By J. Daniel Beckham

Sustaining Competitive Advantage for Academic Medical Centers

Ensuring that strategies are sustainable requires a deliberate and incremental approach.

Leaders at Wellington University Medical Center feel under assault from all sides. Wellington has a century-old legacy of pioneering research and a reputation as one of the nation's top hospitals. Still, its financial performance has eroded significantly over the past five years. Its tertiary and quaternary market share has begun to shift to competitors. Anxiety about the future has already caused some key faculty members to accept positions elsewhere, and at all levels of the organization employees are considering their options. The deterioration in Wellington's financial status and market position recently precipitated a downgrade in its bond rating. Bondholders have become nervous. Investments in new facilities and recruitment have been put on hold. Full integration of Wellington's information systems remains unfinished. Leaders of the community hospitals, whose employed physicians represent major referral sources, have stopped attending Wellington's network affiliation meetings, and health insurers have become noticeably inflexible in their negotiations with the academic medical center.

There is, of course, no Wellington University Medical Center. Unfortunately, the confluence of a number of forces reshaping the health care landscape could turn fiction into reality for many of America's academic medical centers. Already they face significant reductions in reimbursement from public and private sources as well as cuts to research and education. These reductions coincide with rising expenses related to increased consumer expectations, advancing technology and the need for qualified staffing.

Differentiation Is the Key to Competitive Advantage

Today, rather than representing a besieged sector of health care, academic medical centers as a group continue to outpace community hospitals. They generally have higher margins and better bond ratings. They also continue to dominate the upper strata of *U.S. News & World Report*'s list of best hospitals and tend to command the highest consumer preference levels.

Differentiation is the essence of competitive strategy. It is only through meaningful differences that organizations create value. There are "core differentiators" inherent to every academic medical center that help account for their enviable performance. Taken together, these core differentiators generate and fortify a unique and powerful value proposition. Academic medical centers derive considerable benefits from four core differentiators, all of which arise from their unique tripartite mission that combines commitments to teaching, research and patient care:

Depth and breadth of capability — Academic medical centers, because of the depth and breadth of their specialty capabilities as well as their commitments to research, are well positioned as the preferred resources for complex care. Michael Treacy and Fred Wiersema in their book, *The Discipline of Market Leaders*, building on work by Harvard's Michael Porter, argued that there are essentially three mega strategies for winning in a competitive environment. You can win by offering customers the "best total solution," delivering a product at the "best total cost" or offering what the market views as the "best product." The last alternative requires an organization that "continually pushes its products into the realm of the unknown, untried or highly desirable . . ." and "strives to provide its market with leading edge products or useful new applications of existing products or services." By occupying this "best product" position for decades, academic medical centers have been able to enjoy a robust position of advantage. Ed Miller, M.D., the former CEO of Hopkins Medicine, reflected on that position when he suggested that what made Hopkins different, particularly compared with community hospitals, was innovation: "We have to innovate if we are to stay in the lead." The differentiated position of academic medical centers reflects their legacy of leading edge capabilities, the momentum of which is still considerable.

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Collegial commitment — Faculty physicians in academic medical centers tend to have a stronger sense of shared purpose and common values than the physicians who comprise the medical staffs of most community hospitals. As Joseph Simone, M.D., once commented, “We in academic medicine are blessed in many ways compared with those in most jobs. We have the privilege of working in a profession that helps the sick and dying while we are engaged in intellectual inquiry.” While faculty are certainly not immune to rivalry, conflict and dysfunction, their shared commitment to research, teaching and patient care gives them a greater potential for the collaboration that is essential to delivering high-value care. Arthur Feldman, M.D., summarized the advantages that accrue from such collegiality in his book *Pursing Excellence in Healthcare*: “Academic specialists and subspecialists concentrate their efforts, innovate rapidly, develop dedicated teams rather than relying on part-time practitioners, have dedicated facilities, and have multiple colleagues in the same practice with whom to discuss difficult cases . . .” They also tend to demonstrate more interest in association with a strong institutional reputation. Thus, they are much more likely to think of themselves as “Hopkins doctors” or “Duke doctors.” This shared identity further enhances the potential for productive collaboration. An edge in collaboration is likely to yield a significant competitive advantage. In his book *Antifragile*, Nassim Taleb writes, “Collaboration has an explosive upside, what is mathematically called a super additive function, i.e., one plus one equals more than two, and one plus one plus one equals much, much more than three . . .”

