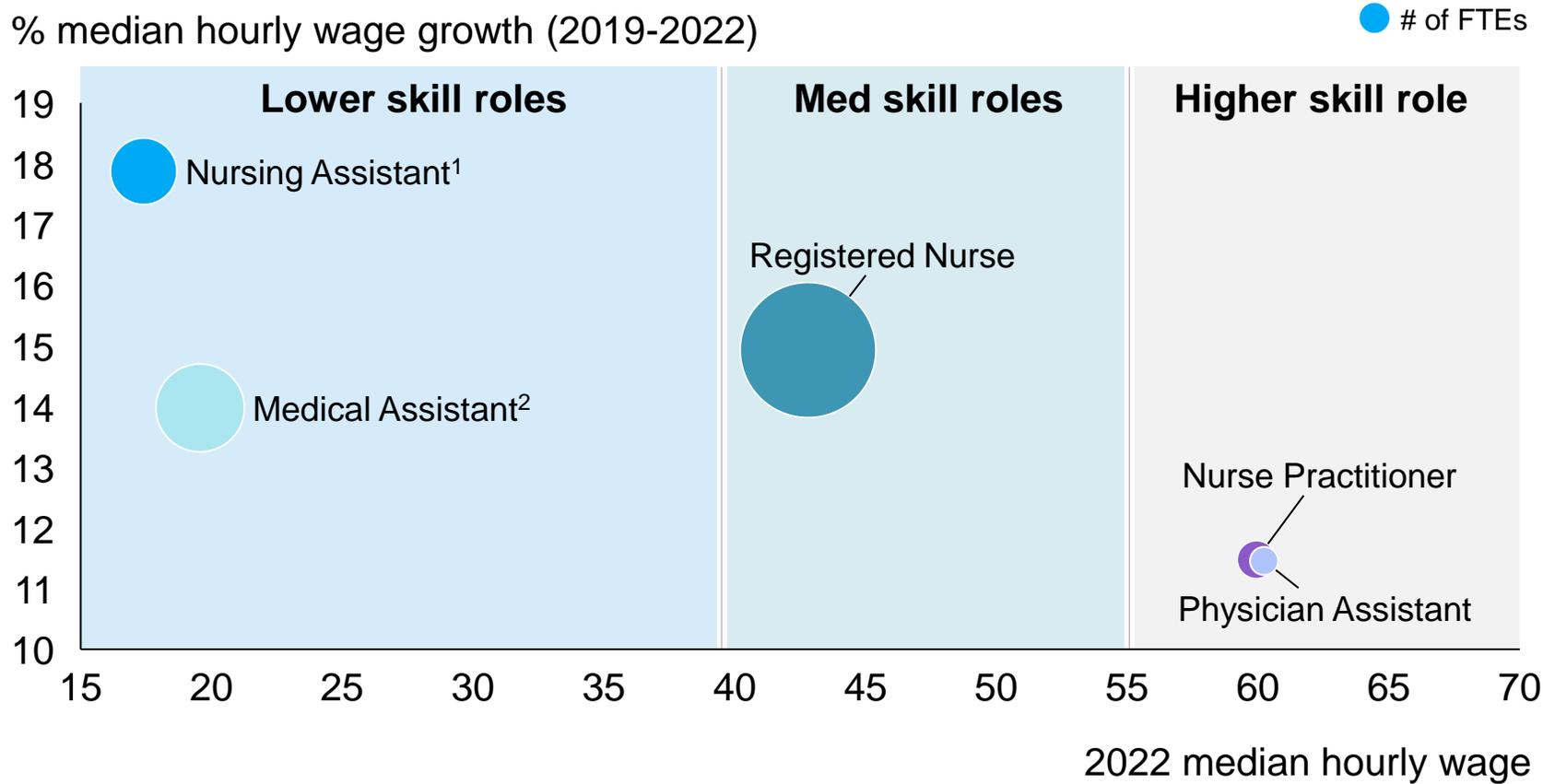
Healthcare has seen higher wage growth than private sector overall from Dec. '21-May '23 (total impact of ~23%¹ vs. ~21%)

1. Includes healthcare and education sector wage growth from Dec 2019-May 2023 (calculated by the US Bureau of Labor Statistics)

Lower skill wage growth has played an outsized role as demand has exceeded worker supply

Wages and wage growth for care delivery roles

Median hourly wages, wage growth rate ('19-'22), and FTE count for roles, 2022



Real wage growth across industries was greatest for low wage workers from '19-'22:

