How Are Your Peers Are Planning for Strategic Growth?

Key insights on how health systems are (or aren't) investing in long term growth

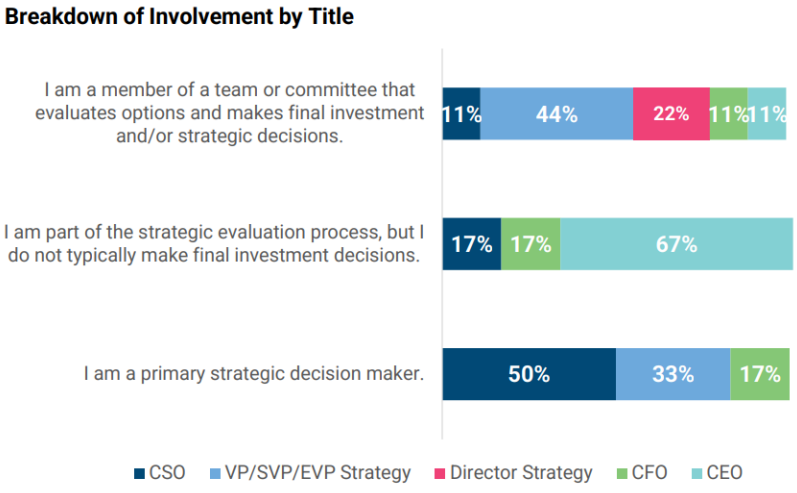
In a time where health systems are balancing cost containment strategies with long term growth, we wanted to get a better understanding of how health systems are thinking about strategic growth and pursuing revenue diversification.

In late 2023, we surveyed strategy leaders at 30 unique leading health systems (LHS) about their one- to five-year growth plans. It defined "strategic growth" as opportunities that are not substantially divergent from a traditional health system portfolio, like ASCs, internally branded telehealth or the expansion of existing service lines. "Revenue diversification," in contrast, was defined as offerings that exist outside of the typical core business of a health system, like spinoff companies (e.g., PBMs), drug manufacturing, or venture investments.

Background on the survey

The health systems surveyed have at least $1.5B in net patient revenue (including six respondents from systems with more than $10B in NPR). Half of the systems were AMCs and half were not. All our respondents identified as being involved in strategy at the director, VP or C-suite level, with a mix of roles including CSOs, CEOs, CFOs, E/S/VPs of Strategy, and Directors of Strategy. Every respondent was involved with strategic decision-making and sits at the enterprise level, overseeing the entire health system.

Twenty-percent of respondents were the primary strategic decision makers at their system, while 60% said they are on a team or committee that makes final investment decisions. The remaining 20% of respondents were part of the strategic evaluation process.



Decision-making responsibility varied by title: half of our respondents who identified themselves as the primary decision maker were CSOs, whereas most of the CEOs said they were part of a decision-making team. Considering the numerous stakeholders that LHS need to align with and the complexity of issues at hand, it's not so surprising that major strategic decisions tend to involve a larger team of executives.

Ultimately, we were able to assemble a diverse panel of respondents representing a range of views on the strategic path forward for their systems.

Six key lessons:

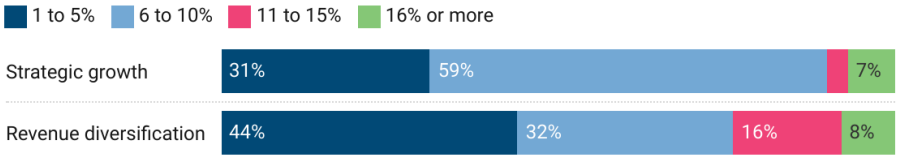
1. Most systems are spending a similar portion of their budget on strategic growth, while revenue diversification spend is more varied

Almost all systems dedicate budget for growth; all but one of our respondents said their system has a dedicated budget for strategic growth opportunities, and 83% of respondents said they have a dedicated budget for revenue diversification initiatives.

Most health systems are dedicating a similar percent of their budget for strategic growth, with a majority (59%) saying they spend 6-10% of their budget, and a strong minority (31%) saying they spend 5% or less.

