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# IS THE TRADITIONAL STRATEGIC APPROACH TO SERVICE LINES OBSOLETE?

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The past two decades have seen significant consolidation by many United States health systems, intended, in part, to drive scale and more financially competitive networks. Yet, despite these efforts, hospital and health system financial performance has deteriorated over the past several years, a Navigant Consulting, Inc. analysis shows.[1] According to Moody's, hospital operating margins are at a 10-year low, and they "expect expense growth will continue to outpace revenue growth over the next year, suppressing margins."[2]

Health systems often claim "market synergies" as a rationale for consolidation. But the difficult decisions around clinical service line rationalization are frequently avoided to prevent upsetting physicians and system staff, as well as the healthcare consumer who expects tertiary services to be provided "in their neighborhoods." The hesitation to fully integrate service lines means expensive overcapacity in specialty services was not addressed, and significant duplication remains. As a result, the provision of care remains fractured, impacting patient outcomes while contributing to operating margin erosion.

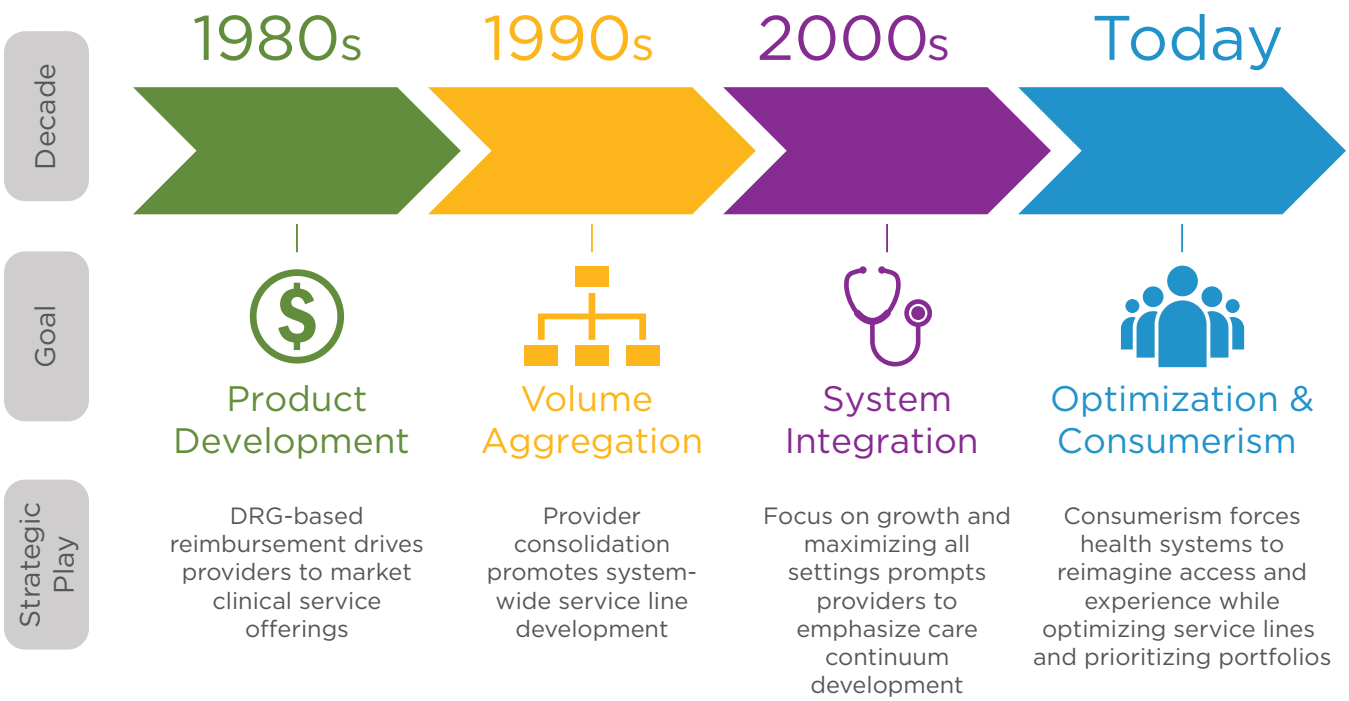
Many health systems have endured multiple rounds of operational belt tightening but still have not solved their financial challenges. Currently, expense gaps have become large enough to warrant rethinking traditional operating models as a key component of service line planning. Margin improvement is possible not only through growing those service lines where there is strategic opportunity, but by downsizing those that have been overbuilt or consolidating ones that are geographically maldistributed. It may also require rethinking existing physician employment strategies and moving traditionally inpatient-focused activity to higher-margin ambulatory care sites, found to have a 30% higher margin than similar inpatient activities at a significantly lower cost.[3]

1. Jeff Goldsmith, Rulon Stacey, and Alex Hunter, "Health System Operating Margins Down 39% Post-ACA Coverage Expansion," Navigant Insights, September 12, 2018, https://www.navigant.com/insights/healthcare/2018/health-systems-financial-analysis.
2. Berkeley Lovelace Jr., "Hospital profitability sinks to levels not seen since the financial crisis: Moody's," CNBC, April 24, 2018: https://www.cnbc.com/2018/04/24/hospital-profitability-sinks-to-levels-not-seen-since-financial-crisis.html.
3. MEDPAC, Report to Congress, March 2014, page 69: http://www.medpac.gov/docs/default-source/reports/mar14_entirereport.pdf.

