Building a better working world

Driving value in health care through optimal capital allocation

Global capital allocation report 2021

Health care CFOs and FP&A leaders can drive the finance function to the next level and create value for their organizations through optimal capital allocation.

For the health care industry, market forces that existed before the COVID-19 pandemic have been amplified – from cost pressures to digitization to site-of-service transformation. These market forces are compelling executives to optimize strategic planning and investments and to reconfigure operations to be successful. CFOs must face trade-offs between multiple investment needs in human capital, digital assets, facilities, equipment and partnerships with outside organizations. Utilizing thoughtful selection frameworks, processes and tools to make these capital allocation decisions will help to achieve long-term value that goes well beyond the financial health of the organization to furthering improved patient access and outcomes.

A majority of providers and payers say it is time to rebalance the company portfolio to focus on the core business.

66%

of providers

71%

of payers

More than three-quarters of provider (77%) and payer (78%) CFOs participating in the EY 2021 Capital Allocation Survey acknowledge their capital allocation process needs to be improved. This is comparable with 80% of 1,050 CFOs across industries who said the same. At the same time, only 48% of provider and payer CFOs say their capital allocation process meets total shareholder return goals.

The COVID-19 pandemic had a negative impact on the ability to invest capital in 2020 for 37% of payers and providers, although this proportion is lower than the 53% of participants across other industries that indicated a negative impact.

The pandemic also has caused many to reevaluate what their organizations focus on: 66% of providers and 71% of payers say it is time to rebalance the company portfolio to focus on the core business.

As capital investment rebounds in 2021, digital technology investment (74%) and R&D (73%) are the top areas where payers plan to increase investment over 2020. These come in second and third for providers, with capital expenditures (72%) mentioned most frequently. One area where hospital decision-makers were looking to invest, even during the pandemic, was in clinician-to-clinician telemedicine capabilities. Other areas ripe for improvement through digital investments include the patient experience, data analytics and the use of cloud-based platforms to help enable seamless care across a number of providers and others in the health care ecosystem.

Challenges to effective capital allocation

What challenges currently get in the way of driving long-term value through capital allocation?

Lack of a holistic capital allocation process

In some organizations, the capital allocation process does not link directly to the company's long-term strategy. This can lead to one-off decisions, rather than a holistic approach. In fact, 33% of health care CFOs say that the capital allocation process is not well integrated with strategic planning and 42% say that their capital allocation process does not objectively assess investments.

For capital allocation to be effective, leaders need to align on a shared vision that ties the process to the company's strategy, identifying the strategic goal that supports the investments being made. The same framework and similar metrics should be employed at the business unit level to evaluate projects consistently and help eliminate personal bias.

Lack of a formal capital allocation process

Another issue may be the approach they employ. Only 48% percent of provider CFOs say they take a formal, systematic approach to allocating capital (compared with 65% of payer CFOs.)

Lack of a formal process hinders attempts to react quickly to market threats or growth opportunities, something that only 48% of providers are able to do. At the same time, 57% of provider CFOs and 58% of payer CFOs say their process or framework, including governance, are not at all or only slightly effective.

Other barriers named by health care CFOs include lack of data access, inability to prioritize projects, ineffective model or decision-making. Increasingly important will be strengthening and focusing health systems' analytics capabilities in order to monitor, review and model more accurately, tying this data to investment decisions.

An effective capital allocation process:

- Encompasses governance that instills discipline and enables unbiased decision-making
- Is agile and adapts to changing business needs, such as the increase in outpatient and telehealth demand and subsequent impact on real estate, digital and workforce investments
- Strikes the right balance between formal and objective
- Should not be so encumbered with rules and processes to impede the ability to move quickly from ideation through implementation, especially as many health care organizations are trying rapidly transform how and where they serve patients

Monitor results

Monitoring the results of the decisions once they are made is also essential, both during implementation and then at the end, to see if the investments are delivering the intended results. Yet, 52% of payers and 42% of providers say lack of project monitoring is one of the primary barriers to their company's optimal allocation of capital.

Monitoring during implementation allows for in-flight adjustments as needed. After implementation, companies can conduct a post-mortem and incorporate those learnings into future capital allocation decision-making.

Lack of project monitoring is a primary barrier to optimal allocation of capital for both payers and providers.

52%

of providers

42%

of payers

Measure what matters

CFOs are well aware of the KPIs that measure financial value. However, long-term value has three other pillars: **patient (customer) value, people value and societal value**.

CFOs should help identify the right KPIs to measure how effective capital allocation decisions are at creating long-term value.

Balanced scorecards can be used to combine quantitative and qualitative metrics. Such a scorecard can provide a consistent framework for the qualitative assessment of individual investments to help decision-makers compare alternatives. Some of the KPIs health care companies can employee are:

- **Financial value:** net patient revenues, cost per discharge, revenue per member
- **Patient value:** access, outcomes, satisfaction, trust and brand loyalty
- **people value:** Engagement, employee loyalty, leadership, diversity and inclusion, health and wellness
- **Societal value:** community benefit, charity care, sustainability, total economic impact and ethics

Remember, however: KPIs should not remain static. As the market or business goals change, CFOs should determine what new KPIs should be added and which current ones no longer measure long-term value.

Create flexibility to respond to future market forces

A formal process that examines all investment opportunities on a level playing field and uses KPIs that focus on the potential for long-term value creation can help health care organizations make the investments needed to improve both patient outcomes and financial stability.

To sustain and grow during this era of transformation in health care, organizations can assess their positions amid key industry forces and intentionally commit to thoughtful and cadenced capital allocation planning. Through the pandemic, health systems have demonstrated remarkable resourcefulness and agility: with attention to strategic capital allocation, they can mindfully prepare for and respond to future market dynamics.

Contacts

Let's talk about your capital allocation strategy.

Global

Loren B. Garruto
EY Global and Americas
Corporate Finance Leader

loren.garruto@ey.com

Americas

Mallory Caldwell
US Health Leader
Ernst & Young LLP

mallory.caldwell@parthenon.ey.com

Natasha A. Hunerlach
Principal, Strategy and Transactions
Ernst & Young LLP

natasha.hunerlach@ey.com

Evan Sussholz
Partner, Strategy and Transactions
Ernst & Young LLP

evan.sussholz@ey.com

Jennifer Gerold, Brett Moore, Heera Mathew, and Jordi Pujol contributed to this article.

Check out the EY Capital Allocation Global Report 2021 with insights from across industries.

ey.com/capitalallocationreport

EYG no. 008055-21Gbl
BSC no. 2010-3600469

ED None