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# *Becoming an activist innovator in healthcare*

## A new way for midsized payors and providers to access innovation

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# *Executive summary*

**In the current healthcare environment,** innovation is critical. Yet many organizations, particularly midsized payors and providers, do not have strong innovation capabilities. They lack the financial resources of larger players and the agility of smaller competitors. The good news is that innovation is becoming more accessible, through external players that are shifting their attention and resources to healthcare. External capital to fund innovation is flowing into the industry from venture firms and other sources, along with talent from the consumer and technology sectors. In addition, many regional markets now feature innovation communities, including venture capital players, startups, academic institutions, and other entities.

These outsiders bring fresh ideas and strong innovation capabilities, but they need the resources and access that payors and providers already have: relationships with customers, local market expertise, and real-world data about the effectiveness of new products and services. To access innovation through these new channels, midsized healthcare players need to become far more strategic in their approach. Specifically, they need to become "activist innovators": organizations that bring resources to the innovation process and form alliances with strong innovators.

Success requires setting an innovation agenda — with a clear understanding of organizational gaps and strengths — along with clear objectives. Moreover, becoming an activist innovator requires leadership. Already, several organizations are applying this model to bring promising new ideas to market. In sum, the activist innovator model allows midsized payors and providers to capitalize on their strengths and tap into innovation without going it alone.

# *A premium on innovation*

As the healthcare environment grows more complex and dynamic, innovation is becoming paramount. A confluence of factors — including retail healthcare, a shift in risk from payors to providers, new entrants, and patients increasingly acting like consumers in how they manage their own care — is forcing incumbent players to adapt. They are developing innovative business models, products, and revenue streams. In fact, 93 percent of healthcare executives are looking to innovation to drive growth. The outcome of the recent U.S. presidential election introduced additional uncertainty, but it didn't change the imperative to innovate. Jonathan Bush, CEO of Athenahealth, said, "For our part, we at Athenahealth are going to take our post-federal energies and focus on cultivating innovation every single day."

In the past, only the largest healthcare players — particularly biopharmaceutical companies — had the means to invest in innovation. Payors and providers were less able to make such investments, due to financial constraints and stiff regulation. As a result, they did not develop (PDF) the right organizational infrastructure, culture, or capabilities to innovate. This was especially true for midsized payors and providers, which do not have access to significant pools of capital. A recent Strategy& analysis found that approximately 70 percent of capital expenditures for midsized Blue Cross Blue Shield (BCBS) plans was spent to meet mandates and lights-on maintenance activities. Payors and providors that do invest in innovation have been limited to incremental measures, such as pooling their resources (for example, BlueCross BlueShield Venture Partners pools resources from 29 individual plans) or participating in shared utilities (such as Prime Therapeutics, a pharmacy benefits manager for BCBS plans). Given the tremendous change in healthcare, there is a clear need to take these efforts to the next level.

*Capital is no longer a limiting factor.*

The good news is that innovation is becoming more accessible. There is far more external capital from venture firms and other sources now funding healthcare innovation, along with an influx of talent from the consumer and technology sectors. In this new environment, capital for innovation is no longer a limiting factor — instead, startups and other innovation entities require nonfinancial elements such as access to customers, sales channels, and real-world data, which regional payors and providers can supply. Because of this shift, it's far easier for smaller health plans and providers to capitalize on innovation.

However, the change will not come easily. Serial innovators such as life sciences companies have already built up the "muscles" and the risk tolerance to make large, long-range bets in search of blockbuster innovations. Health systems and payors, on the other hand, have traditionally thrived by minimizing risk and making incremental improvements. This attitude is embedded in many organizations' cultures and capital planning processes, yet it may be holding them back. In the words of the late Oren Harari, author and business professor at the University of San Francisco, "The electric light did not come from the continuous improvement of candles."

An innovation capability has become "table stakes" for most organizations. To capitalize, midsized players need to be far more active and strategic in how they approach innovation. More specifically, they must become activist innovators — organizations that can bring a range of resources, including customers, clinical talent, sales channels, and local market expertise, to the innovation process to develop differentiating products and services.

# *Setting the innovation agenda*

The path to becoming an activist innovator begins by defining a strategy for innovation — one that is coherent with the organization's existing strengths and capabilities. Management teams need to understand the problems that innovation will solve, and how solving those problems will support the company's overall enterprise goals. They also need to determine the right operating model to achieve those goals, set up a suitable management structure, decide how ambitious they will be in pursuing innovation (breakthrough ideas versus incremental improvements), and determine how to embed the innovation capability within the company.