Most systems spend similar amounts on strategic growth, but approaches to revenue diversification vary

What percentage of your health system's total budget would you estimate goes to fund...



Source: Academy survey • Created with Datawrapper

In contrast, the distribution of budgets for revenue diversification was more bifurcated: while a plurality (44%) said they spend 5% or less of their budget on diversification, nearly a quarter of respondents said they spend 11% or more on such activities. For-profit systems were more likely to devote more budget than non-profits, with all for-profits devoting more than 6% of the budget and a quarter devoting more than 11%.

Some of this divergence is likely due to different definitions of both terms. While the survey sought to define them clearly (as we noted above), we've heard a myriad of different definitions across health systems. When we asked health systems how they defined budget for "revenue diversification" last year, the major points of divergence were:

- A few included geographic expansion outside of their market, while most didn't
- A few included investments to support all ambulatory revenue, while most didn't
- Some included income from investment activities, while some did not
- Some included broad M&A activities, while others only included these activities outside of their markets.

All told, the definition had a broad impact on the overall percentage. For instance, a system including all these divergent points above reported 25% of their total budget going to revenue diversification, while most Strategy Catalyst members reported a total of $25-50M or <5% of their budget. Interestingly, last year 90% of Strategy Catalyst members expected some or a significant increase in their budget for revenue diversification into 2024, which seems reflected in the higher percentages we see in this new survey.

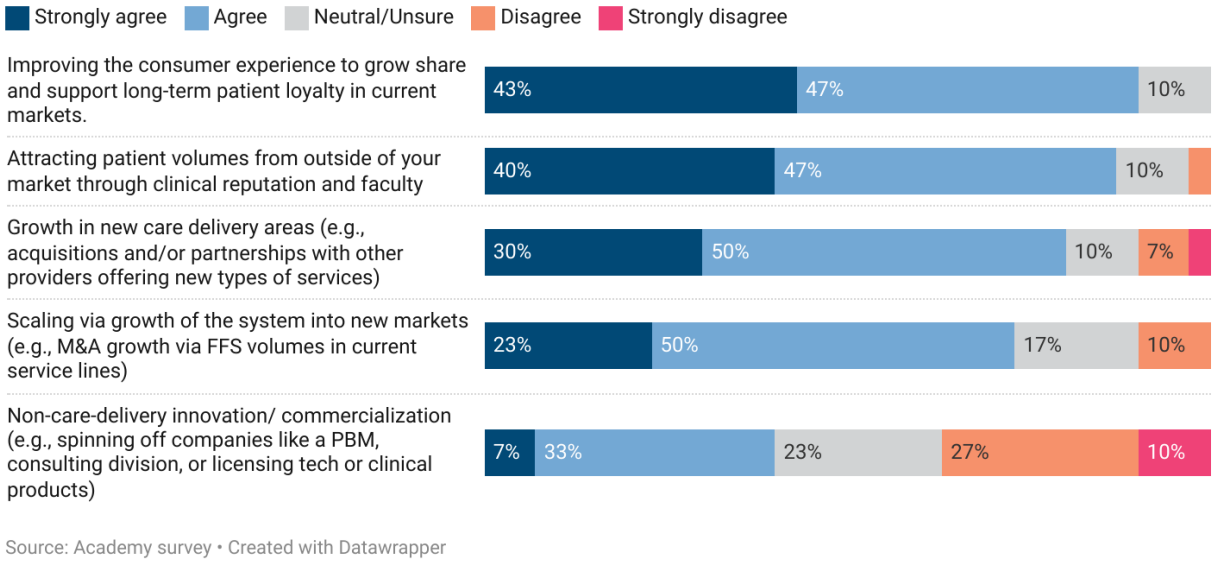
Finally, we were surprised by one important difference between the budgets for strategic growth and revenue diversification. According to respondents, 80% of spending on strategic growth goes towards maintaining current contracts, whereas two-thirds of spending on revenue diversification is put towards new spend.

2. Most systems are focusing growth strategies on patient loyalty and clinical reputation

When we asked respondents how well different approaches to growth matched their strategy, a vast majority (90%) said they plan to improve the consumer experience to grow market share and patient loyalty. Likewise, almost all respondents (87%) said they hope to attract greater patient volumes with their system's clinical reputation and faculty. Given that these are common strengths for LHS, most of which have longstanding relationships with their local communities and mission-based leadership, it's not surprising that systems would want to lean on these advantages.

