Organizational Change in the Wake of Health Care Reform

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There is tremendous anxiety within provider systems about the need to develop new business models. The factors contributing to this anxiety are well known: the Accountable Care Act (PPACA) and its focus on provider innovation, the budget fights in Washington that promise to make cuts to Medicare, Medicaid, and the NIH, and the potential for significant changes in the private health insurance market as a result of both health care reform and global economic pressures. It is very clear that strategies that helped provider organizations become successful in the current market environment are not likely to have the same result in the future.

Firms often face tremendous uncertainty and enormous fiscal pressures when markets shift away from established business models. Sometimes markets undergo fundamental changes because of innovations; for example, Apple’s creation of iPods and iTunes has transformed the music industry. Sometimes geopolitics reshapes the way business is done, such as how globalization has lead to a relocation of U.S. factory jobs in emerging market economies, forcing the manufacturing sector in the U.S. to reconsider business models. In many ways, the need to respond to market change is the norm in business. What is abnormal for the health case sector is that the business cycle has been relatively stable for such an extended period of time. Given this stability, one of the skills we have lost in health care is a concept described in the business literature as organizational innovation.

Organizational innovations are transformations in how firms create and deliver goods and services. Much of America’s innovation -- from mainframes to laptops, from in-person to online banking, from land lines to cell phones -- has involved structural reorganizations that enabled the introduction of far more affordable, higher quality products and services. Since cost reduction and quality improvement are the Holy Grail of health...
care reform, scholars have increasingly promoted organizational innovation as a key component to health policy. (Porter & Teisberg; Herlinzger; Curtis & Schulman)

The health sector has seen cases of organizational innovation. One example is the “Minute Clinics” that CVS has created within its pharmacies, which offer an alternative way of organizing delivery and have expanded access to certain primary care services at affordable prices. PPACA itself suggested innovative ideas, such as care coordination for patients with chronic illness and evidence-based payment schemes for medical imaging services. These ideas would require substantive but manageable changes in the organization of health care delivery.

Nonetheless, despite these and other promising innovations, the core structure of American healthcare has not undergone significant organizational reform. Care remains administered through in-person visits in expensive facilities, professional training adheres to old paradigms, and centers for care remain entombed in legacy buildings. While much of the debate in health care focuses on the variable costs of individual units of service, these fixed costs from an outdated structural model dictate much of our current strategy. For instance, healthcare services often revolve around hospitals and hospital management teams even though most health care is delivered on an outpatient basis. Rather than creating organizational models that tailor services to new technological capabilities, the healthcare sector has reinforced traditional business models at tremendous financial cost while foregoing health benefits.

The fault does not stem from lack of individual imagination; entrepreneurial physicians and non-physicians alike have many ideas that could fuel this desperate need to reorganize healthcare delivery. To illustrate, we recently asked executive students in our health sector management courses to identify opportunities for organizational innovations that would provide high quality health services at lower costs. Drawing on their experience here and abroad, they
suggested a staggering array of high-potential, ready-to-implement proposals: Using hotel services to coordinate care for patients with chronic illness; electronic monitoring that would reduce the need for in-hospital stays; data aggregation intermediaries to manage patient data and generate clinical guidelines; on-line health information services by IT firms that can overcome sixty years of failed efforts to create integrated medical records; partnerships between device manufacturers and healthcare providers; and creative accountable care organizations in which healthcare purchasers -- especially insurers -- can use foreign and domestic providers to build networks of high quality, low cost services. These innovations are feasible for either start-up ventures or the students’ current employers, which include both health sector firms and firms operating in “non-health” industries ranging from computing to financial services to consumer packaged goods to retail to consulting.

With such an abundance of entrepreneurial ideas for reducing costs and improving quality—and offering rewards to innovators and innovative firms—why are these transformative ideas failing to revolutionize U.S. health care? This is the essential dilemma for provider organizations in the US.

One reason is that mature firms resist change. As firms develop, they build information filters that facilitate efficient business practices but typically reduce maneuverability. A firm’s existing design supports current operations and sources of revenue, and managers whose responsibilities and careers depend on sustaining current revenues resist efforts that threaten these core business processes. Yet truly innovative ideas—such as those suggested by our students—require new organizational designs, including new reporting structures, development practices that differ from existing R&D processes, new incentive systems, new marketing organizations, and new performance metrics. Established firms in all sectors have difficulty
breaking their routines and implementing unfamiliar organizational structures, and until now these types of changes have been especially difficult to implement in mature health care organizations.

Given the enormity of the changes that will be required within provider organizations, successful firms will be defined by their ability to successfully adopt these types of transformative business models. To truly change business models, transformational processes must be initiated by dynamic senior leadership and must engage personnel throughout the organization. And when a firm’s leadership fails to recognize the potential for organizational innovation, entrants with new business models arise to create new services and achieve transformative innovation. For example, the traditional US steel companies missed opportunities that newcomers such as Nucor and Chaparral Steel seized with very different organizational strategies. Entrants pose challenges that either push established firms to undertake major changes or displace them.

Yet another reason the health sector has lacked organizational innovation is the many barriers arising from a regulatory environment that both limits entry by new actors and constrains the possibilities of new business models. In health care, the rigidity of internal processes—common to established organizations in all sectors—is compounded by regulatory requirements and administrative relationships that reinforce the inertia in traditional processes. These regulations preclude the organizational diversity and competitive pressure necessary to spur sources of innovation.

Examples of regulatory barriers that deter organizational transformation include malpractice standards, which typically require all practices deemed “medically necessary” and thus preclude innovative delivery that offers alternative forms of care; certificate-of-need
regulations that bar entrants, such as specialty hospitals, with innovative business models; and “any willing provider” regulations and other state mandates that ensure steady reimbursement to high-cost providers that offer little or no quality advantage over lower-cost alternatives. Well-meaning public and philanthropic efforts also protect high-cost and failing business models, thereby insulating providers from pressures to transform.

In sum, capitalizing on the potential for organizational innovation will require both creative energies from the private sector and policy reforms to support that energy. In this sense, PPACA’s encouragement of ACOs presents an extraordinary opportunity to revisit old paradigms and experiment with new organizational forms. For example, rather than emphasize hospital-centered ACOs that rely on “bricks and mortar” vertical integration, which is arguably obsolete due to advances in information technology, providers might build ACOs around multispecialty physician practices or independent physician associations. Such arrangements could lower overhead costs and build upon modern trends in this era of ambulatory care. Regulators have an additional opportunity in PPACA’s establishing the Center for Medicare and Medicaid Innovation, which could experiment with changes in federal policies, cajole state regulatory changes, and incentivize firms to undertake experiments that both reduce costs and increase quality while divesting obsolete management structures.

Organizations and leaders do not like to change and do not change business models willingly, but organizational innovation is a survival strategy that firms often must adopt in response to changing market environments. Challenging traditional paradigms and discarding outmoded concepts is usually a painful process, and many “sacred cows” within organization leadership, structure, and institutional power will have to be abandoned in order to bring about new business models, reduce overhead and legacy costs within firms, and establish new value
propositions for patients. Further, many firms that attempt such a transformation are likely to fail given their lack of skill in navigating this type of change. However, they are most likely to fail in this environment if they refuse to prepare themselves for the market environment they are likely to face in the near future.
References cited


