

Healthcare Systems and Services Practice

Why digital transformation should be a strategic priority for health insurers

Basel Kayyali, Steve Kelly, and Madhu Pawar



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Digital technologies and applications have the potential to markedly enhance a payor's profits. Leadership from the top is necessary to overcome the organizational resistance to change that can make a digital transformation difficult.

Why should senior health insurance leaders make “digital” a strategic priority? Many leaders may be tempted to relegate digital initiatives to their IT departments, or to small teams that have historically dealt with topics like digital marketing, but this would be a mistake. When executed well, these initiatives can achieve substantial, near-term SG&A cost savings and give payors a much more solid footing from which to face the future. Over the longer term, they may also be able to decrease spending on medical services. In addition, digital initiatives can serve as a catalyst to organizational transformation. Given current margin pressures and ongoing industry changes, payors face a strategic imperative to consider fundamental changes to their operating model. Digital initiatives can help payors reimagine their business processes and customer engagement techniques, and enable them to make the needed changes.

By “digital,” we mean the broad range of technologies and applications that enable more efficient automation, better decision making, stronger connectivity with customers and other external stakeholders, and more advanced data-driven innovations. These technologies, together with business process redesign, make possible a new way of working that can fundamentally transform a payor organization. For decades, productivity has improved far more slowly in the healthcare industry than in other sectors. Most payors are only begin-

ning to adopt customer-centric thinking, prompted by the consumerization of health insurance. New, highly agile, digitally native firms are entering the market and could significantly disrupt existing business models.

To understand how severe the disruption could be, consider the music industry (Exhibit 1). Revenues have plummeted as distribution has shifted to downloads and streaming, and much of the remaining revenues have gone to new players. What may be most interesting about this example is that it took about five years from the time Napster was launched until industry revenues were cut in half, which gave some incumbent record label executives a false sense of security.

Other sectors are being affected by digital disruption. Uber is upending the taxi industry. Airbnb is threatening hotel revenues. Netflix, Hulu, and similar services have radically changed TV industry dynamics.

Furthermore, we have seen digital disrupt heavily regulated industries that are more analogous to health insurance, including financial services. For example, property and casualty insurance has seen the rise of digital disruptors such as Progressive and Geico, which have driven what had traditionally been a broker-led sale to a much more direct-distribution industry (about 40% of P&C insurance purchases are now made online without human inter-

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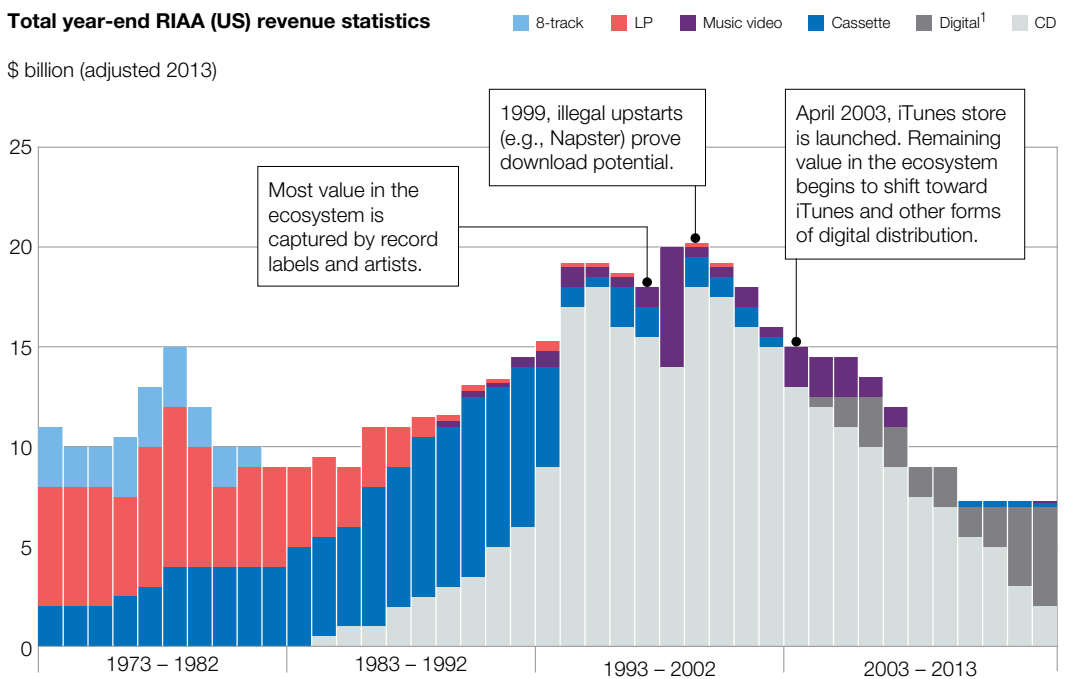
vention). Similarly, personal/retail finance has been disrupted by digital. Many digitally native companies (e.g., Voya, previously known as ING Direct) have gained significant market share despite not having traditional “brick and mortar” assets. In the process, they have fundamentally changed consumer buying behaviors—for example, 34% of consumers now use mobile apps for personal finance. As the US healthcare industry makes the B2B to B2C transition driving by healthcare reform and aging demographics, is there any reason to think that health insurance will be different?

