Sustainable Competitive Advantage for Accountable Care Organizations

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EXECUTIVE SUMMARY

In the current period of health industry reform, accountable care organizations (ACOs) have emerged as a new model for the delivery of high-quality and cost-effective healthcare. However, few ACOs operate in direct competition with one another, and the accountable care business model has yet to present a means of continually developing new marginal value for patients and network partners. With value-based purchasing and patient consumerism strengthening as market forces, ACOs must build organizational sustainability and competitive advantage to meet the value demands set by customers and competitors.

This essay proposes a strategy, adapted from the disciplines of agile software development and Lean product development, through which ACOs can engage internal and external customers in the development of new products that will provide sustainability and competitive advantage to the organization by decreasing waste in development, promoting specialized knowledge, and closely targeting customer value.

For more information about the concepts in this essay, contact Mr. Macfarlane at macfarlane.a@gmail.com. Mr. Macfarlane is the first-place winner of the graduate division of the 2014 ACHE Richard J. Stull Student Essay Competition in Healthcare Management. For more information about this competition, contact Sheila T. Brown at (312) 424-9316.
ACCOUNTABLE CARE ORGANIZATIONS IN COMPETITION

Since 2011, the number of Centers for Medicare & Medicaid Services (CMS)–sponsored accountable care organizations (ACOs) has expanded from 23 pioneer organizations to more than 300 ACOs. The rapid growth of the ACO model has confirmed the early advantages of accountable care, among them that more than 40% of U.S. residents who live in primary care service areas are served by at least one ACO (Gandhi & Weil, 2012). Although ACOs have created a market space in which they are competitive with existing models of healthcare delivery and are beginning to demonstrate an ability to improve health outcomes and reduce cost, little discussion has been given to how ACOs will compete and coexist in the same market. If the explosive growth of ACOs continues, many organizations will be forced to share service areas with competitors and develop strategies for attaining competitive advantage.

However, tools and strategies have been developed in other industries that may help ACOs achieve sustainable competitive advantage. Using a framework of strategic “imaginations,” ACOs can identify customers and market opportunities within a rapidly changing environment. By pursuing a product development strategy that reinforces operational and network sustainability through the identification of new customer value areas, an ACO can provide a diverse mix of low-cost, high-value products and features that will enable it to remain competitive with its peer organizations.

COMPETITIVE ADVANTAGE STRATEGIES

Strategic Imaginations

Generally, competitive advantage is the result of an organization's access to internal or external knowledge and resources. Organizations with better access to valued resources, or in possession of knowledge that allows them to make better decisions, hold an advantage over their competitors (Wang, Lin, & Chu, 2011). By definition, ACOs benefit from a competitive advantage relative to traditional models of care delivery: The ability to coordinate patient care across a continuum of services produces improved health outcomes for a lower cost of care. However, because this capability is a result of the ACO’s organizational design, it does not provide a competitive advantage relative to other ACOs.

To create a competitive advantage, many ACOs have pursued a strategy of quality and cost leadership. Such strategies follow from the incentives created by CMS’s pioneer ACO, Medicare Shared Savings, and Hospital Value-Based Purchasing programs, which reward the delivery of high-quality care by allowing ACO-affiliated providers to share net savings resulting from effective care management (CMS, 2012). Unfortunately, these approaches cannot effectively produce long-term strategic advantage for ACOs; because cost and quality standards are set by third-party payers, such as Medicare and Medicaid, any advantage gained in a specific market can be erased by shifts in minimum requirements for value-based purchasing. Thus, applying a cost and quality strategy to competitive ACOs is
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detrimental to the market, as cost competition between ACOs will ultimately affect the ability to deliver safe, high-quality, and effective care.

Rather than attempting to translate the competitive strategies of legacy business models and fee-for-service reimbursement to the newly created market of competitive accountable care, ACOs should pursue unique strategies based on their own organizational structure and customer value configuration. Following the model proposed by Roos & Victor (2006), ACOs should adopt approaches derived from the “three imaginations”—description, creation, and challenge—unique to the organization.

The descriptive imagination creates an image of the external environment, including competitors, partners, and the regulatory landscape, identifying patterns in the environment and challenges to the organization. The creative imagination responds to the image derived from the descriptive imagination, creating solutions and suggesting value configurations. The challenge imagination evaluates the assumptions of the creative and descriptive imaginations by challenging hypotheses and organizational truths and promoting disruptive innovations (Roos & Victor, 2006).

