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Managing Disruption in the Healthcare Industry

(Source: edited excerpts from an article written by Brendan Buescher, a director in McKinsey's Cleveland office, and Patrick Viguerie, a director in McKinsey's Atlanta office, and published by McKinsey & Co.)

The healthcare industry is undergoing sweeping change. To emerge as winners, incumbents should learn from other industries that have faced similar upheaval, suggest the authors. Disruptive change is now a fact of life for many industries. Healthcare is no exception. Although healthcare has been changing for decades—think about the introduction of diagnosis-related groups (DRGs) or the initial push toward managed care in the 1980s—the Affordable Care Act (ACA) promises to accelerate both the rate of change and the level of uncertainty confronting the industry. Payors face navigating a difficult transition: from an industry in which the customer is often a corporation or small company and the business is paying claims to one in which consumers make healthcare purchasing decisions, the direct provision of care may be necessary for success, and consumer and retail capabilities really matter. Furthermore, payors must make this transition amid regulatory and consumer uncertainty and in a fairly short time frame. This industry and business-model shift, according to the authors, is on a scale that few companies and few sectors in the economy have been through.

There are three strategic paths that companies in other industries have used successfully to thrive during and after disruptive change, states the report. Regardless of which path they took, these companies built the organizational capacity and agility required to lead during the disruption. They made big shifts in leadership focus and major changes to resource allocation, and they developed a faster organizational clock speed and leaner cost structure.

Industries change for different reasons. Sometimes, the cause is a crisis. The subprime mortgage meltdown, for example, rocked the financial-services industry. Institutions that had existed in some form for a century or more, such as Lehman Brothers, disappeared rapidly. More commonly, competitive dynamics (anchored in a variety of drivers, including product quality, performance, and cost) produce big changes in the competitive landscape over time—think about how Japanese competitors gained share in the US automobile industry over several decades. In some cases, a distinct catalyst triggers a discontinuous change. The iPod, for example, transformed the music industry, just as the iPhone and its applications changed the game in mobile handsets, demonstrating the power of creative destruction. Healthcare is facing such a discontinuous change.

Industry leadership volatility has risen steeply. When an industry faces disruption, companies often fail to appreciate quickly enough the nature, extent, and velocity of the changes taking place. A number of reasons explain this failure. Often, disruptions start at an industry's periphery, among companies that provide specialized value propositions to different customer segments. In these cases, market penetration begins slowly, with barely perceptible impact. However, change can occur much more quickly when the "rules of the game" are altered. McKinsey research has

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Doug Long Named IFPW's 2016 Leadership Award Recipient

IFPW is pleased to announce that Doug Long of IMS Health was the recipient of this year's IFPW International Leadership Award. Presented by Ornella Barra at the bi-ennial General Membership Meeting in London earlier this month, this award is given to an industry leader who has demonstrated a commitment to international collaboration and information sharing to assist IFPW on its mission to help members and stakeholders advance the safe, efficient and continuous access to pharmaceuticals worldwide through the promotion of good distribution practices and services.

Doug has been a strong supporter of IFPW and its membership. He is a perennial favorite at IFPW's meetings and his presentations are always the highlight of the business program at both the General Membership Meeting and IFPW's annual CEO Roundtable. This year marked Doug's 14th General Membership Meeting. "We're proud not only of Doug's latest recognition by IFPW, but also of his decades of contribution to IMS Health and to the industry we proudly serve. We, at IMS, are very lucky to have such a talented, dedicated and unselfish individual representing our company." said Kevin Knightly, IMS Health's Sr. Vice President of Supply Management. "Doug has dedicated his working life to servicing the healthcare industry. When it comes to understanding and communicating the numbers and trends shaping healthcare, Doug is a seasoned veteran and a thought leader. He remains a sought-after resource for his perspective on this complex and dynamic marketplace—providing both insights and foresights as to what has happened, is happening and will happen. "

IFPW is grateful for Doug's longstanding support and willingness to be a key contributor to its membership with his IMS colleagues, and looks forward to many years of collaboration.

In Brief . . .

- **Johnson & Johnson** is buying **Abbott's** eye health unit in a cash deal valued at US$4.36 billion.
- *Emma Walmsley* has been named as successor to GSK CEO, Andrew Witty, when he retires on March 31, 2017. She will join the GSK board of directors on Jan. 1, 2017. Walmsley currently heads GSK's consumer health unit and was a speaker at IFPW's 2016 GMM in London.
- **Allergan** is acquiring 2 biopharmaceutical companies, **Tobira Therapeutics** and **Akarna Therapeutics**, both of which develop treatments for nonalcoholic steatohepatitis (NASH), a severe type of fatty liver disease. The announcement came within a week of Allergan's announcement that it would buy dermatology specialist **Vitae Pharmaceuticals Inc.**

(Sources: Chain Drug Review, Drug Store News and Pharma Times)

Disruption(cont.) . . .