Proximity — Academic medical centers concentrate lots of talent and resources in close proximity. In this they are like cities. Cities enjoy significant efficiencies as well as economies of innovation. According to Geoffrey West and Luis Bettencourt, theoretical physicists at the Santa Fe Institute and Los Alamos National Laboratory, “Rather than unnatural human conglomerations blighted by pathologies . . . cities do more with less . . . because they concentrate, accelerate, and diversify social and economic activity.” Bettencourt and West’s research indicates that while a city may double in size, its infrastructure — roads, sewer lines, retail — does not. In fact, the bigger the city, the more efficiently it uses resources.

The keys to “virtuous cycles of innovation and the creation of wealth” are “a spirit of local entrepreneurship, a reputation for cutting-edge novelty and a culture of excellence and competitiveness . . . Concentrated population promotes more intense and frequent social interactions, occurrences that correlate with higher rates of productivity and innovation as well as pressures that weed out inefficiencies.” Academic medical centers with concentrated city-like campuses have the potential to benefit from the same advantages.

Loose coupling — “Loose coupling” describes elements that retain a comparatively high level of independence despite operating as part of a broader system or organization. The strength and relative autonomy of departments in academic medical centers results in their operating as loosely coupled organizations. Often criticized as being disorganized and unfocused, organizations that are loosely coupled arguably generate more advantages than disadvantages. One attribute of loosely coupled organizations, including academic medical centers, is their inherent sustainability. Loose coupling yields sustainability over time because it permits greater flexibility than more rigid command-and-control models. Rigid things are prone to fracture in volatile environments, while flexible things can absorb a blow. They can “take a licking and keep on ticking.”

Loosely coupled organizations hold the potential to be more agile and resilient because their various components don’t have to wait for a centralized bureaucracy to respond. In this they resemble a network more than a hierarchy. They embody the durability often evidenced by other loosely coupled structures like the Internet. Because so much of their decision making is contained within departments and because authority is often emergent rather than delegated, academic medical centers, by their nature, tend to be decentralized. As a result, weakness or failure in one department or division doesn’t necessarily threaten the others. In addition, because they combine distributed decision making and authority with higher levels of autonomy, loosely coupled academic medical centers also provide a potentially more fertile environment for entrepreneurialism and innovation.

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According to University of Michigan organizational theorist Karl Weick, loose coupling allows organizations like academic medical centers to "temporarily persist through rapid environmental fluctuations, improves the organization's sensitivity to the environment, allows local adaptation and creative solutions to develop, permits subsystems and subunits to underperform and break down without pulling down the entire organization, and allows more individual self-determination."

Shared commitment to delivering complex care, collegiality and proximity give academic medical centers coherence sufficient to overcome the fragmentation that might otherwise accompany loose coupling. Organizations can benefit from being loosely coupled but they can't afford to be so loose they lack purpose and direction. On the other hand, they can be paralyzed by being too tightly coupled. Academic medical centers that become too integrated and centralized risk squandering the advantages embodied in loose coupling.

The good news is that the four core differentiators described above continue to support considerable competitive advantage for academic medical centers and will be very difficult for competitors to emulate. The bad news is that they are largely a fortuitous inheritance. Because each differentiator arises naturally from the tripartite mission that distinguishes academic medical centers rather than from intentional strategy making, they are subject to neglect. Success for academic medical centers will require more than good fortune. It will require embracing the characteristics that make academic medical centers unique and the advantages those characteristics can yield. Focused investment of attention, time and resources will be necessary to fully leverage core differentiators into sustainable advantage.

Growing Challenges Intensify the Need to Leverage Core Differentiators

Despite the strength of their inherent differentiation, academic medical centers are already burdened with significant challenges that could endanger their long-term sustainability. Nationally, their costs are higher on a case-mix-adjusted basis compared with community hospitals, as are their operating expenses. The National Institutes of Health budget for research grants fell by 22 percent from 2003 to 2013 while private research funding declined by 15 percent from 2007 to 2012. And academic medical centers are significantly more reliant on federal funding. Median Medicaid levels are 18.5 percent for academic medical centers versus 13.5 percent for nonprofit hospitals in general. McKinsey Health has projected that academic medical center operating margins will fall by 4 to 5 percent by 2019. Growing financial pressures may cause internal conflicts to break out at the interface between research, teaching and patient care as increasingly scarce resources must be allocated and trade-offs made. Some academic medical centers may find themselves compromised by disagreements between leaders of their hospital, medical school and faculty practice plan. And academic medical centers may, because of their high levels of specialization, become even more vulnerable to silo syndrome in which narrow specialty and department interests override those of the broader institution.