For example, Aetna set a strategic goal of pursuing value-based care through a narrow focus on population health management. It sought breakthrough innovations that would foster better collaboration among providers, reward them for achieving better outcomes for their patients, and empower consumers to play a more direct role in their own care. To achieve these goals, Aetna set up and funded Healthagen, an incubator aimed at developing disruptive healthcare solutions, with a dedicated leadership team incorporating cross-functional expertise.

By contrast, Boehringer Ingelheim set a strategic goal of developing a range of innovations — including medicines, programs, and services — to better meet customer needs. The company emphasized incremental innovations and new business models, through decentralized initiatives within individual business units (along with an internal business innovation team). Management of the innovation agenda is shared by business unit leaders and an internal business innovation team.

With the right innovation strategy in place, a company can begin developing an agenda to implement it, which includes several aspects. First, the agenda should establish the leadership roles regarding who will own and manage the company's innovation efforts. People in these roles will prioritize and fund innovation initiatives, assign accountability for project execution, and oversee the entire agenda.

## *Key questions for management teams*

As they develop their innovation agenda, leaders at healthcare organizations will need to answer a set of questions:

- Why do we innovate? To change our business model? To improve product offerings? To achieve financial diversification? To develop new technology? Some other reason?
- How well is our business strategy reflected in our innovation strategy?
- What are the best areas to focus our innovation efforts? How much innovation do we need?
- What types of innovation do we need — adjacent, breakthrough, or radical?
- Are the boundaries for innovation clear, and are they appropriate?

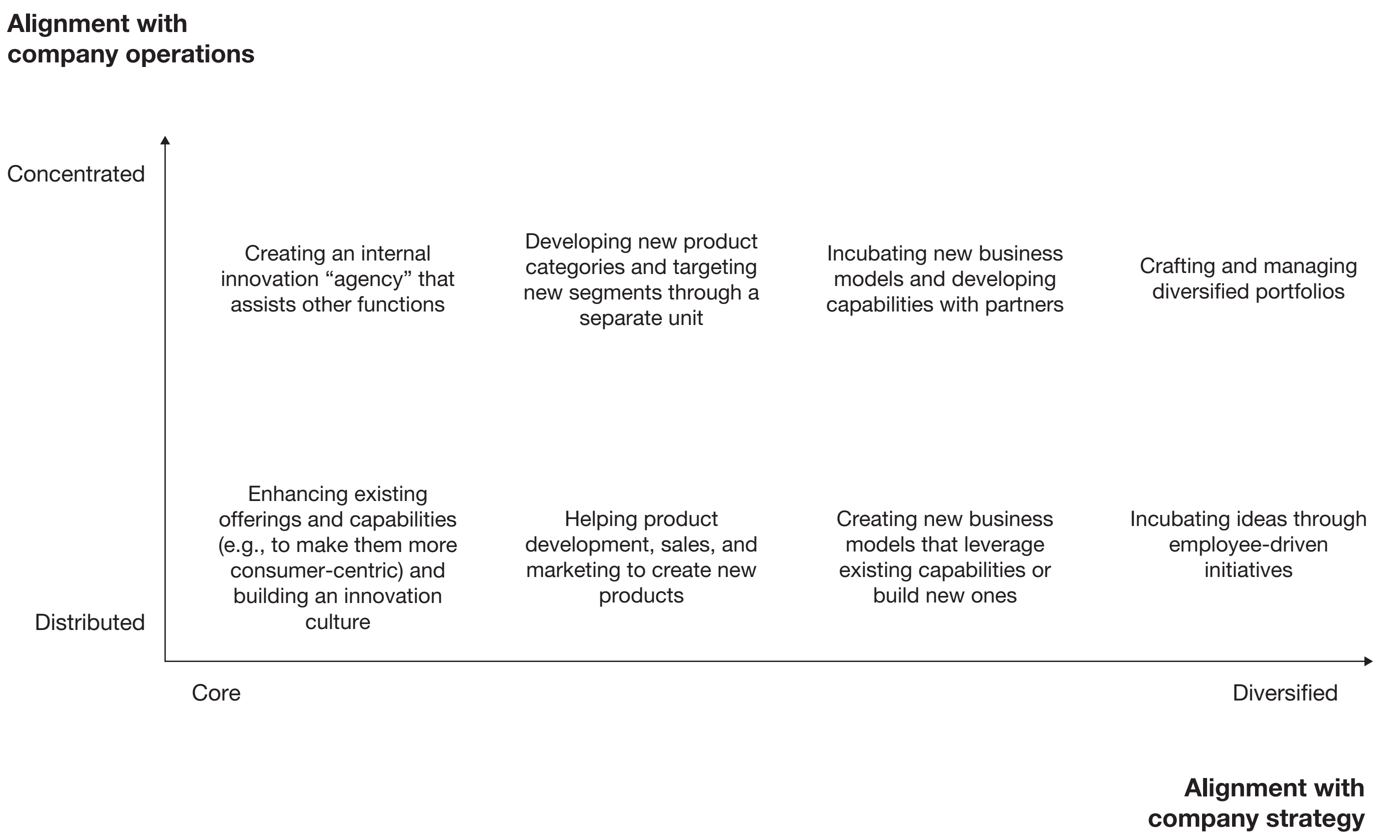
With the innovation agenda in place, companies next need to determine the right operating model to support their agenda. Key questions and considerations that management teams must address in designing the innovation capability:

- What operating model options match our goals and risk management requirements? How should they change over time?
- What key capability gaps do we need to address?
- How should the innovation footprint be set up (e.g., centralized, decentralized, networked)?
- How should we define and measure success?

In addition, companies need to define their objectives. Some may aim for adjacent innovation that focuses on adding value to existing products and services; others will emphasize breakthrough innovation, with the goal of developing new businesses, revenue models, economic models, and collaborations. Similarly, they need to prioritize the scope of innovation in both the short and long terms, within the overall healthcare value chain (from R&D through commercialization until products become mature), and among customer groups (patients, payors, providers, and health systems, among others). Last, companies need to fit innovation initiatives in with their core business units and functions.

There is no perfect model that works for all organizations in all circumstances. The choice depends on how closely the company wants to keep the innovation efforts aligned — strategically and operationally (*see Exhibit, next page*).

*Exhibit*
**Illustrative choices in designing an innovation capability**




Source: Strategy& analysis

# *Closing innovation gaps*

With an explicit, clearly defined innovation agenda in hand, organizations should next identify and fill possible gaps in capabilities and assets that may prevent them from hitting their innovation objectives. Organizations that lack experience with innovation will face a steep learning curve, given the complexity, cost, and high risk of failure. Because of these factors, organizations have traditionally chosen innovation models that leverage their existing capabilities.

- *In-house venture model:* An internal team performs due diligence and invests in startup companies — similar to the way venture capital (VC) firms operate — in exchange for equity, access to the products and services being developed, and potential influence over the development process.

- *Acquisitive model:* A dedicated M&A function analyzes the market, identifies opportunities, and acquires companies (often startups) with the goal of developing specific capabilities.

- *Alliance model:* The company forms partnerships and alliances in line with its internal strategy and/or business development teams.

Although these models are tried and tested, they offer limited upside that may fall short of the financial, competitive, or operational returns a company requires. For example, a venture model can provide access to unique capabilities and — potentially — financial returns, but it does not give the company exclusive access to successful products and services developed through that model. Furthermore, these approaches do not help incumbents fully leverage their internal capabilities or tap into the accelerators, incubators, and entrepreneurial efforts emerging in their local markets.

By contrast, the activist innovator model involves tailoring innovation efforts not only around the company's own organizational capabilities but also around the innovation efforts under way in its local market. Increasingly, many markets feature innovation communities — groups of stakeholders such as venture capitalists, startups, community organizations, academic institutions, and enterprise customers such as health plans and providers — all aligned around a specific geographic region or market domain.

Activist innovators can capitalize on these innovation communities by providing capital and expertise, helping to match products to markets, validating hypotheses, and offering sales channels to help scale up promising products and services. In this way, midsized regional players can form symbiotic relationships with other local organizations, giving them access to innovation that was once limited to national players with scale and capital. Activist innovators can determine how best to deploy innovation resources and effort in a way that will maximize their ability to develop new and differentiating capabilities, while minimizing the investment of time, resources, and effort.

Several organizations are already applying this model.