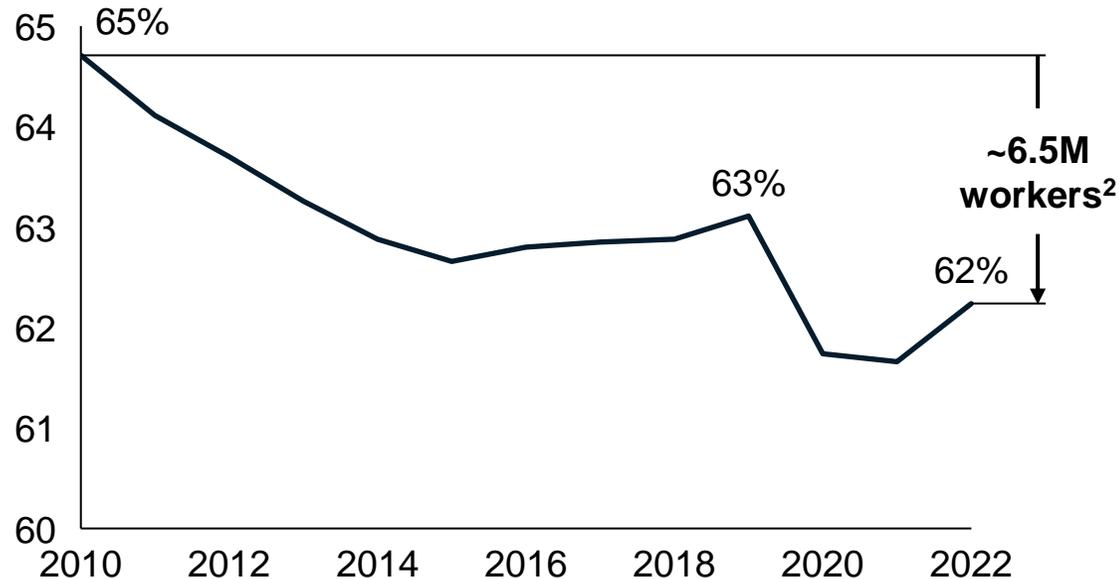
- Bottom decile: +9%
- 40-60th deciles: +2.4%
- Top decile: +4.9%

1. Nursing assistants refer to nursing care attendants, nursing aides, and nursing attendants but excludes Home Health Aides, Personal Care Aides, Orderlies, and Psychiatric Aides

2. Medical assistants refer to hospital employees who perform administrative and certain clinical duties under the direction of a physician but exclude Physician Assistants

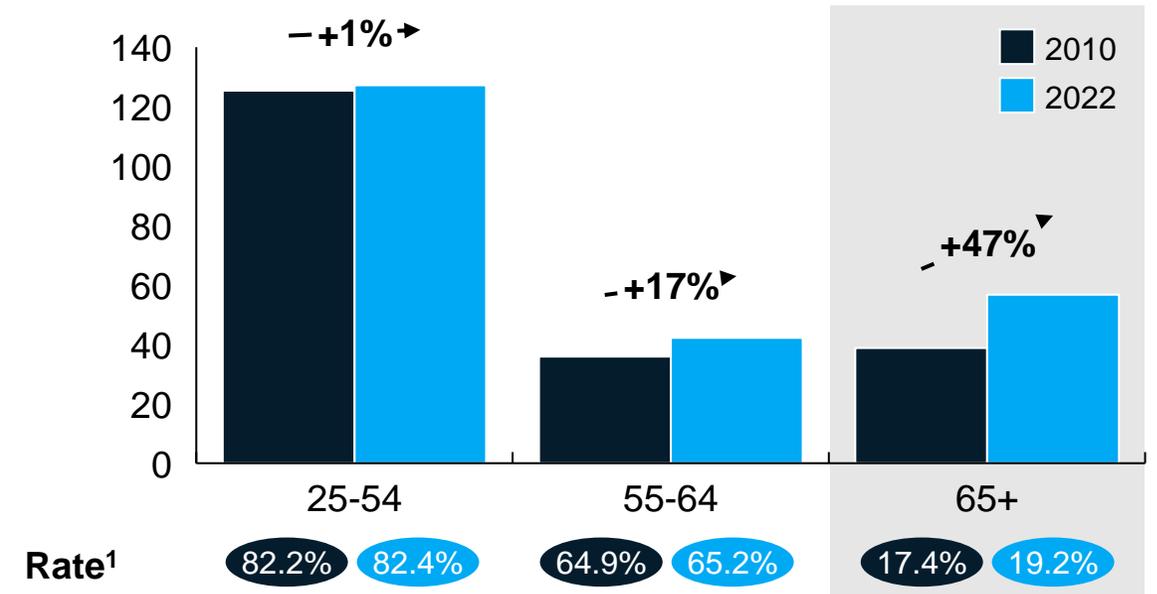
Demographics have contributed to a smaller workforce, despite slight rise in participation within age bands

Labor force participation, 2010-2022
% of population over age 16



Participation peaked at ~67% in 2000, with substantial decline post-2008 (from ~66%)

Labor force participation rate by age cohort,
of US workers, M



Decline is largely attributable to workers aging into cohorts with lower participation rates

1. Labor force participation rate
2. ~2.5% delta between 2022 and 2010 US labor force participation rate * ~264M total Americans ages 16 and older in 2022

Health systems will likely face continued pressure given expected labor demand over the next decade

▲ Healthcare roles ■ Resilient and growing occupations² ■ Stalled but rising occupations³ ■ Hit and declining occupations⁴