Most LHS focus on patient loyalty and clinical reputation

To what extent does each of the following resonate with your organization's growth strategy for the next 1-3 years?



Source: Academy survey • Created with Datawrapper

However, we were somewhat surprised that so many respondents said that their strategy is to attract patient volumes from outside their market through clinical reputation, as we associate this strategy as only being successful for a handful of destination medicine hubs. We've often heard from strategy leaders that despite a desire to get patients traveling over 100 miles for care, even top-rated AMCs only see these volumes equal a small percent (<5%) of their total in a given year. Of course, part of this divergence in our understanding could be that the question did not ask *how far* from the market the plan was expecting patients to travel.

Growth in new care delivery areas and growth into new markets via M&A were also common strategies, with substantial majorities of respondents in agreement. We were surprised by the latter given recent FTC activity challenging even small-scale acquisitions, but clearly M&A remains a major growth path.

A slight majority (56%) of respondents also said their strategies entailed increasing patient lives at risk, either fully or delegated. This is notable given that 94% of all lives at LHS are still FFS but reflects sustained growing interest in getting closer to the premium dollar. Moreover, PSHPs are also falling out of favor to some degree because they take a long time to build up (potentially over decades) and can generate substantial fixed expenses in the meantime.

Finally, while innovation and commercialization outside of traditional care delivery is certainly a hot topic, only a minority (40%) of respondents said that their strategy includes this kind of diversification. For many systems, this kind of work falls outside of their core competencies, and some have given up after initial failures. With that said, the ongoing mismatch between

reimbursement trends and care costs is creating more pressure to find creative new directions for growth, and we wouldn't be surprised if this share rises in future years. Attempts to commercialize AI tools could open a new door.

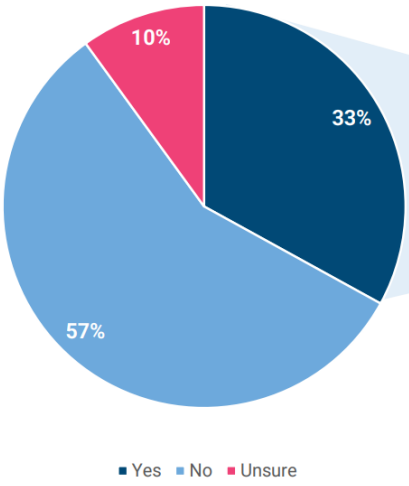
3. Few systems have active dedicated venture capital arms

Venture capital investing has gone in and out of fashion over the past few years: after an initial surge of interest during a bull market for digital health startups in 2021, the venture investment market suffered in 2022 and 2023, bringing down the balance sheets of LHS with dedicated venture arms with it. As a result, many systems paused or slowed down their VC activities at least temporarily.

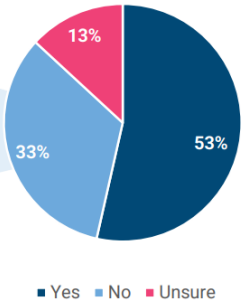
Our survey data falls in line with this narrative. Only a third of respondents in our sample said their system has a dedicated venture capital arm, and within that group, roughly half (53%) say they are actively investing with 4 or more investments per year. These systems are largely sitting on past investments and waiting for the market (and subsequent valuations) to heal before getting further involved.

It's also worth noting that this question relates specifically to standalone investment arms, whereas some systems make VC investments directly off their balance sheets. While these two forms of investment are in many ways similar, we were particularly interested in standalone VC arms because they signal a system is prioritizing investment as an independent revenue stream, and not just as an extension of its other activities.

