

Executive Briefing

Prediction

Modeling and analysis of segmented consumer behaviors and preferences, reform-influenced market trends, and competitor actions. A chief goal: “crystal ball” market structure to enable competitive differentiation.

Profit Model

A coordinated model for achieving acceptable margins, rooted in deep understanding of how to capture value in the new world and the required operational activities to support it.

Product Portfolio

A coherent set of products, including ancillary options, that serve customer needs, attract appropriate risk, differentiate from the competition, and support the profit model.

Positioning

Branding, value proposition, and systems for marketing and distribution that reinforce and align with profit model and product portfolio choices.

“Four P’s” for Post Reform

The challenge of health reform isn’t figuring out how to comply with a complex new law. It’s figuring out how to do business in a complex new world. The details are still being worked but the basics are clear. Introducing your survival kit: a new “Four P’s” of healthcare.

Healthcare reform can feel like a bad dream. For many health plans, it’s a very specific dream, one we all know too well: Something awful is bearing down on you—a runaway truck, an avalanche—and though you try to run, you’re stuck. Your feet won’t move.

In dreams, the paralysis is a mystery. In real life, as health plans contemplate the oncoming juggernaut of healthcare reform, it is all too understandable: The stakes of reform are enormous—more than 40 percent of members and 80 percent of profits in a typical plan will be seriously affected (Exhibit I and II), and scarcely a single part of the plan’s business will be untouched. What’s more, the full implications of the dauntingly complex law won’t be completely understood until multiple rules and regulations are written and implementation is well advanced, several years from now. Today, it is tempting just to focus on current business and hope for a swing of the political pendulum—but inaction is not an option.

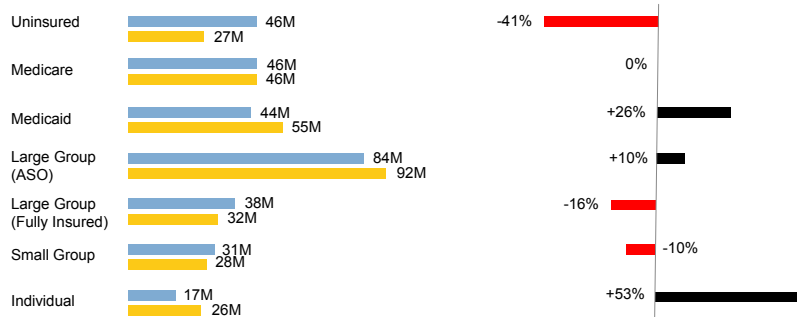
At Oliver Wyman, we believe there’s a danger that healthcare executives will become caught up in the almost overwhelming task of complying with the law and will fail to execute their highest-priority mission: preparing properly for the radically new business environment they will soon face. Yes, compliance is essential; it deserves adequate resourcing and talented people. But senior leadership cannot afford to spend the next few years in the weeds of the new law. For top leaders, the task is to *understand* the forces reshaping healthcare, *master* the logic of the emerging business model, and *implement* their companies’ version of it. It’s true that many details of the post-reform environment are still to be worked out, but the key factors are clear. It is time to get to work.

In this briefing, we will introduce the building blocks of post-reform go-to-market strategy—a new “Four P’s” of the post-reform world, updating the traditional Product, Price, Place, and Promotion and adapting them to the unique needs of healthcare. In the weeks and months to come, we will flesh out this framework with more detailed analysis and recommendations on each of the building blocks. Our goal is to contribute to a shared vision of what the industry must and will become over the next few years, to help enable creative thinking and collaborative efforts; the industry, as well as its individual constituents, have a great deal to accomplish before 2014.



Exhibit 1 Healthcare reform will drive significant changes in U.S. plan membership

Membership by category today and Oliver Wyman's estimate of post-reform membership, plus percentage change plus or minus.

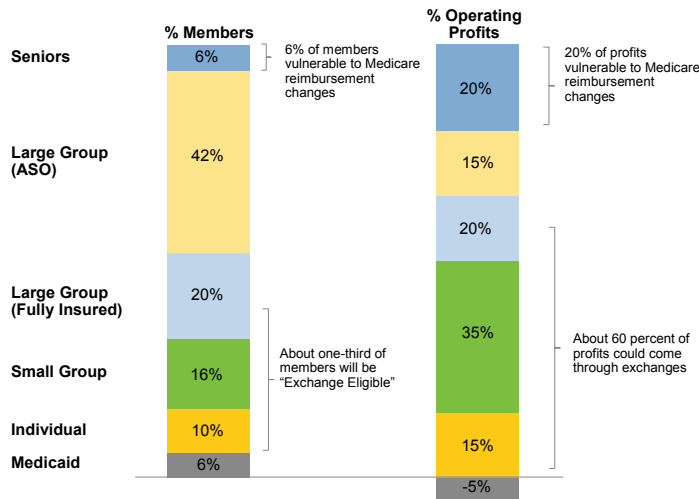


Contrary to government predictions, Oliver Wyman estimates that only about 19 million uninsured individuals will become insured. But that, and smaller but significant movements out of small and large group insurance, will lead to a significant "retailization" of healthcare.