## SERVICE LINE EVOLUTION: FROM MARKETING TO PHYSICIAN ALIGNMENT TO CARE MANAGEMENT

Service line planning is not a new idea (Figure 1). It initially flourished during the 1980s, through hospital marketing and public relations departments, to increase the number of commercially insured patients. Service line planning was supposed to extend the system's brand and market share of major clinical services that created positive margin, such as cardiovascular services, oncology, and musculoskeletal surgery.

**Figure 1: Evolution of Service Line Strategic Planning**




In the late 1990s and early 2000s there were still opportunities to create consistent service offerings based on clinical protocols and integration across the care continuum. The post-Affordable Care Act movement to develop bundled payments for large service lines with significant cost variation, such as orthopedics and cardiovascular, has also shown to be generally ineffective. There have been occasional short-term cost and quality improvements for participants with supply chain or post-acute care cost problems, along with arbitrage opportunities for participating physicians. However, sustainable improvements have yet to be realized at the health system level due to incongruence in, or lack of, financial incentives for health systems still reimbursed on a MS-DRG basis.

Many health systems today are no longer financially benefiting from their marketing expenditures on service lines, and the majority of physician practice acquisitions that were central components in key service line strategies have mostly served to accelerate financial losses. Given the margin squeeze they're facing, providers must confront duplicative service offerings in given geographies and find alternatives to employing all service line physicians. Doing so requires initiating uncomfortable conversations with their clinicians and communities about relocating services to settings where capacity matches demand, and value can be better delivered.

At the same time, despite growing demand, service lines like obstetrics, pediatrics, and mental health produce operating losses due to an adverse payer mix and a failure to manage the delivered cost of care. Health systems will need the strategic discipline to rationalize service lines that have traditionally been loss leaders and identify strategies and tactics for generating margin improvements by narrowing those losses.

## HOW TO STRATEGICALLY ASSESS SERVICE LINES

Overall, the industry has lacked a consistent strategic method and the objective discipline required to assess service line growth potential, as well as identify meaningful opportunities for consolidation and/or rationalization. However, growth and contraction are not just scaling exercises. Providers also need to understand if their operational (delivery model and infrastructure), clinical (quality and outcomes), and financial (expenses and operating margin) models are appropriate and optimized for each of their service lines.

In other words, all service lines can be positioned somewhere on a development continuum (Figure 2). Top national destination or brand-name institutes with a comprehensive and integrated service offering, coupled with consistent top decile quality and outcomes scores, represent the most developed service lines and identify them as top institutes. Single sites with level-one basic care provided represent the least mature.

### Figure 2: Service Line Maturity Continuum


From a national level, this development continuum is not normally distributed, statistically speaking. There are few opportunities at the ends of the continuum, so the key is rationalizing a service line to the appropriate development. There has been a propensity for many organizations to overdevelop their large competitive service lines, such as cardiovascular lines where routine high-volume and high-margin surgical and interventional procedures have been significantly declining for most of the past decade in favor of medical management.

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A service line development continuum needs to incorporate the assessment of the following dimensions: infrastructure, scale, clinical performance, and service delivery model, at each of the key points of development into a single assessment matrix. Once the matrix assessment is completed, there are five key steps to the rationalization process:

1. Conduct a baseline assessment of current service line development (including sites, infrastructure, delivery model capabilities, and clinical performance) using the matrix
2. Assess your market for any saturation, as well as unexploited growth opportunities
3. Assess the market physician dynamics and strategies, including any employment investment required for the service line specialties and subspecialties
4. Assess upgrades required in consumer-focused infrastructure/programs, technology, and innovation
5. Utilizing the same development matrix, conduct a gap assessment from your current to future opportunity level (i.e., level of development) that is consistent with the enterprise strategy and estimate operational, clinical, and financial impacts

## CONCLUSION

Hospital and health system assets, clinical portfolios, and geographic footprints by service line require disciplined rationalization. This is even more critical when large health systems merge across major metropolitan markets, such as the Advocate-Aurora Health Care and Baylor Scott & White Health-Memorial Hermann Health System mergers. Successful service line strategic planning requires all future planning scenarios to be internally consistent with the overall enterprise strategy, and to employ a robust methodology designed to align service line leaders, physicians, and senior executives — all in a financially responsible manner.