The Academy
The Health Management Academy

THE ACADEMY LUMERIS STRATEGIC TRACKING SURVEY

Q2 2018 SPECIAL TOPIC: ASSESSING DISRUPTION

JULY 2018

Lumeris

ASSESSING DISRUPTION

INTRODUCTION

Over the last year, the healthcare industry has been a breeding ground for disruptive trends. Between changing consumer demands, vertical integration (e.g., CVS-Aetna), employer activism (e.g., Amazon-Berkshire Hathaway-JP Morgan Chase), new entrants (e.g., Google, Amazon), and new technology (e.g., AI, Blockchain), it has become difficult to differentiate the noise from substance. As these trends transform the healthcare industry, Leading Health Systems (LHS) are implementing strategies to capitalize on this changing environment.

In Q4 2017, The Health Management Academy (The Academy) highlighted healthcare disruption in its quarterly Strategic Survey, focusing on defining disruption. In this report (Q2 2018), The Academy revisits the topic of disruption in healthcare to understand LHS executives' perspectives on the impact of current disruptive trends, as well as the associated challenges and opportunities for LHS.

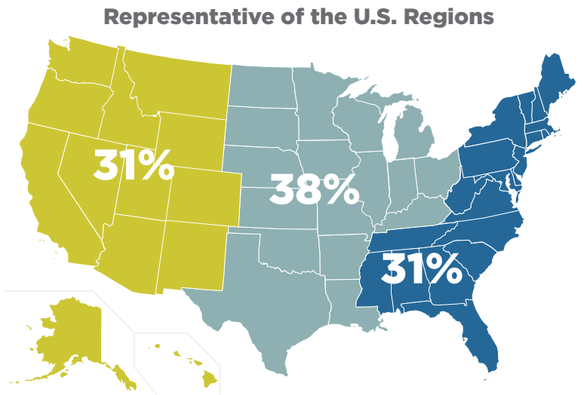
METHODOLOGY

In June 2018, The Academy conducted the fifteenth round of phone interviews for its quarterly strategic survey among 16 senior Leading Health System executives, including: CEOs, COOs, CFOs, CMOs, CNOs, and CSOs.

The survey for the interview consisted of:

1. A tracking section that provides insight into trends around primary strategic areas; and
2. A special topic area that allows for an in-depth look into a timely, developing issue.

PROFILE OF PARTICIPATING HEALTH SYSTEMS



MEDIAN REVENUE **$5.0** BILLION

OWN OR OPERATE **238 HOSPITALS** WITH **43,249 BEDS**

SINGLE-STATE SYSTEMS: **50%**
MULTI-STATE SYSTEMS: **50%**

KEY FINDINGS

1. Health system executives anticipate that vertical integration, technology, and entry of non-traditional players are the recent disruptive trends that will have the most significant impact on the healthcare landscape.

2. The majority (69%) of responding health systems indicated that they expect to see the number of provider-owned health plans to increase over the next 5 years.

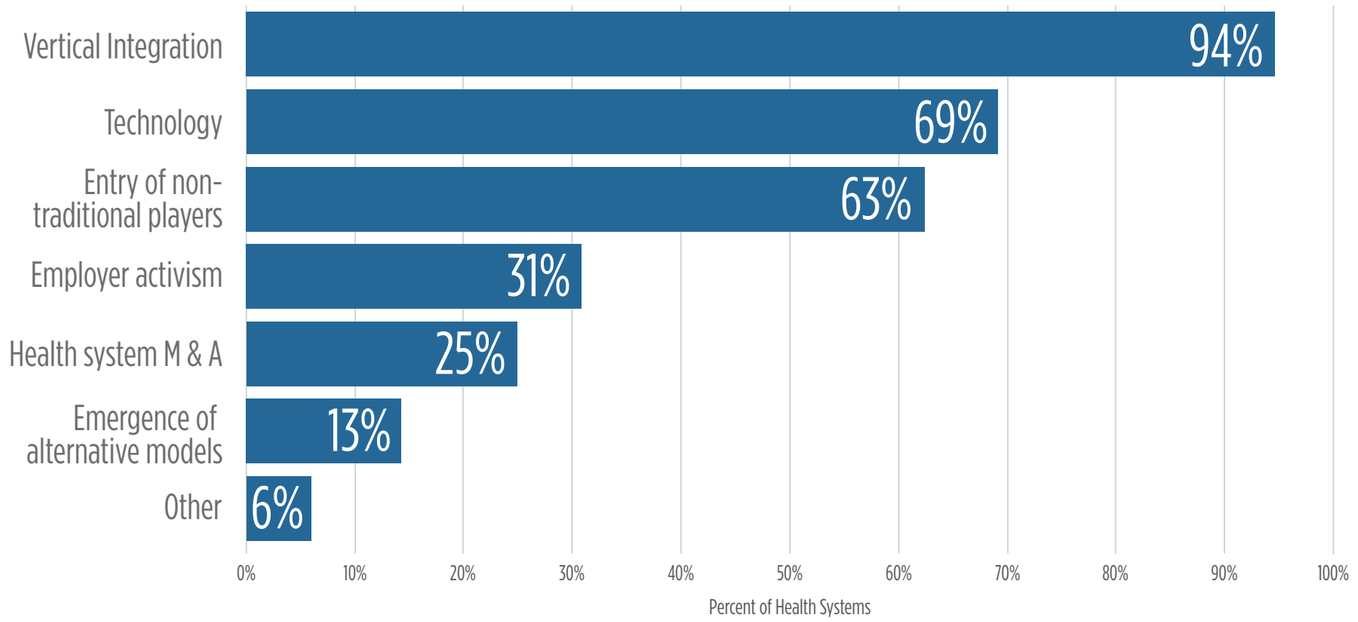
3. Over half (57%) of health system executives reported that specialty pharmaceutical costs were disruptive to their organization's budget.