Some senior payor executives are beginning to grasp the significance of digital for their

organizations. McKinsey’s recent Digital Enablement Survey, for example, shows that they are devoting an increasing proportion of the IT budget to building digital capabilities rather than supporting core IT infrastructure (e.g., claims processing systems). Our forecasts suggest that digital transformation will account for more than 50% of their strategic IT budgets within next three to five years.

We believe, however, that most payor executives need to think bigger and move faster. Digital should be at or near the top of their strategic priorities, and CEOs should proactively champion digital transformation. We also believe that the time

EXHIBIT 1 Digital dramatically shifted value among music industry participants



¹Includes synchronization, on-demand streaming (ad-supported and paid subscription), ringtones, kiosks, downloaded music videos, downloaded albums, and downloaded singles.

Source: Recording Industry Association of America (RIAA)

is right to take significant action. In many industries (not just music), there has been a delay of about four or five years from the time a new digital technology is launched to the time its disruptive effects become apparent. The delay results largely from two factors: the speed at which consumer behavior changes and the time until the huge scale advantages that digital can provide take hold (not only economies of scale but also the impact of having a large participant network). Both factors eventually reach a tipping point, and the subsequent changes can be dramatic. As many other industries have discovered, incumbents that can get ahead of the changes can create a strong competitive advantage and gain considerable value. Most of the other incumbents are significantly disadvantaged; some may have to exit the market. Thus, the delay in impact should not lull payor executives into a false sense of security. If they wait until the disruptive effects of digital are more noticeable, it may be too late to change course.

How digital can help payors

To derive maximum benefit from digital, payors should learn to view it not as a *thing* but as a *way of working*—that is, as a way of thinking about and running their businesses. Digital can have a significant positive impact on payor economics, primarily through four levers:

Stronger connectivity. Digital gives payors new ways to engage with all stakeholders. For example, it can be used to improve the *consumer* experience by simplifying the buying process and making it easier for consumers to select the right product. In

addition, it can provide tools to help steer consumers to the lowest-cost high-quality provider, thereby optimizing the care setting for their needs and enabling them to better manage their health. In today's world, any payor that wants to connect with consumers must include social media and online channels as a core part of its strategy. In addition, payors must accept that the expectations of today's consumers are increasingly being set by their experiences in other sectors.

However, digital also enables payors to engage more effectively with *providers*. For example, payors can give the providers more sophisticated, digitally enabled tools to manage the population health of their patient panel, as well as clearer methods for gauging the quality of care delivery. Digital also enables better collaboration and data sharing with providers, which supports more effective care coordination.

Greater efficiency and automation. Digital can do far more than enable payors to optimize their current processes. It makes possible automations that allow them to radically reimagine workflows. Think of all the things that digital can do today that it could not do even five years ago—and then think about how you might build new, vastly more efficient workflows using a clean-sheet design approach. Many of the processes payors currently use have resulted from a series of small decisions made over many years. There is no reason most of those processes need to be that complicated. Digital makes it feasible to design minimally viable processes based on the end-to-end journeys taken by external stakeholders (see below for more details).

Better decision making. Digital also includes advanced analytics and big data insights. Without digital, it becomes far more difficult—if not impossible—to implement value-based reimbursements and other payment innovations. Population health management also depends on advanced analytics. In addition, digital enables payors to optimize their networks at a highly atomized level and to design more attractive (and profitable) products that cater to the needs of a given demographic, area, or segment. To understand the impact advanced analytics can have, consider the auto insurance industry. Years ago, a few companies (e.g., Progressive, GEICO) gave themselves a source of advantage by using advanced analytics and segmentation to better understand customers and risks. As a result, these companies outperformed the industry and took significant share from competitors.

