

BAIN & COMPANY

Redefining

Cost-Effectiveness

Standards

Health Care Viewpoint

Number 5



Bain health care expertise

As the year 2000 approaches, the health care industry is still turbulent. Customer requirements and competitive dynamics continue to evolve. The industry is seeing more deals, more alliances, more investment, and more experiments than ever before. It's not always clear whether a new approach is a fad or a real basis for leadership in the marketplace. Health care organizations are rethinking every element of their strategies, structures, and business practices to find the path to sustainable results.

Bain & Company helps health care companies navigate a course to outstanding results. We work closely with motivated management teams to create a clear map, a goal and direction for achieving not incremental improvements, but full potential returns.

Bain's global health care practice combines expertise, an industry network and years of experience accumulated across all parts of the health care industry. Bain helps health care companies, including product suppliers, distributors, providers, and payers worldwide, select a strategic course and create a practical migration path to the goal.

Increased **FOCUS** on cost effectiveness

The historic price insensitivity of the clinician decision-maker has allowed pharmaceutical and high technology product manufacturers to increase prices substantially above inflation and add costs, while simultaneously growing earnings.

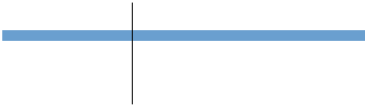
As decision-making shifts to outcomes and full system cost, becoming the low-cost supplier will become more critical. Eliminating the easy excesses will not be sufficient. Companies will be required to restructure all business processes and costs around a redefined value proposition.



Redefining Cost-Effectiveness Standards

Cost Restructuring Has Just Begun

Over the last decade alone, health care companies created over \$10 billion in restructuring reserves, affecting more than 60,000 employees. While certainly significant by any standard, this first round of restructuring was primarily focused on cleaning out the clear cost excesses in the system, not fundamentally redefining the cost structure. Given that cumulative price realization over the next decade will likely be substantially less than the historical average, maintaining margins will require significantly greater cost structure adjustments than the 5-10% accomplished to date.



Cost Structure and Process Realignment

In addition to eliminating the excesses, realigning the total value chain around an updated strategy and redesigning core processes will be critical to achieving the required improvements. Quantum improvements in cost and value will require:

- 1) a clear strategic focus on how to increase value to targeted customers,
- 2) a total system perspective with an emphasis on core processes, not functions,
- 3) a balance of near-term wins and bold strokes,
- 4) strong senior management leadership and communication, and
- 5) internal systems to reinforce the gains, such as realigned organizational structure, revised measurements, new incentives, and individual training and development.

Realign the Cost Structure with the Strategy

Significant leverage exists from realigning the total cost structure around future strategic requirements for success. Most companies will find opportunity by:

- 1) focusing business and R&D portfolios,
- 2) aligning sales and service around the managed care customer,
- 3) rationalizing plant capacity,
- 4) reevaluating traditional business and functional structures, and
- 5) conducting rigorous make/buy evaluations.

The key is not to make these changes in isolation, but rather with a clear view of the strategic direction and imperatives.

The New Business Systems Require Process Redesign

Strategic cost realignment should eliminate large blocks of cost and provide clarity about critical future capabilities. Core process redesign is also required to create effective, efficient day-to-day operations and to serve as the basis for continuous improvement. Significant process improvements result from looking for opportunities to:

- 1) integrate and unify tasks,
- 2) push decisions closer to the customer,
- 3) improve first-time yield,
- 4) link processes with customers and suppliers,
- 5) synchronize activities, and
- 6) de-average processes to reflect differences in customer segment needs.

Redefining the Business Requires Focus and Investment, but Payoff Potential is High

Large improvements in cost-effectiveness have a price: senior management leadership and time, investment in process redesign, and the human cost of change. The payoff comes not only from the direct cost savings, but also, more importantly, from the creation of cost and capability structures that will provide the basis for winning in the new environment.



Bain is one of the world's leading global business consulting firms. Its 2,400 professionals serve major multinationals and other organizations through an integrated network of 26 offices in 18 countries. Its fact-based, "outside-in" approach is unique, and its immense experience base, developed over 26 years, covers a complete range of critical business in every economic sector. Bain's entire approach is based on two guiding principles: 1) working in true collaboration with clients to craft and implement practical, customized strategies that yield significant, measurable, and sustainable results, and 2) developing processes that strengthen a client's organization and create lasting competitive advantage. The firm gauges its success solely by its clients' achievements.

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