Sources: MEPS Adjusted D&B Employer Data 2009, CMS Filings 2009, Kaiser State Health Facts 2008, United States Current Population Survey Data 2008, Oliver Wyman Health Reform Analysis; Congressional Budget Office.

Note: Analysis reflects membership changes based solely on impact of reform and does not take into consideration any demographic shifts.

Exhibit 2 In a typical plan, reform could have an impact on 40% of members—and 80% of profits



Source: Oliver Wyman analysis

The New Dynamic

Healthcare reform imposes hundreds of requirements on the industry, but from the perspective of the healthcare go-to-market business model, four points stand out:

- A quantum shift toward retail.** Health benefits distribution is already moving toward a retail model, but the trend will be taken to a new level almost overnight when the exchanges open and tens of millions of the previously uninsured flood into the market. We also expect to see significant movement from small group to the individual market, as employers take advantage of their newfound ability to exit the insurance business. And as the exchanges open up in 2017 and beyond, we could see as many as 70 million members buy insurance through that platform, representing almost half the commercial market. Retail distribution is an area where plans have made strides already—marketing through big-box retailers,

As the exchanges open up to additional customers in 2017 and beyond, we could see as many as 70 million people, representing almost half the commercial market, buying health insurance through that platform.

Healthcare reform is change at a new level. It doesn't feel like evolution or even revolution. Instead, it is as if someone has hit the reset button: You find yourself suddenly at a new company in a totally new industry.

launching brick-and-mortar storefronts, forming distribution alliances, moving to the Web, and so forth. But these efforts pale compared to what lies ahead.

- **Standardized benefits.** The reform act dictates minimum levels of actuarial value and an array of required benefits, making it difficult to differentiate products (especially in the exchanged-based marketplace), but also weakening a tool plans have used to control costs. Consumer directed buy-up products and services are likely to become a growing part of the retail marketplace as higher income consumers seek to close perceived benefit gaps.
- **Floors on Medical Loss Ratios.** MLR floors represent a direct reduction to margin and will force health plans to aggressively reduce administrative costs. The high cost of broker commissions will stimulate significant debate over brokers' long-term value in the small group market. MLR floors will also have a major impact on pricing: Price too high and you will both lose customers and have to rebate premiums. Price too low and you may lose your shirt.
- **Restrictions on the ability to control or price for risk.** Post reform, health plans will be obligated to take all comers and will have less pricing flexibility as the market moves to community rating. The market will shift from one of risk selection to risk attraction—health plans will have important decisions to make regarding the role risk and selection management will play in market positioning and overall profitability. Will they (a) play for the healthy, (b) balance in the middle, or (c) attract specific risk profiles?

The New “Four P’s”

Just how different will the new healthcare world be from the old? Consider the smart-phone industry: As telecommunications companies learned, the shift from voice-only to voice-plus-data was more than a matter of technology. It completely altered value creation, pricing, the way the customer uses and regards the product, the balance between product and related services, competitive set—everything. For participants, change at this level doesn't feel like evolution or even revolution. It is as if someone has hit the reset button, and leaders find themselves suddenly at a totally new company in a totally new industry.

Senior leaders need to rethink their market development strategies—and the business infrastructure that will enable them to reboot their businesses. The process will be complex, because the basic elements are interconnected. As a result, the new “Four P’s” must be thought of holistically, as a single business system. Fail on one element and you compromise the whole.

1. Prediction To varying degrees, health plans already model customer behavior, claims, market movement, and many other factors. But in the future, they will need to do it in a more detailed, refined manner, both because the market will be much more nuanced and because with tighter margins, plans need to better understand the relationship between buying behavior and future healthcare costs. Companies that can successfully model and predict customer migration, reform influenced market shifts, competitive factors, and future profitability will be in the best position to chart a course that optimizes risk-adjusted returns. Prediction activities include:

- Understand the legislation, what actions it demands immediately, and how it is likely to play out tomorrow.
- Model shifts in population and profitability. In the early years of reform, customers will take up insurance at an unprecedented rate. But there will also be massive movement among plans and market segments as customers turn from traditional retail to the exchanges, small employers drop coverage, and customers seek out plans suited to their needs.

- Segment your customers based on sensitivity to price, brand, and product—but also in terms of their attitudes: how they want to access product, for example, and their potential for engagement in wellness programs, disease management, and other “pro-health” activities. A key segment to understand: the currently uninsured.
- Understand market dynamics and competitor plays through competitive analysis that includes new entrants, broker research, and market trends.
- Size the market by population and segment shifts, demographic trends, etc.

Prediction is also about planning. Health insurers need to put in place short- and long-term plans not only to respond to immediate mandates but also to prepare for the future through the development/acquisition of needed competencies.