Does your health system have a dedicated venture capital arm?
Percent of respondents (n=30)



Is your venture capital arm actively investing (e.g., 4+ investments per year)
Percent of respondents (n=10)



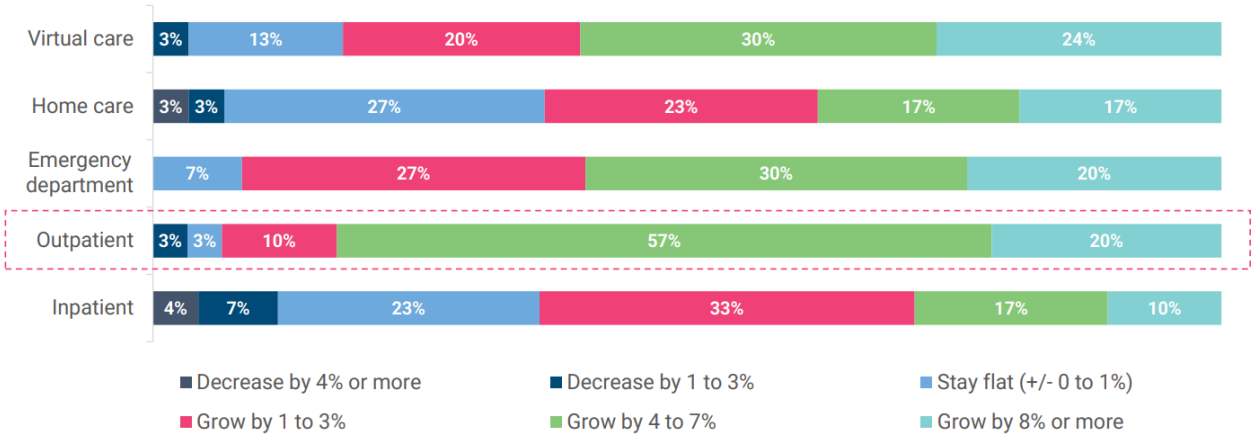
20% of LHS say that venture/PE arm is part of growth strategy

Overall, just 20% of respondents said that a VC or PE arm is part of their growth strategy. Those that have invested saw increasing returns. For example, one health system revealed a $387M markup for its investment portfolio as of September 2023—nearly triple its operating margin for the same period. With that said, those that do have a venture arm tend to believe that it's capable of driving value even beyond the direct financial opportunities. Some systems invest in a partner to deepen their relationship and develop new capabilities—for example, one health system invested in the pharmacy benefit management company **CapitalRx** (as part of The Academy's Strategic Partnership Alliance) in order to further development of their back-end claims platform, JUDI.

4. Systems are continuing to invest in outpatient and virtual care but pulling back from home care

When we asked respondents where they expect to see rising volumes, it's not surprising most predicted that the strongest growth would take place at outpatient sites of care. Virtual and ED volumes were also expected to grow, possibly at a somewhat slower rate. In contrast, most respondents think growth will be slow (or even negative) in inpatient settings and for home care.

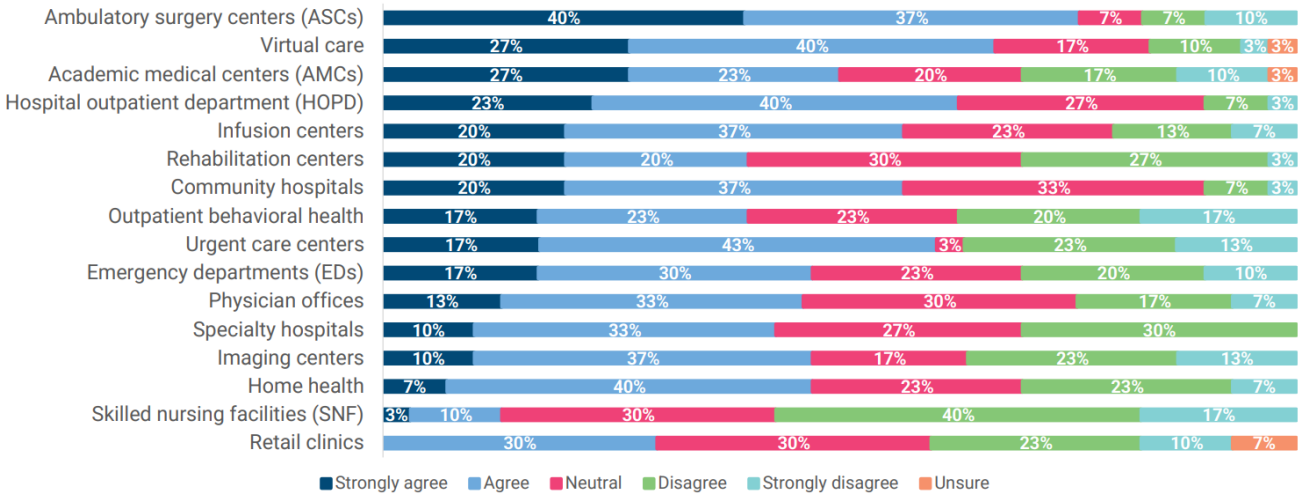
What is your organization's approximate overall expected percentage volume changes in 2024 by site of care?
Percent of respondents (n=30)