Estimated future job growth and current educational attainment by occupational category,

Midpoint automation scenario¹, with generative AI acceleration

Occupational category	Net change in labor demand, 2022-30, %	Share of workers with bachelor's degree or above ⁵ , %
▲ Health professionals	30	77
▲ Health aides, technicians, and wellness	30	21
STEM professional	23	73
Builders	12	8
Managers	11	64
Creatives and arts management	11	66
Property maintenance	10	9
Transportation services	9	11
Mechanical installation and repair	7	10
Business and legal professionals	7	68
Community services	7	44
Education and workforce training	3	75
Agriculture	2	12
Production work	-1	10
Food services	-2	11
Customer service and sales	-13	22
Office support	-18	28

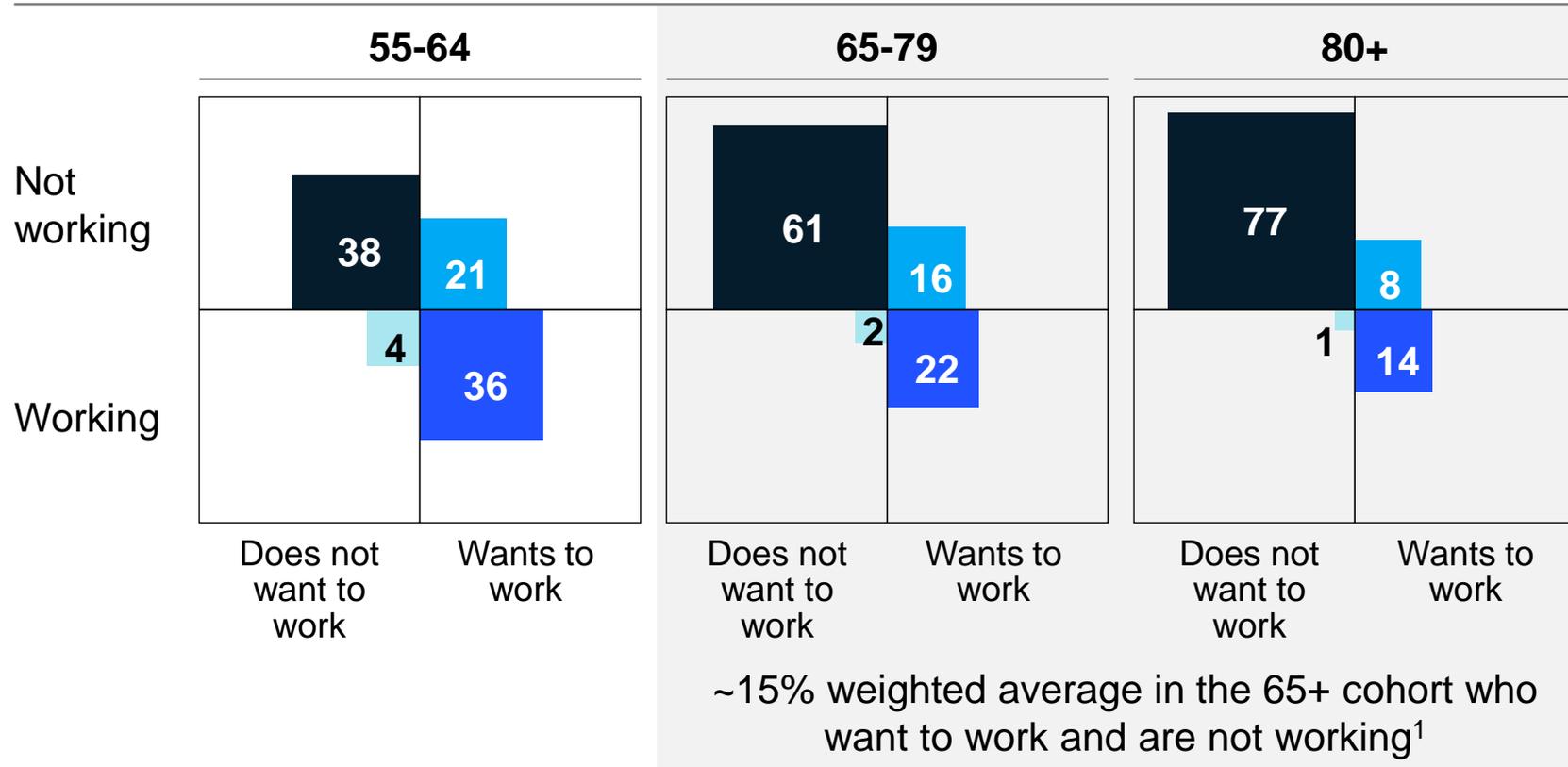
1. Midpoint automation adoption is the average of early and late automation adoption scenarios as referenced in The economic potential of generative AI: The next productivity frontier, McKinsey & Company, June 2023;

2. Resilient during the pandemic, 2019-22, and expected to grow between 2022 and 2030; 3. Stalled during the pandemic, 2019-22, and expected to rise between 2022 and 2030;