2. Profit Model Profit Model consists of a value-capture mechanism, a range of activities and products that the company will focus on in chosen markets, and an operational infrastructure—all of which work together to enable a business to achieve an acceptable margin. The process of developing one embraces a wide range of analytic and planning tasks from optimizing pricing to designing internal operations. In the case of the healthcare industry, some of the most difficult issues to address have to do with the relationship between buying behavior and future healthcare costs. Some examples:

- Under the new constraints on MLR, you must rationalize SG&A. But as you do that, how do you manage service? Is it desirable to offer multiple tiers of service, or to focus on self-service via the Web? What elements can be outsourced?
- What is the price point that yields the optimum balance of membership, risk profile, and margin?
- Where can you create new revenue streams? Are there services that you could sell to your customers, providers, or other plans?
- What other changes can alter the economics of your business: Outsourcing, distribution alliances, acquisitions, creating newcos? Can you use Integrated Health Management techniques to both improve quality and reduce medical costs to differentiate your offerings?

A new profit model will almost certainly require a new operational infrastructure, and costs will be a vital concern. At the same time, your profit model has to match your market position. You can’t sell yourself as the Cadillac plan and then offer narrow networks, thin service, and off-the-rack benefit designs.

3. Portfolio Design Portfolio design is about designing coherent sets of products consistent with the needs of your targeted customers and your chosen profit model. A crucial aspect of portfolio design is choosing how and where to compete for business—but also making good decisions about where *not* to compete. Key questions in portfolio design include:

- Which of the designated benefit levels—gold, silver, bronze, etc.—make sense within the constraints of your new profit model? Which geographies? What market segments does it make more sense to avoid?
- Can you link your products to add-ons not subject to the constraints of reform, such as dental or voluntary coverage, or even non-health-related products?

Your profit model must fit with your market position. You can’t represent yourself to customers as the Cadillac of health plans, then turn around and offer narrow networks, thin service, and off-the-rack benefit designs.

- How does your portfolio design support your market positioning, and vice versa. What impact will portfolio choices have on the behavior of new and existing customers? Can your distribution systems support your product portfolio choices?

4. Positioning Positioning is how you want to be viewed in your chosen market—by the consumer, the employer, the channel. It is about developing a value proposition that is based on your insights from Prediction and reinforced and enabled by your Profit Model and Portfolio choices. What do you want to be known for? What kinds of marketing activities do you need to conduct to get your message out? What channels do you utilize in combination with the exchanges to reach your target segments? What kind of relationships with brokers/GAs do you develop to maximize customer acquisition and create “stickiness”?

With its emphasis on standard benefit levels and distribution through exchanges, the healthcare reform legislation may ultimately commoditize health insurance and focus the customer’s attention squarely on price. Paradoxically, this means that branding and differentiation will become more important than ever. But in the constrained new world, every positioning choice has to be tied to the profit model and to a deeply developed sense of costs and opportunities:

- Do you want to position your company as being convenient and easy to work with? You’ll need the technology, personnel, and business practices to back it up.
- Do you plan to compete boldly on price? You will need to find ways to reduce claims, through network choices, contracting, or solutions rooted in Integrated Health Management.
- Are you the wellness company? You’ll need to know how to stay compliant while managing quasi-medical services and offering patients incentives to keep their own costs down.

There are new possibilities to be explored here as well as to take advantage of the potential of linking brand, marketing activities, and distribution plays: white labeling or co-branding (would your customers prefer to buy health coverage branded by Virgin, Disney, or GE?), the new role of a broker, and even the idea of establishing private healthcare exchanges to compete in parallel with the public exchanges.

Phase One Begins Now

Under the new rules of healthcare, you need not just a new profit model and go-to-market-strategy. You need the infrastructure, skills, and culture to support new models, new levels of responsiveness to customer needs, new sophistication about the flow of costs and revenues, and the determination and imagination to play your part in building a new, robust healthcare industry to replace the old one.

Companies have a spectrum of choices in how to play, from a “defensive,” compliance-oriented model to an “offensive,” market-transforming model. In our view, good defense is required to survive but good offense is needed to thrive in the post-reform world. By embedding the new “Four P’s” approach into go-to-market strategy, health plans can position themselves to succeed in the post-reform era. But the heavy lifting needs to begin immediately.

Oliver Wyman has deep expertise in helping health plans meet today’s growth challenges and prepare for the future market shifts. Our consultants would be pleased to meet with your team in the weeks to come to discuss the details of your own situation and how to respond to it.

Healthcare reform may ultimately commoditize health insurance and focus consumers on price. Paradoxically, that will only make differentiation and brand more important factors than ever before.

About Oliver Wyman

With more than 2,900 professionals in over 40 cities around the globe, Oliver Wyman is an international management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm helps clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC].

Oliver Wyman's Health & Life Science's practice serves clients in the pharmaceutical, biotechnology, medical devices, provider, and payer sectors with strategic, operational, and organizational advice. Deep healthcare knowledge and capabilities allow the practice to deliver fact-based solutions.

U.S.A

Howard Lapsley
howard.lapsley@oliverwyman.com
+1 617 424 3439

Michael Main
michael.main@oliverwyman.com
+1 312 345 2984

www.oliverwyman.com