identified eight characteristics that are commonly found during industry disruptions, particularly those triggered by significant regulatory shifts. Healthcare executives can expect to see most or all of these in the next few years: Competitors churn (Although a few incumbents are able to gain stronger positions, many shrink, are acquired, or disappear); Battles occur on Two Fronts (During industry disruptions, companies often face regulatory as well as competitive challenges); Structural advantage prevails (Understanding and exploiting the future points of advantage can enable companies to thrive despite disruption); Performance differences widen (As the level of competition increases and the basis of competition shifts to true sources of advantage, the difference in the financial performance of top and bottom players increases—and the gap often persists for years); Productivity and innovation increase (Strong financial performance depends not only on competitive advantage but also on operational efficiency); New value propositions reveal new customer segments (Few people knew they wanted smartphones until smartphones were invented. In healthcare, new customer segments will emerge as innovative products are introduced into the market and consumers become more aware of the diversity of their choices); Profit pools often shift (During disruptions, the most attractive industry segments often become the least attractive, and vice versa, as new entrants flock to the more attractive segments and compete away profits); The volume of mergers and acquisitions rises (Deal activity tends to increase during industry disruptions, but it often comes in waves as competitors attempt to keep up with one another.)

The net result of disruption is usually a massive reshaping of the affected industry and its key segments—where the profit pools lie, who gets them, and through which business models. Entire parts of the value chain may be unseated or change in importance.

Disruptive change in the healthcare industry: Even before the Affordable Care Act (ACA, also known as Obama Care) was enacted, healthcare had the hallmarks of an industry vulnerable to disruption. For decades, rising healthcare expenditures have triggered industry changes (for example, managed care and ongoing cost shifting to employees). Nevertheless, cost and productivity pressures have continued to mount and have created enormous impetus for innovations that drive better outcomes at lower costs. Many such innovations are now possible. For example, technological developments (universal mobile "end points" or handsets, cloud computing, big data, and so on) make it feasible to manage chronic diseases more efficiently. On their own, the cost and productivity pressures would probably have been sufficient to produce major structural shifts within the healthcare industry. However, the added pressure from ACA implementation provides the catalyst for even more changes to occur, and to occur more quickly.

Consumers may well benefit from the innovations that healthcare disruption is apt to unleash—consumers typically do when disruptive changes arise. Incumbents, on the other hand, often falter during disruptions, for many reasons. Many incumbents focus on the status quo; have incentives that encourage profit-and-loss leaders to concentrate on near-term performance across existing businesses; and are hobbled by significant organizational complexity that makes major adaptations difficult. The coming disruption is likely to significantly reshape the healthcare industry. Payors have occupied a large and critical—but relatively focused—role in the industry's value chain. As the full effects of the ACA take hold, disruptive forces will begin to attack payor business models. Winning payors will get in front of these forces by aggressively moving to refocus their portfolios around the most attractive segments, successfully transforming their business models, and/or building significant new businesses.

This article is from Beyond reform: How payors can thrive in the new world. To read other articles from this compendium and more from McKinsey on healthcare, visit the McKinsey on Healthcare website.

2016 Sales will exceed US$400 billion for the Big 3 U.S. Pharmaceutical Wholesalers

(Source: Drug Channels Institute)

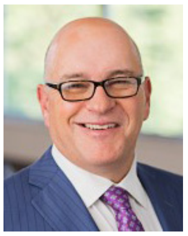
Drug Channels Institute's new *2016–17 Economic Report on Pharmaceutical Wholesalers and Specialty Distributors* (http://drugchannelsinstitute.com/products/industry_report/wholesale/) reveals how list price increases of brand name drugs are boosting the industry's revenues, even as changes in the U.S. healthcare system threaten wholesalers' profits.

"We project that U.S. drug distribution revenues at the Big Three public wholesalers—AmerisourceBergen, Cardinal Health, and McKesson—will exceed US$400 billion in 2016," said Drug Channels Institute CEO Adam J. Fein, Ph.D., the study's author. "But any change in drug price inflation rates or in manufacturers' rebate strategy will be very negative for wholesalers' future revenues and profits."

"Consolidation among pharmacies and hospitals is making it difficult for wholesalers to capture value and profits from the booming specialty drug market," Fein adds. "And contrary to many people's expectations, specialty biosimilar drugs seem poised to deliver only minimal incremental profits for wholesalers." These findings are among the many insights and trends in the report, now in its seventh edition.

The report analyzes many crucial healthcare trends that will affect wholesalers and distributors, including: the growth of specialty pharmacies, changes in the generic drug market, new government regulations, hospitals' acquisition of physician practices, the growth of narrow pharmacy networks, and more.

IFPW Names New Board Members



IFPW is pleased to announce the election of its new chairman, Steve Collis, and vice chairman, Ken Suzuki, as well as the appointment of its regional directors.

Steven H. Collis is Chairman, President and CEO of AmerisourceBergen Corporation, currently ranked No. 16 on the Fortune 500. Ken Suzuki is Chairman of VITAL-NET, Co., Ltd., a leading wholesale distributor in Japan, as well as Chairman of JPWA.

The following regional board directors were also elected: EMEA - Ornella Barra and Eero Hautaniemi; Latin America - Maria Luisa Macchiavello and Elias Salomon; U.S./Canada - Steve Collis and Paul Julian; and, Asia - Ken Suzuki and Yulin Wei. They join at-large directors Juan Mulder, Keisuke Nakakita, Chuncheng Wang, and Eric Zwisler. IFPW looks forward to working with its board members for the 2016-2018 term.