As applied by Siemens, this framework for strategy crafting has proven effective when market shifts threaten the organization’s access to resources or customers (Gibbert, 2004). Applied to ACOs, the three imaginations allow competitive organizations to form hypotheses about market and value conditions that stem from organizational and customer intelligence rather than from generic market knowledge. The new, tacit knowledge resulting from this process (see Figure 1) provides the organization with an inimitable advantage over competitors.

**Sustainability**

Sustainable management strategy emerges when organizations engage in *biomimicry*, or the imitation of naturally sustainable cycles of growth, decay, and regeneration. For the healthcare organization, sustainable strategies must reduce waste resulting from the production, use, and disuse of goods and services (Senge & Carstedt, 2001). Sustainability for ACOs can be framed in terms of operational and network management, with the primary goal of reducing waste arising from operations and network attrition. Sustainable operations seek to reduce operational waste, or the net of an ACO’s variable costs, which includes the net waste produced by discontinuities in patient care, variations in practice among providers, and rework resulting from inadequate communication. Sustainable network management, in contrast, focuses on reducing the fixed costs associated with assembling and maintaining the ACO’s delivery network.

The operational and network hemispheres of ACO sustainability are critical codrivers of strategic advantage in the competitive accountable care environment. Improved operational sustainability reduces the ACO’s exposure to variable costs, resulting in greater opportunity for shared savings among network partners and long-term stability within the network. Similarly, a
identifying novel or improved products or services on the basis of the organization’s hypotheses about consumer value configurations, market competition, and the value added by new products or services to the organization’s business plan and strategy (Zuckerman, 2005).

When applied in emerging and highly competitive markets, however, these hypotheses are vulnerable to the effects of disruptive innovations, which rewrite customer expectations and value configurations. As a result, industries and markets in which the impact of disruption is strong, such as software development and technology start-ups, have created product development sustainable ACO network with few disruptions among providers and partners is able to engage in long-term organizational learning, developing new ways to produce value for internal and external customers (see Figure 2).

**Product Development**

If ACOs cannot create or sustain competitive advantage on the basis of classical market differentiation strategies, such as cost and quality leadership, they must create and sustain an advantageous position through the discovery of new value opportunities within the market. Defined broadly, product development is the process of identifying novel or improved products or services on the basis of the organization’s hypotheses about consumer value configurations, market competition, and the value added by new products or services to the organization’s business plan and strategy (Zuckerman, 2005).

**FIGURE 1**

The Three Strategic Imaginations

**Descriptive Imagination**
- Environmental analysis
- Evaluation of partners and competitors

**Challenge Imagination**
- Confronts dissatisfaction with descriptive image and creative solutions
- Promotes disruptive innovations

**Creative Imagination**
- Problem solving
- Discovering new value configurations

strategies that address these shortcomings by leveraging customers as a resource to validate the hypotheses contained in a business or product plan.

The product development strategies adapted in highly disruptive industries closely follow the Lean management framework that evolved from the Toyota Production System, which identifies the voice of the customer as the ultimate determinant of value (Joint Commission Resources, 2006). The principles of Lean are also at the core of customer-driven strategies such as agile software development and, as the term implies, the Lean start-up model. These consumer-driven frameworks have produced the highly consumer-focused product development strategies of build–measure–learn and minimally viable products (MVPs). Applied to ACOs, these strategies act as drivers of operational and network sustainability, allowing the ACO to develop knowledge and resource-based tools of competitive advantage that are unique to the organization and its imaginations.

**FIGURE 2**
The Relationship Between Sustainability and Competitive Advantage

Reduced variation in care processes improves outcomes, increasing likelihood of shared savings distributed to network.

Operational Sustainability
- Lower Variable Costs
- Member Satisfaction

Competitive Accountable Care Organization
- Lower Fixed Costs
- Partner Satisfaction

Network Sustainability

Reduced turnover of network partners reduces variability of ACO services, improving operational sustainability

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**PROCESS IMPROVEMENT AND COMPETITIVE ADVANTAGE**

**Build–Measure–Learn Cycle**

Most healthcare organizations are currently engaged in some form of process improvement based on the Plan–Do–Study–Act (PDSA) model. This model provides an iterative framework for engaging in validated learning about the effectiveness of current organizational processes (IHI, 2012). However, PDSA is insufficient for generating customer value or new products, because it does not validate the organizational hypotheses about customer value. To continuously create customer value, ACOs require a process that engages customers in evaluating business hypotheses, transforming them from the passive recipients of business strategies to cocreators of highly customized strategies.

An evolution from PDSA and a result of the impact of emergent and disruptive technologies in software development, the build–measure–learn
ACO’s internal customers in the development of ideas and products allows for the early identification of value misalignment between network partners, preventing the cost and disruption of partner turnover and providing an opportunity to develop consensus with mutually beneficial features and service configurations within the ACO. (Although internal customer codevelopment is also an important phase of idea and product development, it often is pursued at the expense of external customer codevelopment.)