More advanced innovation. Finally, digital enables payors to think more broadly about business model and care delivery innovations. For example, it can help payors envision new approaches to care delivery that have the potential to hold down costs (e.g., wearables that monitor the health status of patients with chronic conditions, telemedicine “virtual visits” that reduce the need for in-person physician consultations). Digital can also make healthcare more accessible by giving patients easy access to their medical history and help them locate nearby clinicians, specialists, and facilities.

By combining these four levers, payors can achieve significant impact. One large payor, for example, decided to completely

“clean sheet” its member sign-up process/ journey after it discovered that it was swamped dealing with enrollments in the individual market. The payor began by using customer-centric design (supported by advanced analytics) to permit consumers to start and complete the sign-up process online. Thanks to digital automation, the new process entails considerably fewer steps than the old one did. The payor also used advanced analytics to predict when human intervention was likely to be needed during auto-enrollment so that customers were not inadvertently lost. The result: the defect escape rate was reduced by 80% and the cycle time, by 50%. Overall spending on customer sign-up was lowered by 30% to 50%.

Financial impact of digital transformation

Payors that employ the four levers could achieve a large near-term reduction in SG&A costs. The exact amount would vary from payor to payor, given the broad dispersion in individual carriers’ per-member administrative spending. We estimate that, on average, payors would save roughly 10% to 15% of their SG&A costs—\$15 billion to \$25 billion industry-wide.¹

Over the longer term, we believe that digital could significantly decrease spending on medical services. Most of the savings would come from the substitution of lower-cost services for more expensive alternatives. (Remote monitoring and virtual visits, for example, could decrease the need for in-person consultations.) In addition, digital transparency tools that inform consumers about variations in provider pricing could

¹ Payors’ administrative savings were calculated as follows: About half of the U.S.’s \$3 trillion in annual spending on healthcare flows through non-governmental payors. Administrative expenses account for 10% to 11% of that \$1,500 billion, or \$150 billion to \$165 billion. If that amount, in turn, is reduced by 10% to 15%, the savings would be between \$15 billion and \$25 billion.

encourage them to seek out lower-cost providers. Utilization of primary care services is likely to rise (as would spending for those services), but we estimate that the increase in costs would be more than offset by lower utilization of more expensive services. (For example, by making it easier for patients to access healthcare, digital technologies could improve patient outcomes and lower the rate of hospital admissions and readmissions.) Consumers will be the primary beneficiaries of the lower spending, but some of the savings will accrue to payors and providers.

The size of the potential prize helps explain why venture capital investments in digital health more than quadrupled between 2011 and 2015 (from \$1.1 billion annually to \$4.5 billion).² No other investment category has seen an increase of this magnitude since the dot.com era in the late 1990s. At present, more than 1,200 companies are working on innovations for the healthcare industry. Many of these companies are looking to partner with incumbent payors and providers—but many are also targeting pure-play disruption.

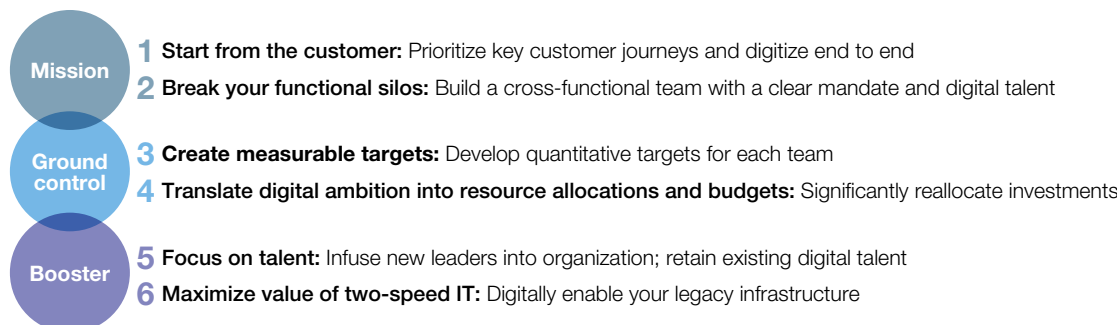
Using digital for organizational transformation

Today, most health insurance companies are siloed organizations that have been optimized for specialization and efficiency in performing current processes (in essence, the companies use a divide-and-conquer approach). As a result, most employees find it very hard to challenge the status quo and suggest new ways of working. All too often, business unit leaders are highly resistant to innovation and cross-functional collaboration is difficult.