VERTICAL INTEGRATION AND TECHNOLOGICAL INNOVATION WILL GREATLY IMPACT CARE DELIVERY

Health system executives anticipate that recent trends including vertical integration (e.g., CVS-Aetna, Cigna-Express Scripts,), technology (e.g., precision medicine, AI, blockchain), and entry of non-traditional players (e.g., Walmart-Humana) will have significant impact on the healthcare landscape.

Many executives agreed that the healthcare environment is at an inflection point, and pointed to catalysts such as increasing consumer demands for convenience and economic pressure on individual patients, payers, and providers.

WHAT ARE THE TOP THREE (3) RECENT TRENDS/NEWS/ANNOUNCEMENTS THAT WILL HAVE THE MOST SIGNIFICANT IMPACT ON THE HEALTHCARE LANDSCAPE?



> "This inflection point is caused by economics as well as a consumer mindset; technology is driving the need for on-demand services." (CEO)

MOST CONCERNING TRENDS FOR LHS

- **Vertical Integration** and non-traditional players will increase competition
- **Alternative models** (e.g., Minute Clinics, Telehealth, Concierge Medicine) can fragment the system
- **Consumerism** is difficult to keep up with; user experience is not a provider specialty

MOST ENCOURAGING TRENDS FOR LHS

- **Technological Innovation** provides exciting opportunity to improve care
- **Employer activism** forces historical systems to think differently about their models
- **Consumeris**m presents opportunities for brand cultivation

HEALTH SYSTEM STRATEGIES VARY FOR ADDRESSING FINANCIAL PRESSURE FROM PAYERS

Health system executives differed in how they planned to address downstream movement from payers (i.e. health insurers acquiring physician groups, ambulatory surgery centers, etc.) depending on whether their system had a health plan. Those without health plans hope to focus on the following:

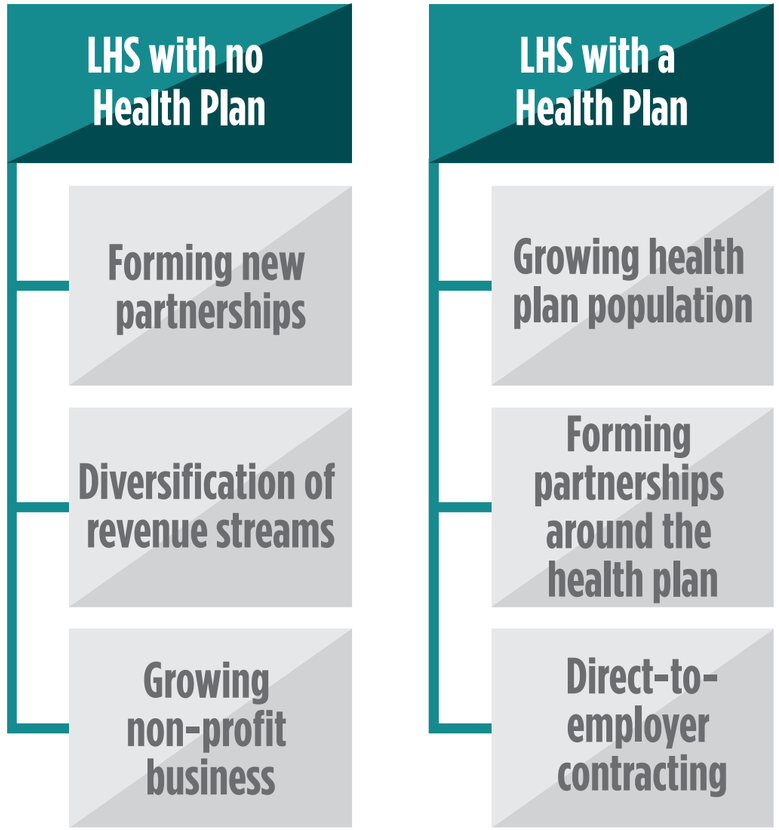
- Forming new partnerships
- Diversifying revenue streams
- Growing non-profit segments of their businesses

Those organizations with provider-owned health plans hope to use their own health plans to address pressure from commercial payers. Strategies include the following:

- Scaling plans to serve a larger population
- Creating partnerships around their health plans
- Involving themselves in direct-to-employer contracting.