These expectations are driving decisions about where systems are investing for strategic growth. As seen below, a clear majority of systems are investing in ASCs and HOPDs to meet growing demand. This is a clear continuation of existing strategy, but we have recently seen a wide divergence in the financial outcomes of those that invested more in these settings vs. those that have invested less. Those in the lowest quartile of a hospital to ASC ratio (e.g., those with fewer ASCs and more hospitals), saw a -4% operating margin in Q3 versus a 7% operating margin for those in the top quartile.

Virtual care is also a top area for investment, reflecting both projected demand and the role it plays in meeting other needs—like improving primary care access and appealing to younger consumers as part of a patient acquisition strategy.

To what extent do you agree or disagree with the following statement: Our organization is prioritizing this setting of care for strategic growth, either through organic (patient market share increases) or inorganic (acquisitions, JVs, etc.) growth in 2024.
Percent of respondents (n=30)



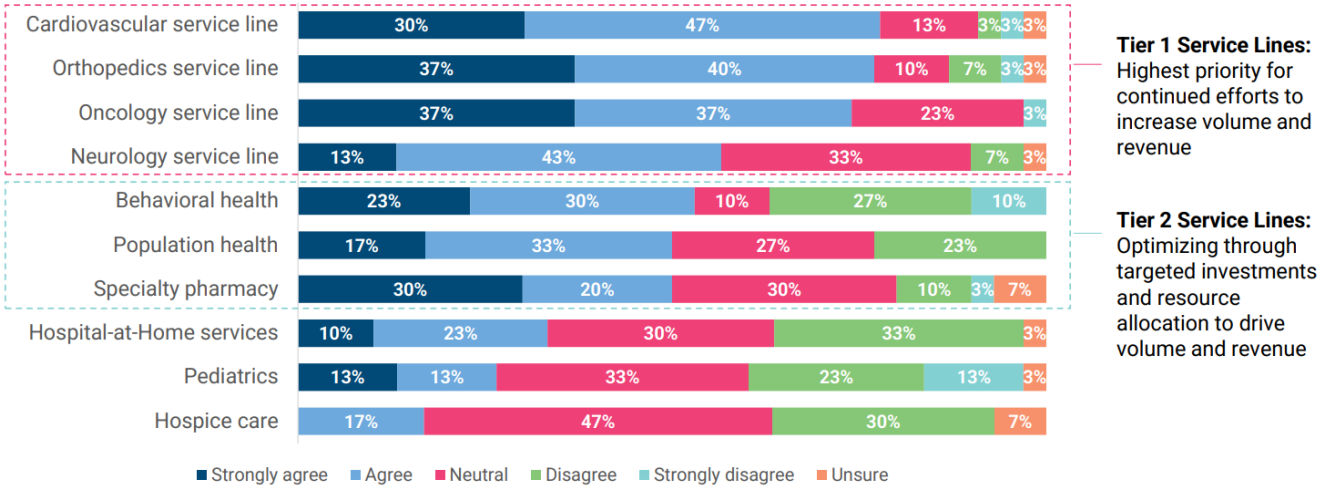
The relative lack of interest and optimism for home care is striking because it was seen as such a trending area for investment just a few years ago, especially amid a surge in Hospital at Home programs. In contrast, the national payviders have aggressively expanded into this segment (most recently through **Optum**'s acquisition of **Amedisys** for $3.3B and **LHC Group** for $5.4B)

5. Most systems are prioritizing the same profitable service lines

According to our survey, many systems are prioritizing the same highly profitable service lines for volumes and revenue growth: cardiovascular, orthopedics, oncology, and neurology. This is consistent with the general trend we've been hearing of strategy teams specifically focusing on a couple of key service lines for growth.