Internal concerns can distract academic medical centers from external challenges including those posed by aggressive community hospitals committed to competing for tertiary patients. A number of other developments bode ill for academic medical centers, including the growth in employment by community hospitals of physicians who generate a significant percentage of the referrals to academic medical centers. Consolidation of insurers will increase the negotiating clout of health plans, further building downward pressure on reimbursement rates, particularly for academic providers who have enjoyed a premium. And the central focus of health care reform will continue to be on reductions in government reimbursement overall.

A growing abundance of comparative data, demands for transparency and relentless pressure to demonstrate value will require academic medical centers to prove they deserve their differentiated positions, higher margins and superior bond ratings. Already, some studies suggest that academic medical centers, despite their significantly higher prices, show little advantage when their outcomes are compared with those of tertiary-level community hospitals. Inability to demonstrate superior clinical performance, particularly related to complex care, could devastate the intrinsic differentiation academic medical centers enjoy.

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Hubris is another potentially debilitating affliction. Too often academic medical centers have demonstrated a propensity to dismiss external realities, including customers and competitors. This, in turn, can cause them to ignore the importance of respectful and responsive relationships with the community physicians who generate their referral base and who have the discretion to send their patients elsewhere.

Change and uncertainty is increasing for all health care organizations including academic medical centers. Taken together, change and uncertainty generate varying degrees of volatility — the degree to which swings in a situation become wide and erratic as well as prone to cascading into disruptive consequences.

For academic medical centers, the need for strategic thinking that unifies and orchestrates commitments throughout the enterprise will grow as internal and external challenges intensify. More than ever, academic medical centers will be compelled to recognize that they operate in an environment where only the most fit will prosper. Fitness will require using core differentiators, at an overall institutional level, to guide the allocation of increasingly scarce resources toward a focused set of unifying strategies that generate clear advantages in value.

Strategy Is the Most Important Obligation of Leadership

A strategy is a plan for getting from the present to a better future in the face of uncertainty and resistance. Absent uncertainty and resistance, there is no need for a strategy. A “to do” list will suffice. Some strategies are more important than others. “Driving strategies” represent the organization’s most important strategies. They represent the handful of things that must be done to secure continuing sustainable advantage. A goal is not a strategy. A goal is an endpoint. A strategy describes how you intend to get across the goal line. It is a means to the end.

Driving strategies are part of a planning hierarchy that includes at its top a statement of mission (the never changing purpose of the organization), values (what the organization stands for) and vision (what the organization aspires to become). Driving strategies answer the question “What are we going to do to fulfill our mission and, in accordance with our values, accomplish the aspirations embodied in our vision?” Mission, values and vision provide the boundaries within which driving strategies are focused — the outer boundaries of what the organization will and won’t do. Organizations need more than one driving strategy. “What’s your strategy?” is the wrong question. Complex organizations operating in complex conditions need a handful of driving strategies that are complementary and synergistic.

It is the job of leaders to lead, not ask for a show of hands. Effective strategy making is top-down. It doesn’t result from consensus generated out of a bottom-up group hug involving thousands at all levels of the organization. The formulation and implementation of driving strategies is leaders’ most important job. It requires tough-minded choices fortified with input from the organization’s management team overall. This requires strategic dialogue, facilitative leadership and trade-offs attuned to the volatility certain to confront academic medical centers.

Leaders of academic medical centers actually have advantages related to formulating strategy. Depth and breadth of capability yields richer insights. Proximity and collegiality make it easier to organize and facilitate strategic dialogue and decision making. And strategic flexibility and tactical adjustments are enhanced by loose coupling.

An academic medical center’s core differentiators should be fully leveraged when leaders formulate and implement driving strategies. Core differentiators are not strategies. They make driving strategies more robust and effective. Core differentiators offer potential. But potential must be exploited. It has to be translated into advantages like a powerful brand derived from depth and breadth, collaboration derived from collegial commitment, higher productivity and innovation derived from loose coupling. When exploited, core differentiators can supercharge an academic medical center’s driving strategies. They are fuel for the fire of competitive advantage. And they are a wasted asset when they’re not recognized and used.

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Core Competencies and Focus Are Essential

In addition to leveraging core differentiators, the driving strategies of academic medical centers should build on “core competencies.” These are operating capabilities that the institution is already really good at, or has a realistic potential to be really good at, and that translate into high value. A competency is useless if it doesn’t generate differentiated value for those served by the organization. Differentiated value is defined from a customer perspective and determined relative to the offerings of competitors. So, thoughtful understanding of customers and competitors is essential to defining and developing core competencies.