Only very senior leaders—especially the CEO—can ensure that the new way of working enabled by digital is embedded across the organization, a prerequisite for achieving maximum impact. And only very senior leaders can decide what the ultimate goals should be. Do they want to use digital to diversify their company? Completely transform the core organization? Something else?

Once senior leaders have prioritized their goals, six specific actions can help them get the effort going (Exhibit 2).

EXHIBIT 2 Six steps help get the digital transformation going



Source: McKinsey Healthcare Technology Practice

²Wang T, et al. Digital health funding: 2015 year in review. Rock Health. December 2015.

Start from the customer

Senior leaders should begin by understanding the key journeys taken by their external stakeholders—consumers, providers, employers, and brokers (Exhibit 3). A journey is the end-to-end experience someone has as she or he navigates a particular activity. Journeys that can be digitized for health insurance consumers include enrollment, billing, claims submissions/processing, and issue resolution. For both payors and providers, digital analytics can enhance care management, value-based reimbursement, and performance evaluations. Digital approaches can also make it easier for payors to credential providers, design networks, and improve reporting to providers, employers, and brokers.

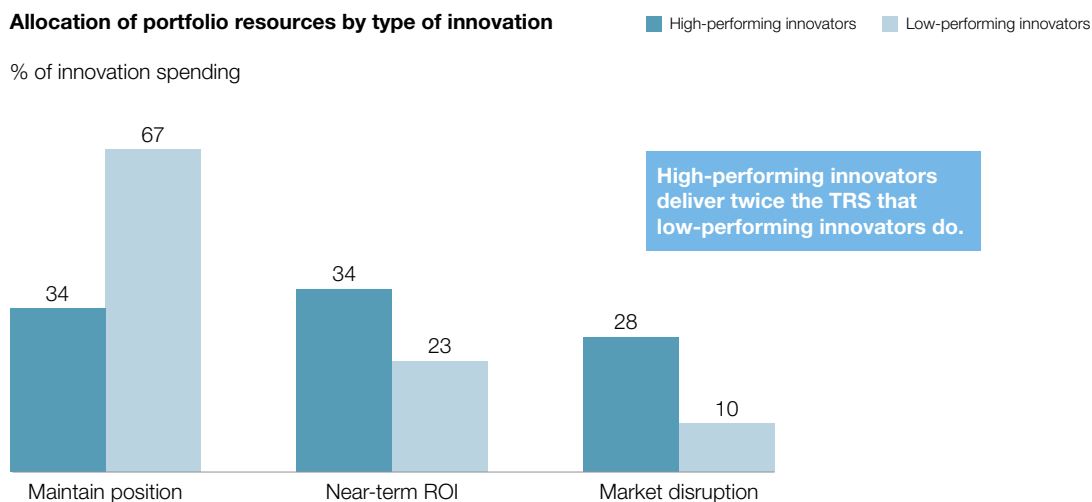
Once leaders have identified the journeys their customers take, they should determine which of those journeys should be prioritized. Prioritization helps keep the entire organization focused on a limited set of crucial changes. It also helps ensure that important projects are funded adequately. To prioritize, start by considering two variables: which journey redesigns are likely to produce the most value and which ones are most likely to succeed. (The success of one project helps break down resistance to other redesigns.) Then, consider which managers are open to change and where resistance is highest in the organization. Once the prioritized journeys have been selected, all steps within them should be digitized to the fullest extent possible.

EXHIBIT 3 Eight customer journeys matter most for payors

Journey	Activities
Increase consumer awareness	Product education, consideration, and evaluation
Enroll consumers	Inquiry, quote-to-card, and billing
Solve problems	Customer/broker issue resolution, provider servicing
Pay what's owed	Claims processing, broker commissions
Analyze and report data	Employer and broker reporting/analytics
Help members take control	Member care management and wellness initiatives
Help providers deliver better care	Provider healthcare value programs and performance review
Optimize the provider network	Provider credentialing and network design

Source: McKinsey Healthcare Technology Practice

EXHIBIT 4 High-performing innovators shift spending to capitalize on market disruptions



TRS, total return to shareholders.
 Source: McKinsey Global Survey on Innovation 2014

Break your functional silos

The next step is to build a cross-functional team for each prioritized customer journey and encourage an extraordinary level of cross-functional collaboration. In most cases, the team will include representatives from multiple divisions. Google, for example, built Google Drive, its cloud storage service, by staffing a team with representatives from marketing and sales as well as engineering and IT.