However, while this is a sound strategy in isolation, it's important to note that everyone is competing over slices of the same pie. That is, if you're investing in a given service line because it's profitable, there's a good chance that direct competitors in your market are doing the same, and to a degree competing over these same volumes is zero-sum.

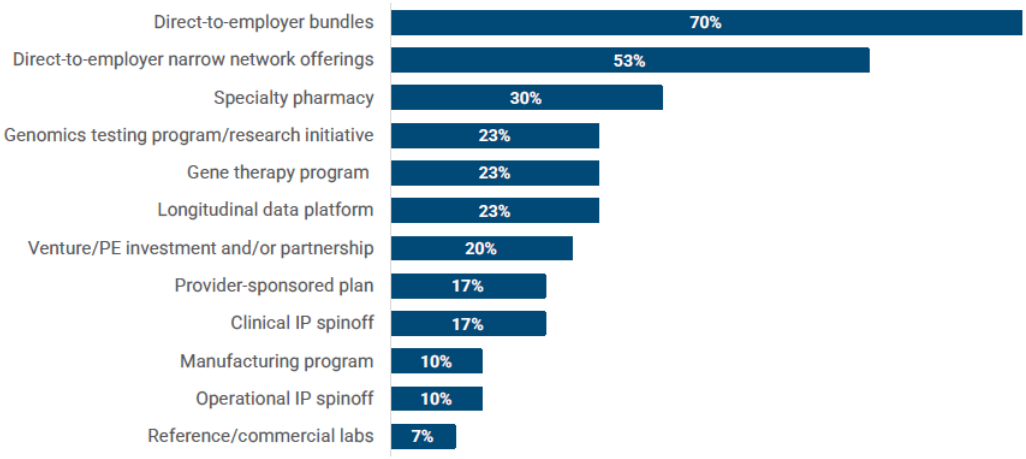
To what extent do you agree or disagree with the following statement:
Our organization is prioritizing this area for volume and/or revenue growth in 2024.
Percent of respondents (n=30)



As with our previous observation on care at home, we were once again struck by how few systems said they are prioritizing Hospital at Home services, given how trendy the topic was just a few years ago at the start of the pandemic. In many cases, systems have established programs and may have pulled back after failing to generate the volumes they were hoping for (many of the largest programs only have average daily censuses in the 15-30s).

It's also interesting that only half of systems are prioritizing specialty pharmacy for revenue growth in 2024. This is an area where many systems have already invested heavily, so to some extent this belief might reflect diminishing returns. With that said, specialty pharmacy was the third-most-popular focus area for revenue diversification:

Our organization is focused on this area for revenue diversification
Percent of respondents focused on specific areas (n=30)

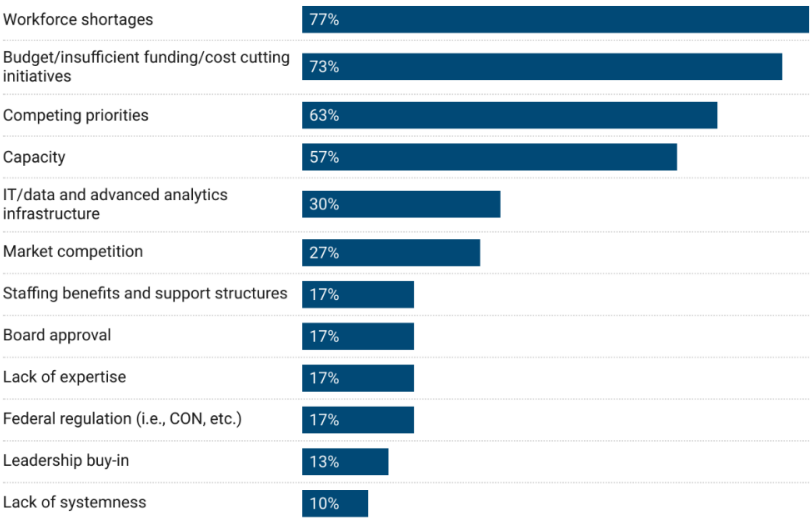


6. Inadequate staffing and funding are the most common barriers to strategic growth

Respondents identified workforce shortages and insufficient funding as the greatest obstacles to achieving their strategic growth plans. In many ways these two headwinds are related, since labor is usually the largest cost for any given service line or initiative and overall labor costs are limiting overall capital. Capacity, the fourth most common answer, is also closely related.

