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# Innovating in Health Care Delivery

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## Abstract

**What is the message?**

As more people are enrolled in high deductible plans, they will begin to act more like consumers in any other market, who are price sensitive and willing to shop around for a service that satisfies their preferences. Innovation targeted at these consumers will be differentially rewarded, and as the health care industry becomes more consumer-centered, innovators will have more opportunity to target specific market segments based on the heterogeneous preferences of individuals.

**What is the evidence?**

Surveys and external evaluations provide evidence of the movement toward a consumer-centered health care industry, and brief case studies of newly developed companies illustrate the benefits of targeting specific market segments.

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## Introduction

Gary Hamel once explained that "[m]ost of us understand that innovation is enormously important. It's the only insurance against irrelevance. It's the only guarantee of long-term customer loyalty. It's the only strategy for out-performing a dismal economy" (Denning 2012).

While it is true that innovation is necessary for survival in almost any industry, not all innovation is created equal. Truly valuable innovation—not innovation for the sake of innovation—appreciates who the customer is and what that customer values.

The recent resurgence of Best Buy in the face of competition from Amazon illustrates how valuable true innovation can be (see Kelleher 2016). Once written off as the next victim of Amazon in a world increasingly dominated by online sales of electronics, Best Buy successfully converted what many considered to be a significant liability—its large number of brick and mortar stores—into an asset. Best Buy realized that, although maintaining a network of stores was more expensive than Amazon's warehouse and logistical system, its stores provided value to the consumers of its products.

Best Buy focused on its ability to allow customers to take a variety of electronics for a "test drive" and discuss their potential purchases with a knowledgeable staff—something online retailers could not offer. To prevent people from returning home to buy a product online, Best

Buy implemented price-matching, allowing consumers to obtain their new gadget at the same price but with the added benefit of instant gratification, as they walked out of the store with it. The company essentially converted its stores into fulfillment centers, which has proven valuable to American consumers—70% of whom live within 15 minutes of a Best Buy store.

Best Buy identified an important market segment within the consumer electronics market and aggressively pursued a strategy that served the needs of consumers in that segment. Because it appreciated who the consumer was and what that consumer valued, Best Buy was able to thrive in a world dominated by online retailers.

While Best Buy understood that innovating in a way that consumers valued was critical to success, other companies have misunderstood this proposition. For example, Blackberry recently ceased producing mobile phones, despite having been one the most successful companies in this industry less than a decade ago (De Vynck 2016). While Blackberry continued to innovate as it released new phones—each successor contained new features and could do many things the previous generation could not—it failed to appreciate both the supremacy of the consumer and the changing nature of that consumer.

For instance, while some users remained nostalgic over the physical keyboard, Blackberry was left behind as other companies focused on new ways to allow consumers to type messages on touchscreen devices. Similarly, Blackberry focused heavily on the corporate market—where firms dictated which phones their employees would use—instead of focusing on the actual user of their devices. While firms obviously influence their employees' decisions, Blackberry's failure to focus specifically on the consumer's needs contributed to its eventual exit from the smartphone market. These two examples illustrate that, while innovation can be value added when it is directed at the consumer, all innovation is not created equal.

The same holds true for the healthcare industry, despite its myriad differences from other sectors of the economy. In this paper, we explain that the customer in health care is shifting from third party payers to individual consumers. The focus of innovation has, to a large extent, failed to keep pace with this change, and most innovation in health care remains directed at the wrong actors. In fact, the allocation of health care spending has remained largely unchanged over the last 40 years.

In this article, we argue that innovation targeted to the proper consumer—the individual, not the payer—will be differentially rewarded in the future.  The outcomes from such innovation will be markedly different when it is consumer-focused resulting in new treatment modalities, venues, and modes of interaction with providers.  Starting a process of innovation where you begin with consumer preferences and budget constraints results in very different solutions and business models.

Additionally, as the health care industry returns to a patient-centered approach, providers will recognize increased heterogeneity in demand, as individual consumers differ from one another to a greater extent than do third party payers. This increased heterogeneity will offer more opportunity for health care companies to find solutions that serve different market segments. We provide several examples of companies that both appreciate the changing nature of the health care consumer and have begun to target individual market segments successfully.