Provider organizations are all progressing at different paces in terms of implementing their strategies, with executives ranking their progress as a 3.6 on a scale of 1 (Developing a strategy) to 5 (Fully implemented), on average.

WHAT IS YOUR HEALTH SYSTEM'S STRATEGY ADDRESSING PAYERS MOVING DOWNSTREAM TO CONTROL A GREATER PORTION OF THE HEALTHCARE DOLLAR?



> We continue to get larger as a provider system and provider group, ensuring that we are a must-have in our market. We are looking to get vertically integrated on the payer side, getting closer to joint ventures and joint products in our market." (CFO)

> Our number one strategic initiative is taking our health plan and scaling it to service other providers who want to be in the provider-owned health plan business. They need help stabilizing, and we can create partnerships around our health plan." (CSO)

EXECUTIVES EXPECT THE NUMBER OF PROVIDER-OWNED HEALTH PLANS TO INCREASE

Reflective of health systems' strategies addressing payers moving downstream, the majority (69%) of respondents indicated that they expect to see the number of provider-owned health plans somewhat increase over the next 5 years.

Many executives mentioned that those organizations already in the provider-owned health plan business will have an easier time adjusting to payer activity, but acknowledged that even the established plans are facing losses and are looking for alternatives to their current strategies.

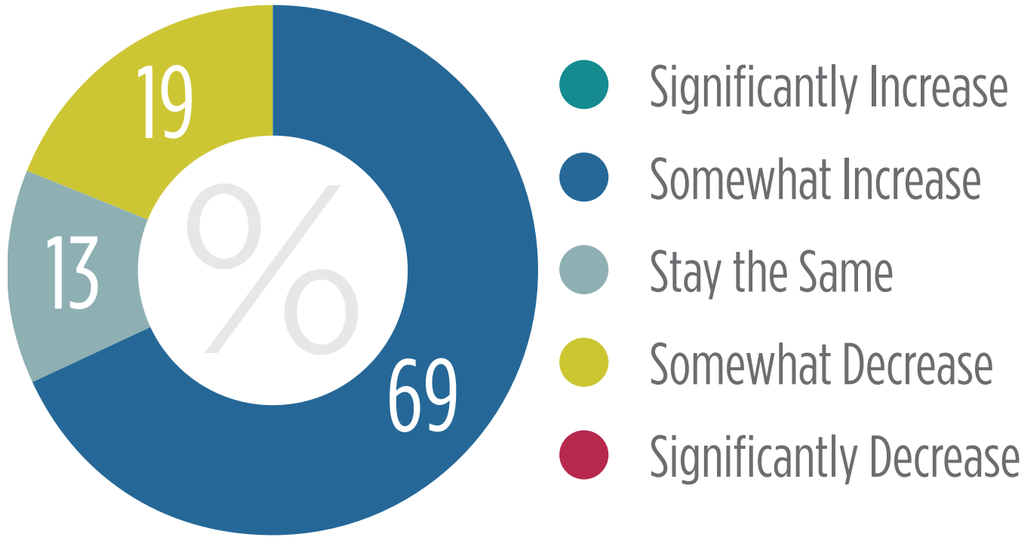
> "As we look across the country, many plans are losing money, especially because of regulatory burdens that created disparities in the marketplace. Some plans are closing, while others are looking to partner and do this differently. They realize something must change." (COO)

For those provider organizations who do not already own a health plan, entering the business will present multiple challenges around cost, negotiation, and scale. Executives described the largest barriers as the following:

- Start-up costs and administrative infrastructure;
- Effects on existing relationships with payers and backlash; and
- Ability to scale and take on risk and additional financial burden.

> "Many systems won't admit it, but the biggest challenge is unquestionably fear of what their contracted payers will do. Even though most provider systems hate their dynamic with payers, they don't want to do anything to compete. They're worried about how rates may change." (CSO)

IN THE NEXT 5 YEARS, HOW DO YOU EXPECT THE NUMBER OF PROVIDER-OWNED HEALTH PLANS TO CHANGE?



SPECIALTY PHARMACEUTICALS ARE DISRUPTING HEALTH SYSTEM BUDGETS

Health system executives reported that specialty pharmaceutical costs were disruptive to their organization's budget, rating the effect as an average of 3.4 on a scale of 1 (Not at all disruptive) to 5 (Highly disruptive).