Staffing and budget are greatest potential obstacles

When thinking about strategic growth at your health system, what internal or external barriers do you expect might slow system progress in 2024?



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It's also notable that many respondents said competing internal priorities are a greater obstacle than outside competition. For many systems, the sheer breadth of service lines they need to juggle and the plethora of community commitments they need to maintain leaves little leadership energy left for the tall task of finding a growth path that will sustain the future. While we're sympathetic to the fact that systems need to balance these responsibilities, we note that it's important not to lose track of the bigger growth picture.

So What?

Overall, we saw quite a few similarities across health systems in how they are plotting strategic growth, starting with the portion of the budget allocated, expanding to which service lines they are prioritizing, sites of services that are of focus, and the major barriers limiting success. The biggest

divergence areas we saw were how bullish systems were about revenue diversification, specifically things like spinning off internal IP and investing through a venture arm.

We also noted substantial differences in overall "growth archetypes" of different systems. Clearly, each of these archetypes or paths are driven by the financial and operational pressures that health systems face depending on their market and situation, and each call for different approaches to investment.

	Battle for Non-inpatient Volumes	Service Line Prioritization	Pursue the Premium Dollar	Care Transformation	Seek Alternative Revenue Streams
Pressures	• Sustained shift of care outside of four walls of hospital due to payer steerage, patient preference • Proliferation of disruptors offering convenient alternatives • Pressure to reduce cost of care	• LHS needing to be all things to all people in a community can sometimes threaten economic sustainability • Some services offer low or even negative margin	• Fee-for-service (FFS) increasingly unsustainable as reimbursement increases fail to keep up with costs • Contentious relationships with commercial payers	• Continued workforce gaps causing overburdened employees • Generational shifts, lack of adequate future workforce supply	• Increased workforce and supply costs • Financial market pressures
LHS Growth Strategy	**Focus on capital-light ways to grow outpatient footprint (e.g., ASCs, retail, urgent care, and virtual/home options)**	**Focus on analytics-driven insights to uncover and allocate more resources to most profitable services for growth; optimization of other services to maintain**	**Focus on systemwide commitment to risk to capture premium dollar for patient care**	**Focus on redesigned care models with layered tech to support current staff**	**Focus on revenue streams outside of care delivery such as labs, specialty pharmacy; growth of LHS venture/investment arms**

One clear takeaway is that most health systems are engaging in a combination of multiple growth strategies, but some strategies are table stakes. For example, given the broad and longstanding problems with reimbursement and cost trends in inpatient care, as well as site-of-care shifts, almost all health systems are now investing in expanding outpatient care. Likewise, most systems are prioritizing certain service lines with a clearer focus on supporting the services that contribute to the system's bottom line.

Within the less popular strategies, we see a greater variation in whether each LHS has the underlying competencies and assets they need for success. For instance, given that it's often prohibitively difficult to launch a provider-sponsored plan from scratch, those without one have fewer options for getting risk-based lives. In a similar fashion, systems can only expand alternative revenue streams or spinoff valuable assets if they have those assets to begin with. In some cases, LHS leaders reject strategies like venture capital investing because they judge that they don't have the talent they need to staff these teams (and know that recruiting this kind of talent falls outside their core competencies).

Ultimately strategy leaders need to tailor their approach to their system's strengths and weaknesses, as well as their markets. There's no "safety in numbers" when it comes to health system strategy: just because everyone else is doing something doesn't mean the numbers will pencil in for your health system. With that said, the fact that certain strategies are almost ubiquitous suggests the same pressures that are playing out in most LHS communities.

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