## The Changing Health Care Customer

In his popular book, *Catastrophic Care: Why Everything We Think We Know About Health Care is Wrong*, David Goldhill argues that what he calls "the Surrogates," i.e., insurance companies and government programs that function as insurance companies, have assumed the role of consumers in health care markets (Goldhill 2013). These Surrogates negotiate prices, preapprove medical services, determine who can serve as a patient's physician, and provide other intermediation services—all functions typically associated with consumers in other markets. Goldhill (2013) argues that, because the Surrogates are the true consumers in health care, health care companies—hospitals, clinics, and others—cater to them, not to the individuals actually receiving the care.

While the propriety and desirability of insurance companies fulfilling these roles has been debated extensively, Goldhill (2013) is, as an empirical matter, correct that insurance companies have come to dominate health care markets. The very language used to define the purchase makes this clear. Purchases are defined and prices assigned after the fact using CPT Codes, HCPCS, SNOMED, ICD-10, and DRGs communicated on UB and HCFA 1500 forms. But this is changing.

Although the number of uninsured has dropped in the wake of the Affordable Care Act (ACA), the percentage of individuals enrolled in high deductible plans has increased. In the individual market, nearly 90% of people in the ACA Marketplaces enroll in a plan that qualifies as a high deductible plan (Dolan 2016).[1] And in the employer-sponsored insurance market, there has been a shift towards high deductible plans over the last ten years. A survey conducted by the Henry J. Kaiser Family Foundation in 2016 found that deductibles in employer-sponsored plans have increased 67% since 2010 and that, while only 4% of workers were enrolled in a high deductible plan in 2006, 29% were enrolled in such a plan in 2016 (Kaiser 2016). Moreover, more than half of workers were enrolled in a plan with a general annual deductible of at least $1,000 for individual coverage.

While the reasons for the movement toward high deductible plans are many, the point we want to emphasize is that high deductible plans are proliferating and that this marks the beginning of the return of the individual health care consumer. Below the deductible, a patient shopping for an MRI, a strep test, or just about anything else,[2] will act just like any other customer shopping in the market for any other good or service. Because she is "paying with her own money," she will be price sensitive and therefore willing to shop around among different providers of the same medical service.

Thus, just as Walmart competes with Target for customers on price, selection, and quality, health care providers—no longer assured of customers as a result of their negotiations with third party payers—will have to compete for patients along dimensions that matter to patients. These dimensions are likely to differ from those that defined competition over the last 40 years. The companies that innovate to serve the needs of this emerging health care consumer are the ones that will survive and thrive, while old models of innovation—those focused on third party payers or on metrics that are largely irrelevant to individual consumers—will begin to fade away.

## Innovating for a CHANGING HEALTH Care Consumer

In an article appearing in this issue, Regina Herzlinger and Kevin Schulman (2017) conclude that successful innovation targets one (and only one) of three opportunities: "[c]onsumer-facing activity; system integration; or technical advance." We agree with this characterization but would add that any successful innovation in health care—regardless of what opportunity it targets—must appreciate the changing nature of the health care consumer in order to be successful. Innovation for innovation's sake may (rarely) be successful, but innovation directed at the true consumer will be differentially rewarded because it creates value for those who are making the decisions regarding whether to buy a product or service.

There is no dearth of “innovation” in the health care industry. Insurance companies and government programs have been extensively experimenting with innovation over the last ten years. Out of the ACA came the Center for Medicare and Medicaid Innovation (CMMI), which—as its name suggests—is focused on innovating in health care markets. CMMI has produced innovations such as the next generation Accountable Care Organization (ACO) Model, which allows provider groups to assume higher levels of financial risk and reward, and a variety of episode-based payment initiatives, which focus on changing how certain procedures are reimbursed (CMMI 2017).

The problem with these innovations is that they are targeted squarely at third party payers and not at individual consumers.  Their objective is to change the nature of competition and conduct in health care markets. Unsurprisingly, they add essentially no value for the health care consumer, i.e., the patient receiving the care. Payment reforms, at best, have little impact on how an individual consumer receives the care she needs. At worst, American society may see a “reboot” of Helen Hunt’s famous tirade against HMOs in the film “As Good As it Gets” (TriStar 1997).