Minimally Viable Products
One of the greatest challenges in developing a good, service, or business strategy is striking an appropriate balance of development costs and time and product sophistication. In response to these pressures, agile software developers conceptualized the MVP model. Unlike in traditional product development, the

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**Figure 3**
The Build–Measure–Learn Cycle

Source: Reis (2011).
goal of MVP development is to produce the smallest bundle of features that creates value for the customer (Junk, 2000). As outlined in Table 1, MVPs do not include all the features that the organization believes its customers want. Rather, they are the smallest bundle of features that represent a value hypothesis that can be tested in a build–measure–learn cycle or similar customer-centered development process (Reis, 2011). Because MVPs target the organization’s customers, the validation process results in unique and valuable tacit knowledge of customer value configurations (Lubit, 2001). MVPs have the potential to significantly increase the speed at which the organization creates new business products and the net customer value of

<table>
<thead>
<tr>
<th>Table 1</th>
<th>Comparison of Product Development Methods</th>
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<tr>
<td>Product development philosophy</td>
<td>Traditional Product Development</td>
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<tr>
<td></td>
<td>Develop a product or service that maximizes market share and minimizes production costs (scalable)</td>
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<tr>
<td>Development goal</td>
<td>Produce market-ready product</td>
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<tr>
<td>Structure and timing of development activities</td>
<td>Linear: New products developed at end of current product life cycle</td>
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<tr>
<td>Key development partners</td>
<td>Engineers, marketers, product managers</td>
</tr>
<tr>
<td>Customer value engagement</td>
<td>Occurs at end of product development cycle; customers engage with finished products and provide input on product marketing (price, branding, etc.)</td>
</tr>
<tr>
<td>Product features</td>
<td>Complete, final feature set to compete with similar products and services</td>
</tr>
<tr>
<td>Production scalability</td>
<td>Designed for scalability into mass production</td>
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Sources. Reis (2011); Junk (2000); Campos, Norman, & Jadad (2011).
the organization’s market offerings. Similar to the agile philosophy, MVPs are intended to deliver rapid incremental additions to customer value (Beck et al., 2001). Favoring speed over quality, individual MVPs have a low cost of development and relatively small impact on net customer value. However, through rapid iteration, MVPs provide organizations with validated intelligence about the direction of customer value. For example, Amazon.com recently demonstrated a delivery system using automated aerial drones (Rose, 2013). Despite lacking the regulatory guidelines, distribution infrastructure, and drone technology to deliver this innovation to its major markets, Amazon has successfully answered the underlying question of whether its customers are interested in new methods of package delivery. Rather than fully developing the service, Amazon created an MVP to validate assumptions about a customer value proposition.

**Market Applications**

The application of build–measure–learn and MVPs by ACOs promises to produce the knowledge and resources necessary to thrive in a competitive market by allowing them to develop offerings that are responsive to customer needs. For example, ACOs are challenged by the negative outlook shared by a majority of the millennial generation regarding the costs and quality of healthcare prompted by passage of the Affordable Care Act, which suggests an ambivalence toward new models of care delivery among this demographic (IOP, 2013). Lack of engagement among millennials, who consist of a generally low-utilization population, will directly threaten ACO sustainability, considering that their participation helps ACOs offset costs to treat high-utilization groups. Using MVPs and build–measure–learn, ACOs can test assumptions about these customers’ opinions of value in particular and design sets of features that match the resulting value configuration. The ability of an ACO to differentiate in the local market by meeting the specific value configuration of its members and partners will allow the network to capture and retain members and partners, providing a competitive and sustainable advantage.

**Conclusion**

For ACOs to develop competitive advantage in the marketplace, they must have the ability to meet the value requirements of internal and external customers. As the ACO market becomes increasingly crowded, those organizations focused on delivering customer value will enjoy greater insulation than others from shifting cost and quality targets set by third-party payers. However, sustaining such an advantage demands that ACOs engage with customers in novel ways, such as having them participate as cocreators of unique and highly customized products. By focusing on the development of validated customer value hypotheses, ACOs substantially reduce the waste incurred in the production of noncompetitive products and services while gathering tacit knowledge about value configurations among internal and external customers. The accrual of savings in development costs and higher
satisfaction among external customers will in turn allow ACOs to operate stable networks of satisfied partners, reducing the organization’s exposure to the costs of losing its network partners, including payers, provider groups, and acute care networks, and perpetuating a cycle of organizational sustainability that will drive long-term success.

REFERENCES