### ***Cambia Health Solutions and Cambia Grove***

Cambia Health Solutions launched Cambia Grove in 2015 in collaboration with several other anchor partners to foster entrepreneurial activity in healthcare in the Pacific Northwest. The anchor partners represent the continuum of care delivery, and each aims to develop pilot businesses through the Grove, based on ideas that entrepreneurs would pitch to them. A secondary goal of the Grove was to serve as a mechanism for drawing external capital to Washington state's healthcare industry from outside investors in places like Silicon Valley. The Grove holds "reverse pitch days," in which industry executives and other stakeholders share their pressing problems and engage entrepreneurial talent and capital to work toward solving them.

*Midsized regional players can form symbiotic relationships with other local organizations.*

### ***Boston Children's Hospital and Rock Health***

In November 2015, Boston Children's Hospital and Rock Health (a digital health seed fund) formed a strategic partnership to accelerate the development and commercialization of health technologies for pediatrics. Both organizations were already prolific investors and developers of new ventures. Rock Health has funded hundreds of digital health startups since its inception in 2011, and Boston Children's has launched numerous startup companies including Epidemico (an analytics firm that helps healthcare companies and public agencies visualize large data sets to generate insights), ACT.md (a care coordination platform to help patients manage complex medical conditions), and Oneder (a startup focusing on education for special-needs students). The collaboration is organized to capitalize on the respective strengths of both firms. Boston Children's brings clinical, educational, and scientific expertise (including big data/data science, digital devices, social media analysis, genomics, 3D printing, and epidemiology, among others), as well as access to pilot programs both within and outside the hospital. Rock Health brings capital and strategic guidance to commercialize and scale up the most promising ideas.

### *University of North Carolina Health Care and Rex Health Ventures*

Rex Health Ventures (RHV) is a VC-type initiative started by a community nonprofit hospital (UNC Rex Healthcare, a member of the University of North Carolina Medical Center). In 2012, Rex Healthcare launched the fund with an initial US$10 million investment. RHV's goal is to finance the most promising innovations in the fields of healthcare services, IT, medical services, and biopharma technologies and bring them into the healthcare marketplace. Rex also allows startup partners to tap into its network and expertise to support innovation activities (for example, navigating clinical trials). In return, Rex aims to bring these new innovations back to its health systems.

In all three examples, the founding organizations provide some capital, along with market and clinical expertise, in exchange for access to promising new innovations. Notably, regional players that have nearby access to established universities, research networks, and other innovation ecosystems may have an advantage. Yet virtually all midsized payors and providers can capitalize on their deep ties to local markets.

A potential barrier to entry for some health organizations is internal — cultures and processes that reward risk avoidance. However, risk mitigation can also be a strength in the innovation game. For example, health organizations are uniquely positioned to develop care bundles for chronic conditions, to better meet employers' demands for lower healthcare costs for their employees. These bundles are essentially risk mitigation vehicles, producing a consistent and predictable outcome at a transparent, predictable price.

# *Getting started*

The U.S. healthcare market has never evolved as quickly as it is doing today, and innovation is now a baseline capability required to stay competitive, placing additional pressure on midsized and regional health plans and providers. In the current market, incumbent payors and providers need to develop innovative business models and products, and enter and exit markets faster than ever before. Yet midsized players need not take these steps on their own. With a record amount of capital and talent flowing into healthcare, innovation is more accessible than ever before.

By becoming activist innovators and leveraging internal capabilities and assets, regional payors and providers can tap into these external innovation networks, increasing the number of bets they can place while minimizing risk and maximizing their innovation investment. To do so, however, these organizations need to make key decisions regarding their innovation capability and objectives, and how those align to the larger enterprise strategy. Once they have the right strategic rationale in place, they must develop the appropriate internal infrastructure to be activist innovators. Those that get these measures right will give themselves a clear edge as they compete against larger national players. Those that don't risk being left behind.

At the conclusion of the recent 180° Health Forum, an annual event organized by PwC, Don Tapscott, coauthor of *Blockchain Revolution*, had a powerful message for the attendees. The traditional model of healthcare in the U.S. — in which doctors wait in their office or hospital for sick people to come to them in order to be told what to do — "is really a crisis of leadership," he said. Developing a robust and bold innovation agenda is a great way for a company to identify and empower the leaders within the organization and in surrounding communities. In today's healthcare environment, these leaders are critical in helping the organization capitalize on innovation to transform, grow, and thrive.

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