In contrast to the innovations that have been aimed at payers and providers, a number of new companies have emerged that specifically target their innovative efforts at the health care consumer. These companies appreciate what Herzlinger (1996) predicted long ago—that individual health care consumers will reassert their dominance.

Perhaps the most visible examples of consumer-focused innovations are retail health clinics, such as CVS’s Minute Clinic or Kroger’s Little Clinic. In contrast to simply tinkering with how providers and payers interact with one another, these clinics address a consumer want that is met in most every market beyond health care—convenience (see, e.g., Mehrotra et al. 2008; Spetz et al. 2013). They also compete with traditionally delivered primary care and urgent care on the price dimension, often costing substantially less than a visit to an urgent care clinic or a visit after hours to a physician’s office.

While not completely divorced from the traditional health care industry—clinic patients still often submit their claims for reimbursement by third party payers—the creators of these clinics appreciate that consumers value convenience and access more than abstract quality metrics, population health, and aligned financial incentives. Consumers appreciate the ability to receive the care they need for a lower price while "getting in and getting out" quickly.

Retail health clinics represent one type of innovation in primary care, and they target what may be described as the "convenience driven, price conscious" market segment. However, retail health clinics are not alone in innovating in the provision of health care services. For example, in several cities in California, Heal offers a smart phone app that allows a consumer to summon a doctor to her home just as easily as she would order a ride through Uber. In Nashville, Dose offers similar on demand urgent and primary care services through the convenience of a consumer's phone. For a price as low as $99 (Heal) or $50 (Dose), a consumer can see a board certified physician in the comfort of her home for any medical needs she may have.

The companies responsible for these apps have taken the model pioneered by retail health clinics to the next logical step and have provided the consumer—not the provider or payer—true value in the form of even greater convenience. If a consumer faces a $1,000, $5,000, or $10,000 deductible, the ability to pay less than $100 for a visit *from* the doctor (not *to* the doctor) not only makes sense from a convenience perspective, but from a financial one as well. These apps may be described as targeting the "location-specific" market segment, as individuals using these apps may be willing to pay a little more to avoid leaving their homes and offices while still receiving the care they need from highly trained providers.

The majority of interactions between a patient and physician do not require a physical assessment. In these cases, telemedicine services, which offer near instantaneous connections with health care providers, are valuable alternatives. The CDC estimates that fully one third of all outpatient encounters could be delivered through a telemedicine platform—a potential market of over 400 million (Gorevic 2016). Many companies have begun to develop a wide range of telemedicine services, with some focusing only on cash-pay consumers and others working with large employers or insurers.

The market leader, Teladoc, will deliver approximately 1 million visits this year, suggesting that there is tremendous potential for growth (Teladoc 2017). Legal barriers to telemedicine continue to crumble in many states (see, e.g., Bryan, Rhoades, and Graboyes 2017), most recently in

Texas (Teichert 2016), and telemedicine services will only become more prevalent as consumers demand more access to the services they want when they want them. This expansion will occur because, when individuals are the health care consumers, companies will respond to their demands, not the demands of providers or payers.

Of course, retail health clinics, smart phone apps, and telemedicine do not represent the only innovations targeted at health care consumers. And as more consumers choose (or are forced into) high deductible plans or opt out of insurance markets altogether with the possible repeal of the ACA, consumer-focused innovations will only become more prevalent. For example, in ten years, the market for primary care services will likely be segmented very differently than it is today, i.e., large health insurers and their networks of providers forcing many into a one-size-fits-all solution.

Some consumers may choose traditional primary care practices, others may opt for concierge services, while others will choose care through apps like Dose and Heal, and still others may opt for direct primary care practices.  It is likely that we will see further innovation toward virtual primary care where the consumer has a relationship with an organization that provides not only medical advice and direction, but also advises the customer on where to receive care and what to pay.