While all academic medical centers must first be good at delivering complex care, core competencies will vary from one academic medical center to another. There are a variety of other core competencies potentially available to an academic medical center, such as integrating and orchestrating care across a relatively wide geography. Such a competency might be complemented by another — for example, the disciplined application of clinical data generated through the care of relatively large numbers of individuals from a wide geography.

Driving strategies should also address the question “What is ours uniquely to do?” No organization has the luxury of being “all things to all people.” As Michael Porter has famously and frequently reminded, strategic advantage is as much about choosing “what not to do” as it is about choosing “what to do.” An academic medical center is not a community hospital. It shouldn’t try to be a community hospital. Its fundamental value proposition is predicated on its ability to deliver complex care. Complex care is what an academic medical center is most uniquely positioned to do. Its driving strategies and resources should always be focused with that powerful distinction in mind.

An appreciation for “core differentiators,” disciplined identification of “core competencies” combined with focus~~,~~ and a pragmatic assessment of internal and external challenges provide the context out of which high-impact driving strategies can be generated. For example, an academic medical center with the core competencies described above might reasonably generate a driving strategy to “orchestrate and demonstrate improvement of population health statewide.” Such a strategy would require depth and breadth of capability, collegiality, proximity enhanced by technology and the decentralized decision making and autonomy that loose coupling engenders. It is a driving strategy that community hospitals would find very difficult to emulate.

Deliberate Incrementalism Is Key to Strategic Success

Organizations that achieve strategic success are deliberate in their pursuit of mission, vision and driving strategies. But they are incremental in how they conduct that pursuit. There are many threats to the formulation of good driving strategies and their effective implementation. Among the most seductive and dangerous of these is boldness. Academic medical centers have often been encouraged to boldly transform themselves. Boldness suggests a significant, potentially revolutionary leap from a current state to a place of discontinuity — presumably to a fundamentally different and better place. That, of course, implies that the better place is knowable and attainable. Knowability and attainability require predictability. Doyne Farmer, a professor at Oxford University and the Santa Fe Institute, is also a pioneer of chaos theory and complexity science. In a rapidly changing and uncertain environment filled with volatility, Farmer has suggested that while you may be able to predict short, you can’t predict far. Bold leaps are, by definition, long leaps. Predicting long in the face of significant change and uncertainty has a name: gambling.

Because the direction and magnitude of consequences are always uncertain in situations with high volatility, a big bold move into the future is more likely to push an organization irretrievably out of synch with its environment. The likely outcome of a bold thrust was captured by one of the 20th century’s most respected military strategists, Liddell Hart, who in 1954 observed, “A plan, like a tree, must have branches if it is to bear fruit . . .” All robust and sustainable progress is of the branching variety. An incremental path doesn’t put the organization too far out on a limb to climb back. Incremental moves at a tactical level reduce the risk of being significantly out of synch as conditions shift. Pursuing deliberate intentions incrementally reduces reliance on long predictions and thus improves the odds of making progress in volatile environments.

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Boldness that encourages a break with the organization's prevailing path threatens its ability to maintain the momentum of past accomplishments and leverage current strengths into the future. Deliberate incrementalism recognizes this "path dependence" by not venturing wildly beyond the organization's realm of demonstrated competence and value. It keeps a strong tether to the characteristics and accomplishments that have anchored past success. While academic medical centers are encouraged to boldly transform themselves, they are less often advised to identify and reinforce those characteristics that have served them well in the past and may be well suited to their future. Core differentiators and core competencies represent such characteristics.

Good strategy requires flexibility. While formulating a handful of driving strategies is key, so is the development of what Taleb calls "optionality." Optionality suggests that because a complex environment is beyond prediction, trial and error will provide the most robust path forward when facing disruptive surprises. Central to optionality is the "option to change." Resolve is critical to the implementation of a driving strategy. Too often organizations snatch defeat from the jaws of victory through premature abandonment of a driving strategy. On the other hand, flexibility is required when resolve is confronted by volatility. While the organization remains resolved in its pursuit of its driving strategies, it must be flexible in how it accomplishes those strategies. A driving strategy can be made flexible by supporting it with a handful of tactics that are changed incrementally through trial and error as the situation shifts.

Today, academic medical centers benefit from the momentum of a legacy of past accomplishment. But momentum has its limits. Absent continued investment of energy and resources, inertia sets in. A volatile future will demand that academic medical centers translate what makes them unique into continuing advantage. And that will require deliberately and incrementally leveraging core differentiators and core competencies into driving strategies that deliver recognized value.

Author's note: An in-depth monograph describing the merits of deliberate incrementalism related to strategy formulation for academic medical centers can be downloaded at www.hcstrategyinnovation.com.

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