4. Hit during the pandemic, 2019-22, and continuing to decline between 2022 and 2030; 5. Based on 2019 demographic shares by occupation applied to 2022 employment by occupation

Engaging cohort aged 55+ may be one partial solution to help alleviate labor shortfall

Employment preferences and status among US population, % of respondents



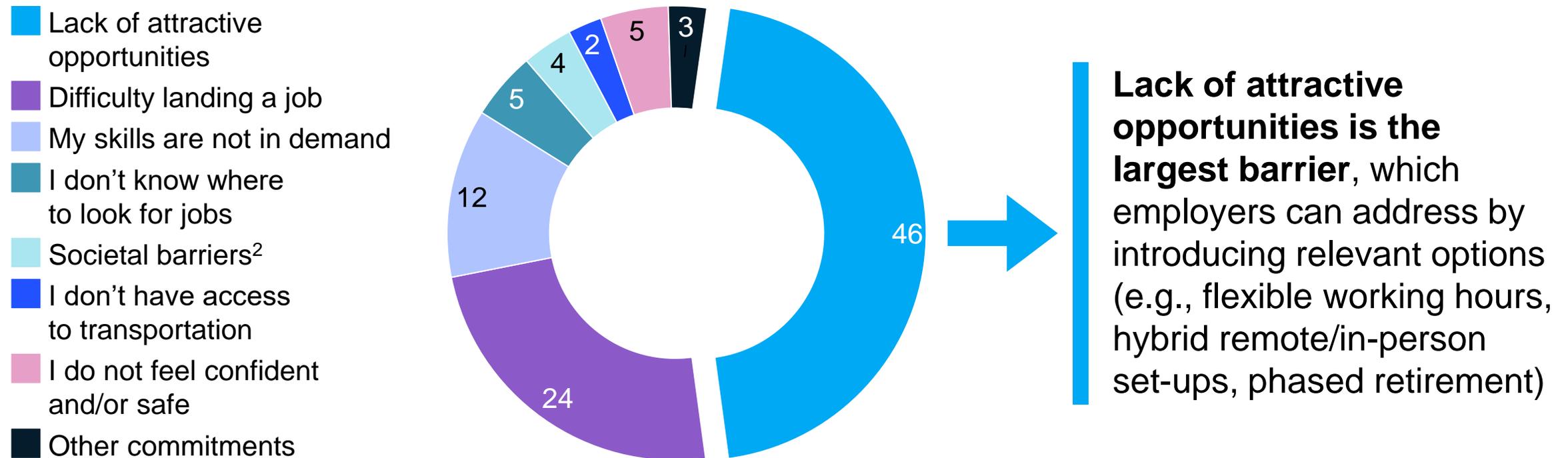
US has ~36M people who are 65+ and have 0-1 chronic conditions, largely in 65-79 cohort

At least some of these individuals **welcome returning to the workforce**, under the right circumstances

1. Weighted average of 65-79 cohort (16%) and 80+ cohort (8%) who demonstrated willingness to work but are currently unemployed (~31M 65-79 and ~6M 80+)

Employers will likely need to adapt to these cohorts' preferences and barriers to working

Barriers to employment, % of US respondents¹



1. Percentage of respondents intended to become employed in the next year reporting as top barrier to employment, excludes unspecified "others" category.

2. In the survey, "societal barriers" include mandatory retirement policies, cultural norms, etc.

Approaches for engaging older workers



Objective



Strategy



Description

Recruitment of new workers



Age de-biased job descriptions

Omit age-limits and use age-inclusive language to not dissuade jobseekers from applying

“Return-ships” or “midlife apprenticeships”

Introduce internships to help those who have taken a career break to return to the workforce

Pipeline partnerships

Work with nonprofits and local agencies to find and train individuals interested in “second acts”

Retention of existing workers



Flexible working arrangements

Provide flexible (or part-time) schedules and/or monthly retainers with tailored benefits

Upskilling, reskilling & rotational programs

Tailor onboarding and rotational programs to build a multi-skilled workforce, as well as certification-based incentives

Multi-generational coaching and mentorship

Train managers on how to manage a multi-generational team and establish mentoring and coaching programs