Those health systems who already own a specialty pharmacy reported that it's a lucrative business for them, as they can manage purchasing, costs, and utilization for high cost drugs, as well as benefit from programs such as the 340B Drug Discount Program.

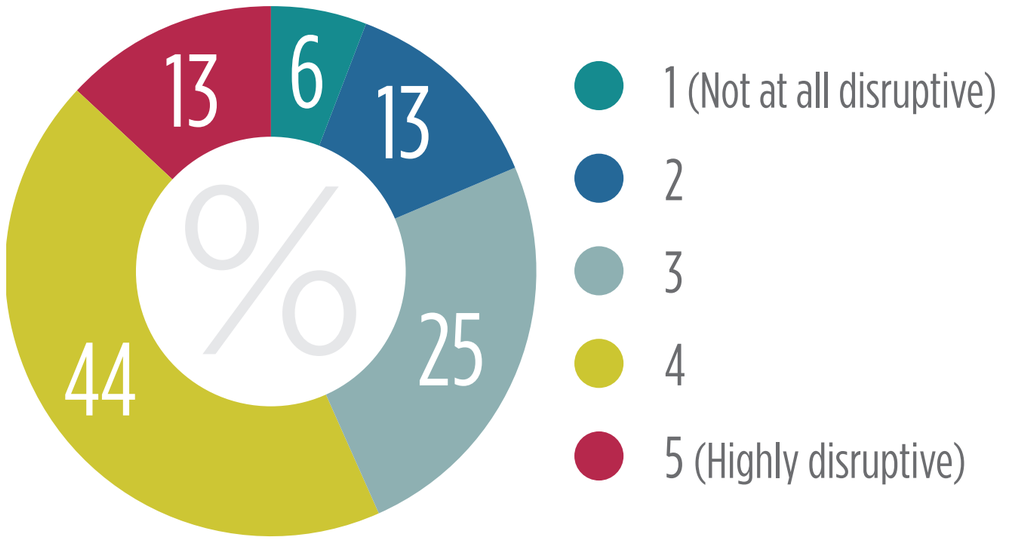
Those provider organizations who do not own a specialty pharmacy have admitted that costs are negatively disrupting their budgets, causing broad financial challenges. Health system strategies for addressing high specialty pharmaceutical costs include the following:

- Strategic outcomes- and cost-based purchasing decisions
- Re-evaluation of drug prescribing strategies for clinicians
- Facilitation of organizational alignment around prescribing behavior

> These costs are really disruptive in terms of our budget, and we actually want to tie more and more of our purchasing decisions with outcomes and costs, as opposed to every time one of these new drugs comes out, we start adopting. We need a disciplined approach – the value proposition must be there when drugs are this expensive." (CFO)

> We have a specialty pharmacy and we're making a lot of money on it as well as 340B, so we are experiencing beneficial disruption. If you're not in that business you're in trouble. It's been disruptive – we're making money on it."(COO)

ON A SCALE OF 1 – 5, HOW DISRUPTIVE ARE SPECIALTY PHARMACEUTICAL COSTS TO YOUR HEALTH SYSTEM'S BUDGET?



ABOUT THE ACADEMY

The Health Management Academy (The Academy) is a membership organization exclusively for executives from the country's Top-100 Health Systems and most innovative healthcare companies. The Academy's learning model identifies top priorities of health system leaders; develops rich content based on those priorities; and addresses them by convening members to exchange ideas, best practices, and information. The Academy is the definitive trusted source for peer-to-peer learning in healthcare delivery with a material record of research and policy analysis. Offerings include C-suite executive peer forums, issues-based collaboratives, leadership development programs, research, advisory, and media services. The Academy is an accredited CE provider. More information is available at www.academynet.com.

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ABOUT LUMERIS

Lumeris serves as a long-term operating partner for organizations that are committed to the transition from volume-to value-based care and delivering extraordinary clinical and financial outcomes. We guide health systems and providers through seamless transitions from volume to value, enabling them to deliver improved and more affordable care across populations—with better outcomes. And, we work collaboratively with payers to align contracts and engage physicians in programs that drive high-quality, cost-effective care with satisfied consumers—and engaged physicians.

An industry recognized leader, Lumeris won the 2018 Best in KLAS award for value-based care managed services for helping clients deliver improved clinical and financial outcomes. This was the third year it received this distinguished award. For the past seven years, Essence Healthcare, Lumeris' inaugural client with more than 65,000 members in Missouri and Illinois, has received 4.5 to 5 Stars from the Centers for Medicare and Medicaid Services. Lumeris is committed to delivering these same results with its multi-payer/multi-population clients to meet their goals and missions.

THE HEALTH MANAGEMENT ACADEMY EXTENDS ITS APPRECIATION TO LUMERIS FOR THE FINANCIAL SUPPORT FOR THIS PROJECT.