In addition to illustrating the importance of appreciating who the consumer is when innovating, these three examples illustrate another important aspect of the changing nature of the health care consumer. As individuals become more dominant in the market for primary and urgent care services, companies will be able to target more specific market segments. Individual preferences are substantially more heterogeneous than are those of third party payers and providers—there are many more individuals in health care markets than there are payers and providers. Given this increase in the heterogeneity of preferences as individual consumers become more dominant, companies will be able to segment health care markets using more specific consumer characteristics and target particular segments as Heal and Dose have targeted the “location-specific” market.

We do not mean to suggest that valuable innovations are limited to primary care. While the first waves of innovation may be targeted toward that market, specialist and surgical markets will not be immune from innovation directed at consumers.

Perhaps the most famous consumer-focused innovations in the market for surgical care come from the Surgery Center of Oklahoma. Unlike most traditional hospitals, specialty hospitals, and ambulatory surgical centers, the Surgery Center of Oklahoma posts the prices for the many surgical services it offers on its website for the world to see (Ray 2017). Patients pay this price and only this price (with no separate bills from the facility, the surgeon, and the anesthesiologist) when receiving care at the Oklahoma City facility.

While posting prices hardly seems innovative in the majority of markets individuals participate in everyday, posting prices in health care is not only innovative, but revolutionary. Without a health care consumer paying for the cost of a surgery out of pocket, posting prices and keeping those prices low makes little sense in a world dominated by third party payers. But as the health care consumer sits down in the driver's seat, consumer-focused innovation like that seen at the Surgery Center of Oklahoma will only become more commonplace.

MDSave was created with a cash paying customer forefront in their design. The online experience was designed to mirror other ecommerce sites found in other markets. The website enables consumers to purchase most any service (from joint surgery to basic imaging) for a cash price in 170 markets in the United States. Providers compete with an all-in cash price and receive payment from MDSave within days of service delivery. MDSave offers two value-added services to consumers shopping for medical procedures. First, the company negotiates with individual providers to offer consumers a lower cash price. Second, beyond the lower prices, MDSave offers consumers a bundled service so that they pay one price and one price only—which is not always the case when dealing directly with providers.

The discussion to this point has centered on consumer-focused innovation with respect to how health care is packaged and delivered. But the response to consumer demands is almost never limited to the market for the primary good or service, as ancillary service providers form to address the needs of consumers operating in the primary market. For example, *Consumer Reports* serves the needs of consumers choosing a new or used car.

In health care markets, companies like Healthcare Bluebook may become the new *Consumer Reports*—not in their ability to rate providers as *Consumer Reports* does, but in their ability to simplify a confusing market of complex goods and services. Healthcare Bluebook, in particular, is an online service where consumers can find a list of medical procedures offered in their area, prices for those services, and associated quality. As more health care consumers begin to shop around for the best, most convenient, or lowest priced services, MDSave and Healthcare Bluebook are examples of companies that will find themselves well positioned due to their attention to understanding consumer preferences and solving the customer's health care needs.

## Conclusion

While many speak to the need for innovation in health care to address its unsustainable trajectory, not all innovation is created equal. Innovation that targets the re-emerging individual health care consumer will be differentially rewarded. As health care customers again become price sensitive under high deductible plans and as these customers begin to demand products and services that satisfy their preferences instead of the preferences of third party payers, companies that understand these new customers will have a distinct advantage over those that adhere to the legacy model.

Importantly, as consumers become more dominant, the greater heterogeneity among consumers, compared to payers, will require greater market segmentation. Providers will have to focus on the specific needs of market segments to a much greater extent than they have in the past.

While we have emphasized the importance of consumer-driven innovation in creating new health care products and services, the value of this innovation is not limited to the products and services that are the subject of that innovation. For example, as Uber began providing more rides to people in New York City, taxi cabs became cleaner as they had to compete more vigorously for customers. The same is true of health care, as facilities that compete with the Surgery Center of Oklahoma have discovered—they now must post their prices online to remain competitive (Ray 2017). It is nearly impossible to predict exactly what form innovation in health care markets will take in the future, but we can be sure that innovations that target the true consumer will make everyone better off.

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[1] In 2015, a high deductible plan was any individual plan with a deductible over $1,300 and any family plan with a deductible over $2,600 (Dolan 2016).

[2] Depending on the plan, certain services may be covered with no out of pocket expense for the consumer.