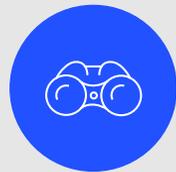
Agenda



Payers' Point of View



Demographics & Engaging an Aging Workforce



Economic Outlook & Strategic Repositioning



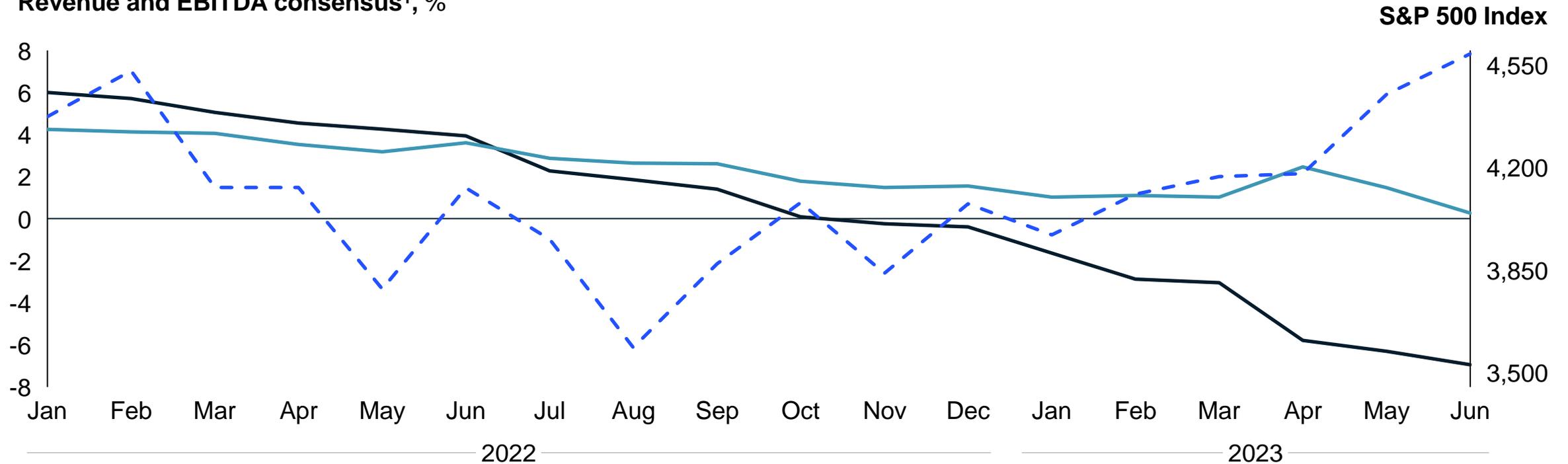
Path Forward

Investors' outlook and S&P 500 appear disconnected in 1H '23

--- S&P 500 Index (RHS) — Revenue growth — EBITDA growth

Growth consensus estimates vs. S&P 500, Jan 2022-June 2023

Revenue and EBITDA consensus¹, %

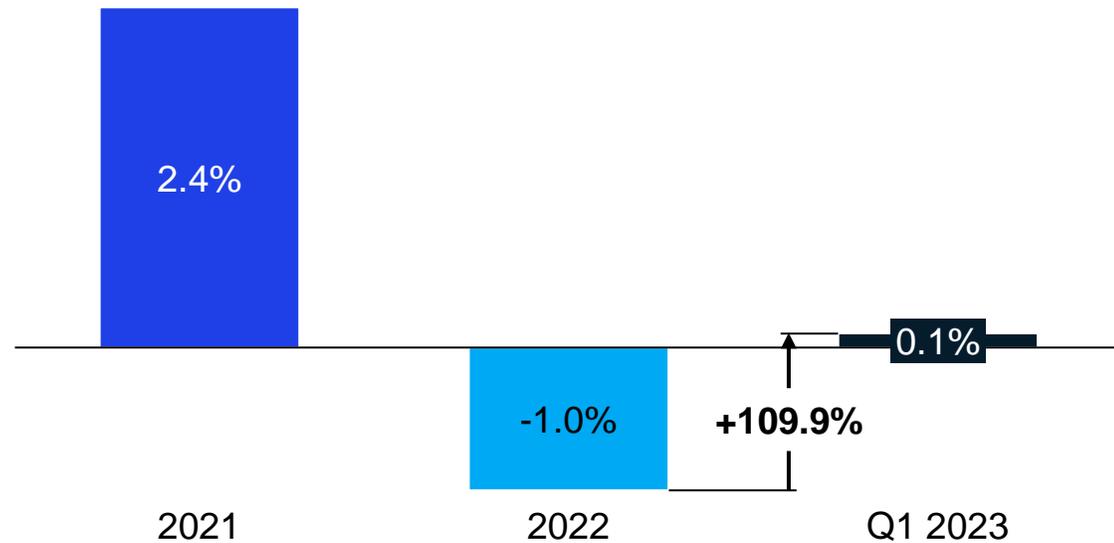


Despite downward estimates, the S&P 500 has risen, indicative of gains in health systems' investment income in '23

1. Sample includes goods and services companies in the set of the top 2,000 most valuable US companies by market capitalization with annual 2022 and 2023 EBITDA and revenue analyst consensus estimates available for each month in 2022 and the first four months of 2023. Excludes non-goods or services sectors (e.g., financial institutions, real estate, insurance, conglomerates) and Big Tech (5 companies). N = 1,397 (1,090 goods companies and 307 services companies)