The cross-functional teams should have a clear mandate for change. These teams are important for redesigning the prioritized journeys, and they are also a key element in changing organizational mindsets. For a typical payor journey, up to five or six different groups within the organization, including operations, IT, sales operations, and business segments, should collaborate on a clean-sheet redesign.

Create measurable targets

Once the teams are set up, senior leaders should challenge them by setting goals that, at face value, may appear to be inconsistent. Stress that the overall goal for each team is a complete redesign of all steps in the journey, but also emphasize that the redesign should result in a minimally viable product. In other words, both the journey and product should be kept as simple as possible and focused on customers' most important needs.

In addition, senior leaders should set bold quantitative targets (e.g., a 30% to 40% improvement in productivity or a 50%+ improvement in cycle time and quality) for each team to push the possibilities of what a clean-sheet design can accomplish. They can then measure progress against those targets on a quarterly basis. Progress should have a strong influence on resource allocations.

Translate digital ambitions into resource allocations

Most companies establish their capital budgets each year by adding similar percentage increases to each line of the previous year's budget. This approach is not compatible with true digital transformation. This is not to say, however, that the IT budget needs to increase dramatically. Rather, money in the existing budget should be shifted toward the prioritized digital investments.

A global survey McKinsey recently conducted showed that high-performing innovators devoted about two-thirds of their innovation budgets to market disruptions and near-term ROI (Exhibit 4).³ In contrast, low-performing innovators spent two-thirds of those budgets on maintaining their current processes. The high-performing innovators produced twice the total return to shareholders as the low performers did.

The implications are clear: to reap maximum benefits from digital, companies have to reallocate a significant portion of their budgets to digital innovations focused on a small number of the highest-priority journeys.

Focus on talent

Digital transformation involves new ways of working and thinking. Senior leaders should take concrete steps to ensure that their organizations have the necessary digital talent by identifying and retaining existing talent and bringing new talent in the door. As in most transformations, there will be some nay-sayers and blockers who resist the changes; these people should not remain on the digital transformation team.

Maximize the value of two-speed IT

It is not realistic—or appropriate—for a payor to jettison all of its legacy IT infrastructure when beginning the move toward digital transformation. Two goals should be pursued instead: to adapt as much of that infrastructure as possible so it can support new digital approaches, and to find methods that would allow new projects to “fail fast” (within months, not years). This way, unsuccessful innovations are abandoned rapidly and successful innovations are identified and scaled up. A staged approach can be used to achieve both goals.

First, payors should build a digital foundation by designing new services for easy consumption. These new services should standardize the existing data models within the company's fragmented legacy infrastructure. In addition, the services should make it possible to quickly integrate new applications with the legacy infrastructure by creating standard “services-based” interfaces. (These interfaces can avoid point-to-point integrations between the applications and legacy infrastructure.) This approach would dramatically increase the speed with which new digital capabilities can be embedded into the IT environment while reducing the integration and testing costs that can make it cost-prohibitive to experiment and fail fast. Investments will still be needed, but development time and resource requirements can be reduced by creating minimal viable products initially. (Using a minimal-viable-product approach and services-based architecture, Amazon was able to take Prime from concept to launch in six weeks.) Additional investments can then be made to improve products that show

³McKinsey Global Survey on Innovation 2014.

solid signs of success. At the same time, companies should leverage their legacy infrastructure wherever possible to maximize the ROI on those systems, but start cutting back on new investments in the legacy infrastructure.

Next, companies should accelerate the shift from old to new by increasing the amount of money allocated to new systems and services. Continuing investments in old systems should be made only if those systems can be upgraded or modernized (at reasonable cost) to meet the needs of the new digital approaches. Eventually, older systems can be retired if they cannot be made capable of changing at the speed digital transformation requires.



For payors, the business case for digitization is strong. Not only can it improve financial performance in the short term, but over the long term it holds the key to increasing consumer satisfaction and fending off attacks from new entrants. The payor industry's net promoter scores (which gauge customer satisfaction) have historically been poor, but there is no reason these scores cannot

equal or exceed those of leading consumer companies. What is the danger of not focusing on these goals? Innovators saw that the cable/pay TV industry had high revenues but very poor customer satisfaction ratings. They used digital not only to design new products but to reimagine how those products could be delivered. The result: direct TV companies are experiencing a rapid rise in market share and valuation. Cable and pay TV companies are scrambling to respond.

The attention of senior leaders can help payors avoid the same fate. The six steps described above can enable payors to embrace digital transformation and move down a path toward a successful future. ○

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