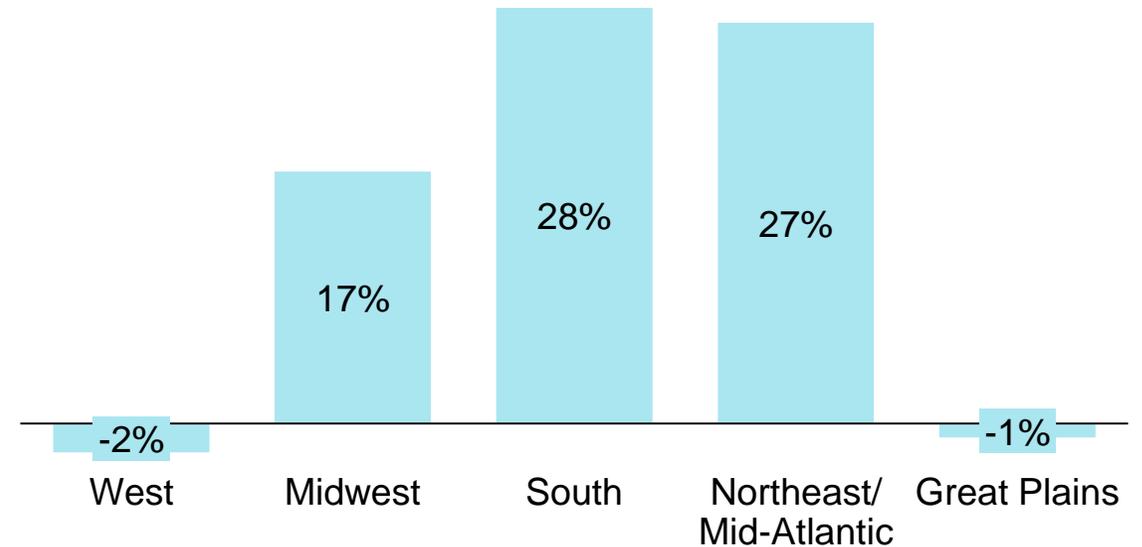
Health systems' operating results have also rebounded, though there is substantial variance across regions

Operating margins^{1,2}, %
Top 25 not-for-profit health systems reporting



Hospital operating margins increased in Q1 2023
after net operating losses in 2022

**Operating EBIDA margin change by region³,
YTD 2020 vs. YTD 2023⁴, %**

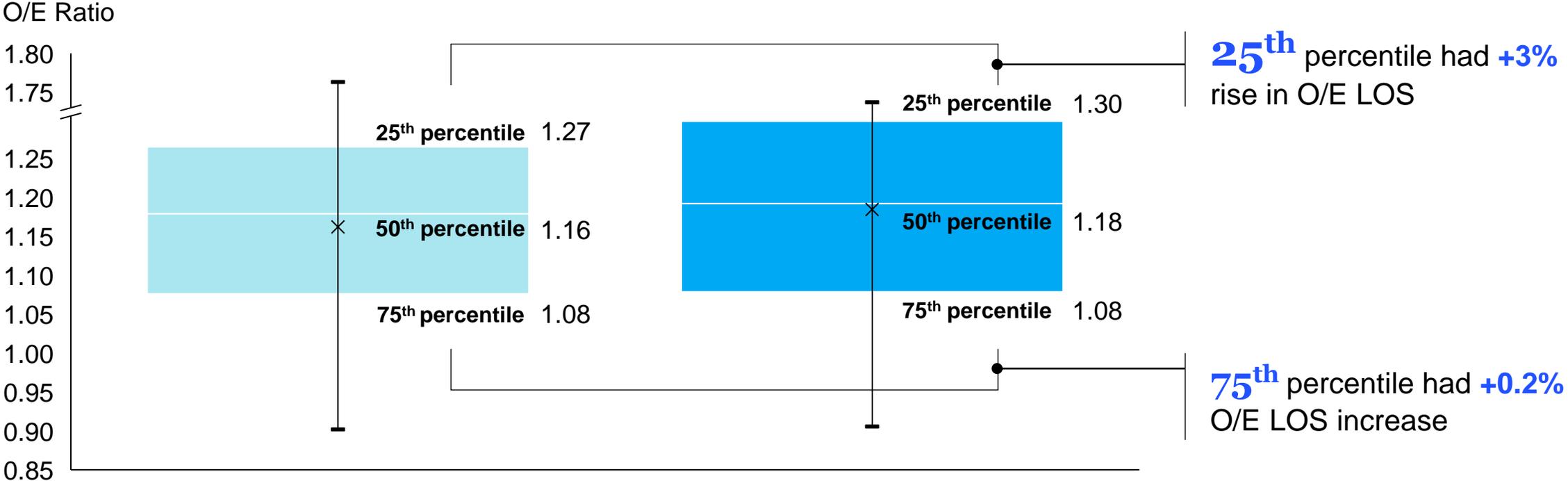


West and Great Plains appear to have recovered more slowly
than health systems in the South, Northeast, and Midwest

1. Operating margin is defined as net operating income margin equal to (total operating revenue) - (total operating expenses); operating expenses include SW&B, supplies, interest, D&A, and services fee
2. Top 25 not-for-profit hospitals by 2022 total revenue
3. Sampled from 1,300 hospitals on a recurring monthly basis from Syntellis Performance Solutions
4. Jan-May financials included in YTD

Despite length of stay (LOS) challenges in recent years, the increase in LOS has been muted compared to ongoing variability

Observed-to-Expected Medicare FFS ALOS Ratio for Hospitals with >350 Beds, 2019 vs. 2022 ■ 2019 ■ 2022

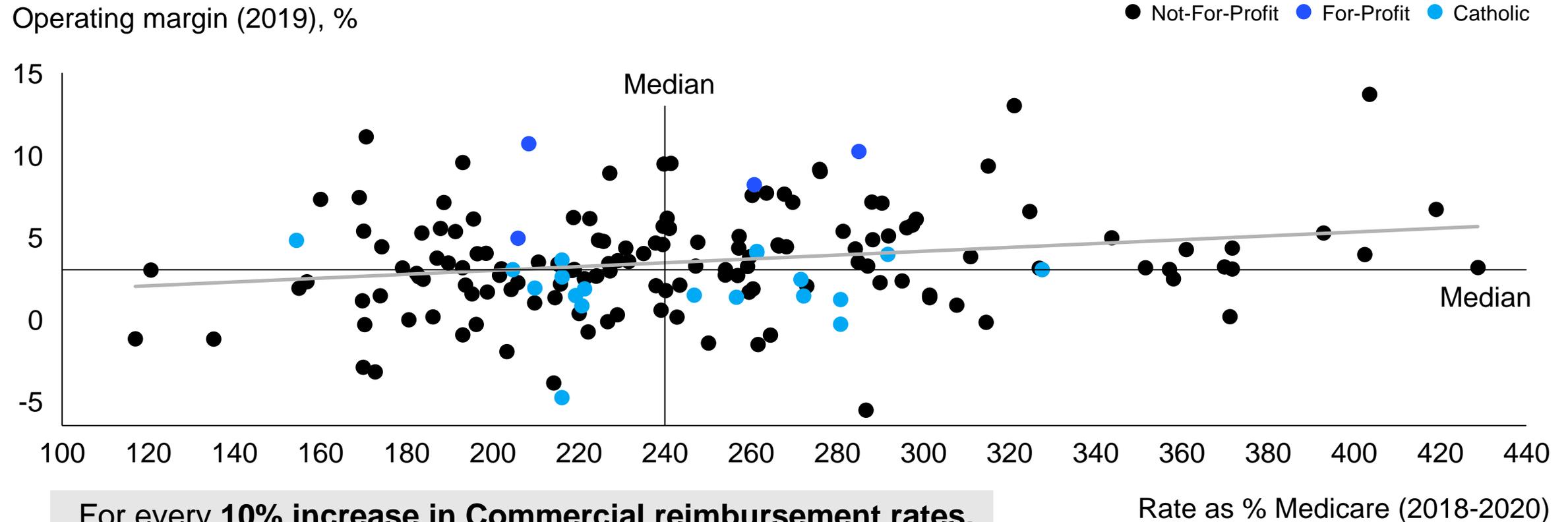


At ~\$400 per patient per day for the final day, a hospital with 20,000 annual admissions would have saved ~\$5.4M in 2022 by improving from 25th percentile ALOS (6.1) to 50th percentile (5.48)

1. Expected ALOS is CMI adjusted based on hospital DRGs

Commercial rates alone do not explain variation in financial results across health systems

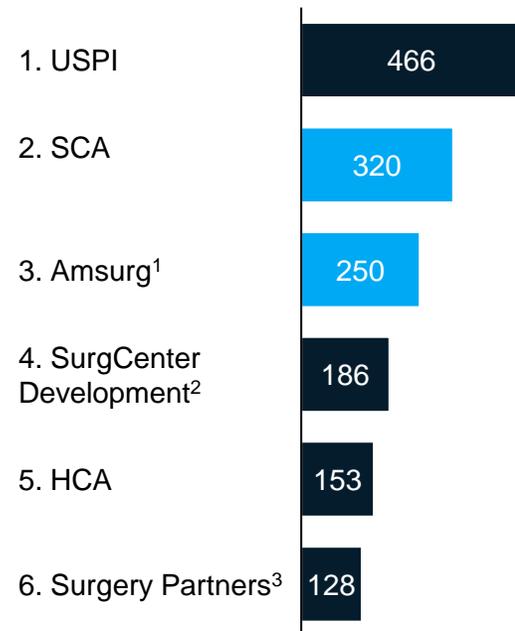
Commercial IP rates and operating margin for health systems with \$1B+ operating revenue, 2019
(N=170; excluding 5 outliers with margin below -10%)



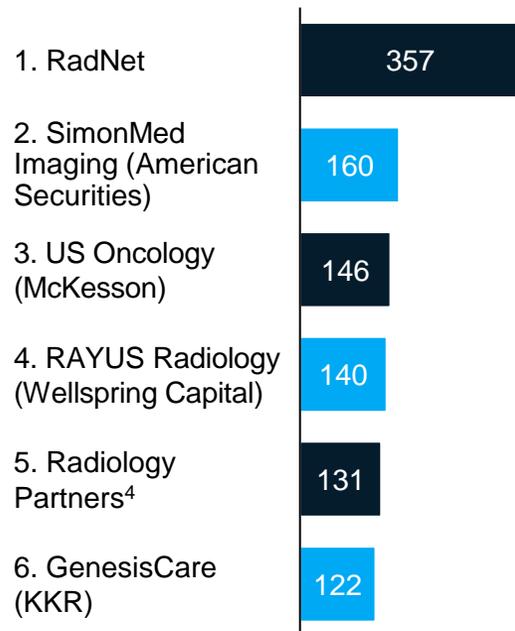
Ambulatory platforms have developed with PE and payers

■ Payer & PE-backed entities

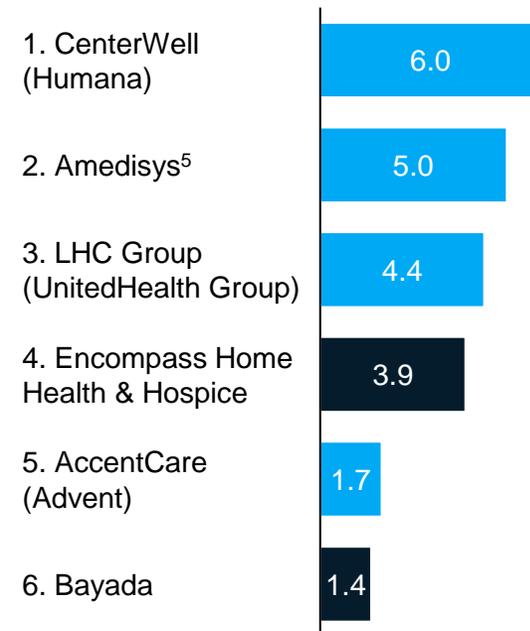
ASC company ranking,
total facility count, May 2023



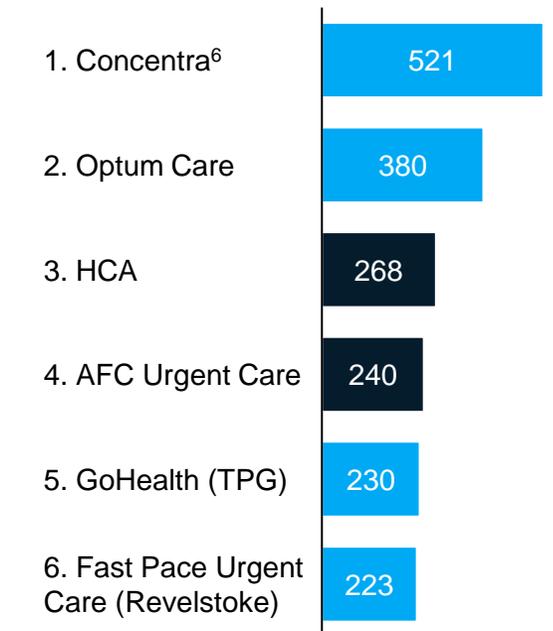
Imaging company ranking,
total facility count, May 2023



Home health company ranking,
% of total claims, 2020



Urgent care company ranking,
total facility count, May 2023



13 of top 24 ambulatory players⁷ by facility count or % of claims are payer and/or PE-backed entities

1. Potential near-term share buy back following Envision bankruptcy filing; however, not yet executed as of July 2023
 3. Though not majority owned, Bain Capital is largest shareholder with 48% shares outstanding as of Dec. 2022
 5. Acquisition agreement announced June 2023
 7. Total across ASCs, imaging centers, home health companies, and urgent care centers as of 2020

2. Acquisition agreement includes Tenet ownership interest in 92 ASCs
 4. Star and NE PE funds have minority ownership stakes
 6. JV ownership between Select Medical Corporation and Welsh, Carson, Anderson & Stowe (PE)

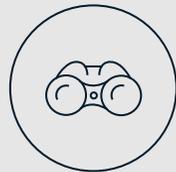
Agenda



Payers' Point of View



Demographics & Engaging an Aging Workforce



Economic Outlook & Strategic Repositioning



Path Forward

Implications for health systems

-  **1 Consumer attraction and engagement**, focused on omnichannel access, compliment of non-physician clinicians, and digital solutions for engagement
-  **2 Long-term workforce strategies** and evolution of care models to mitigate escalating demand for labor and unsustainable cost burden this may present
-  **3 Process and system standardization** for reduced administrative and clinical variability, greater insights to manage operations, and potential for automation and AI applications
-  **4 Operational focus and rigor**, e.g., relinquishing industry-agnostic cost centers and more tightly managing acute length of stay (and resulting demand on labor)
-  **5 Board engagement and enterprise strategy**, including portfolio optimization focused on ROIC, as well as partnerships in areas outside the system's top priorities

McKinsey
& Company

Questions?

Neil Rao

Senior Partner | Seattle

Neil_Rao@mckinsey.com

