A review of global leadership issues
and industry trends

Positioned for Growth: Leadership needs for the generics industry's next phase of development

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The next several years promise to be a time of great opportunity and dramatic change for generics companies. With generics already representing a large and growing share of the pharmaceutical market — and 65 percent of prescriptions filled in the U.S. during 2008 — generics companies are looking ahead to the patent expirations of tens of billions of dollars of branded drugs over the next several years. Generics companies also are expanding their geographic footprints to meet the growing demand in emerging markets for prescription drugs. Finally, innovation will be high on the agenda for most generics companies, as they pursue new technologies and difficult-to-produce formulas, with some looking ahead to the development of generic versions of biologic pharmaceutical products, so-called biosimilars.

To seize the opportunities before them, generics companies will need strong and sophisticated leadership drawn from Big Pharma and other industry sectors, where executives skilled in operations, customer service, supply chain and other critical functional areas can be found. To succeed, these leaders not only need the requisite functional expertise, but also must represent a good cultural fit with the unique and dynamic generics culture. Having shed its image as a mere low-cost copier of Rx brands, the generics industry has emerged as a more attractive career path for executives with the right skills and the ability to adapt to its fast pace and entrepreneurial nature.

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To further explore how the generics industry has changed and the impact on companies' leadership needs, consultants in Spencer Stuart's Life Sciences Practice spoke with senior leaders of generics businesses around the world about their strategies for the future, their evolving leadership needs and how the industry is addressing its talent needs.

Looking ahead: Generics industry trends

While they have many exciting opportunities before them, generics companies also face a variety of challenges. Pricing pressure continues to grow, due to intense competition and, in some markets, the consolidation of retail customers and efforts by retailers or governments to lower drug prices. Innovation is required, yet investments in new technologies will be substantial and, especially in the case of biologics, may be out of reach for many companies. Many companies that grew opportunistically in the past are finding that long-term success requires them to evolve to more strategic, sustainable approaches to the business today. As the gap between industry leaders and new entrants widens, it is ever more important that companies define the right strategies for their organizations and execute flawlessly.

Regardless of companies' specific strategies, improving time to market and achieving economies of scale remain fundamental to success in generics. Speed and price have been the traditional drivers of the generics industry; improving performance in these areas is an even greater imperative today. Generics companies are facing pressure from multiple directions; on the pricing side, competition from lower-priced entrants and negotiated cost controls from retailers and governments are reducing margins, while the costs related to registering products and litigating patents have grown.

"Price will be the dominant factor for the business," observed Hans-Helmut Fabry, country head Sandoz Germany. "The challenge for generics companies is less about managing the life cycle of products than managing the price cycle."

The attention to cost suggests that generics companies will be more strategic in evaluating which opportunities make sense for them to pursue, including which molecules, formulas, delivery forms and technologies to invest in or develop. Generics companies and their leaders must understand what their companies do well and make sure they pursue only those opportunities where they can excel.

"Generics companies traditionally have been extremely opportunistic and the entire approach has been to try and grab opportunities as they present themselves," argued Saumen Chakraborty, president of corporate and global generics operations for Dr. Reddy's Laboratories. "The shift now is toward a more strategic, sustainable approach providing more consistent performance," he said. "As you move to this more strategic mindset, the big difference is that you need to start calibrating across the entire value chain from end to end and this applies to your investments as well."

A major focus will be innovating improvements designed to lower costs across the value chain. As they expand in size and geographic reach, generics companies are looking for more strategic and cost-effective ways of operating. For example, many companies are evaluating whether to centralize certain functions into global roles to derive economies of scale. While commercial roles and others that require local relationships will remain local or regional functions, others — such as research and development, manufacturing and elements of supply chain — may well be more efficiently managed if centralized.

Amar Lulla, chief executive and joint managing director of Cipla, said he expects the entire organization to focus on improving performance and reducing costs. "Innovation has to focus on finding new ways to work and creating new efficiencies. It has to be ingrained in the genetic code of the organization. We need to be prepared to see everything we do differently. Whether it is a product, marketing, launches, logistics or distribution, we

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want to do everything in a manner that is more efficient and innovative."

With competition on the rise and customers consolidating, strong customer relationships and customer service have never been more important. In addition to controlling costs, generics companies are focused on ensuring product quality, providing excellent customer service through product assortment and reliable delivery and staying close to customers and market developments. Executives said they do this by limiting the number of organizational layers, remaining adaptable and working closely with customers.

"You need to be linked within the customer's DNA, from the top of the organization down to the bottom," said William S. Marth, president and CEO of Teva North America. One way Teva builds these rich customer relationships is by closely aligning its distribution with key customers. "We put product where they want it, the moment they want it."

Addressing the generics industry talent shortage

Generics companies are facing a talent shortage — and it is not just a matter of numbers. Not only will generics companies need more leaders in a wide variety of positions to address growth and the new opportunities before them, the required skill-sets represent a composite of capabilities that will have to be found from multiple industries. The generics industry has emerged as distinctly different from other industries; as such, no other life sciences or consumer sector represents an exact match for leadership talent.

So, where will the generics industry find the leaders for tomorrow? Traditional pharmaceutical businesses will continue to be a source of executive talent for roles in research and product development. To fill commercial roles, generics companies are likely to look for talent across a wider breadth of life sciences sectors and in other more regulated industries, such as over-the-counter (OTC) drugs and consumer healthcare products.

Finally, as they continue to seek out new ideas and best practices from other industries to take operations and market-facing functions to the next level of sophistication, generics companies will have to look outside life sciences. For example, general managers and commercial leaders may be found in retail or fast-moving consumer goods, where speed, customer insight and the ability to work in a tight-margin environment are critical. Sectors with strong manufacturing and supply chain operations, such as electronics or automotive, may be good sources for senior-level operational leaders. Those industries that produce executives who are highly trained in Six Sigma principles and practices may prove to be especially valuable sources of talent.

General managers and other senior leaders must have a broader skill-set than in the past and be capable of managing the growing complexity of the generics business. These must be "hands-on" leaders who also are solid strategic thinkers willing to explore counterintuitive approaches to the traditional ways of doing business. They must have excellent communication and influencing skills and exceptional professional credentials.

"Leaders need to be analytical, able to strategize on a process and stay with the facts," said Fabry. "They also have to be able to turn around quickly, improvise and go in a different direction. Executives should be agile and eager to learn. They should have an international mindset and be credible and empathetic to the organization." Horst Uwe Groh, global head of HR for Sandoz International, said Sandoz has similar priorities when recruiting. "When we look outside for talent, the most important priorities are to find people with a multicultural mindset, who are more focused and aggressive than others. They have to have a sense of urgency. The generics industry is becoming increasingly professional and education is more relevant than ever," he said.

At the same time, leaders must be taskmasters when it comes to wringing out costs, improving efficiency and delivering product to market, argued Chakraborty. "Speed and execution are going to be absolutely critical, more than ever, and that is going to take a degree of hard taskmaster kind of leadership."

Companies also will have specific talent needs based on their strategies. For example, as they pursue the development of biosimilars, Teva and Watson are building their technical and R&D capabilities and expect to need additional marketing and sales muscle as well. "To be successful going forward, we're going to have to select the right products, have the right people in place to develop those products, test them, do the right clinical studies and then work through the legal and regulatory morass to get those products to market," said Paul M. Bisaro, CEO of Watson Pharmaceuticals. "Therefore, we will need additional Ph.D.s and chemists, the clinical people to design and run the necessary clinical studies, and the marketing and sales teams to manage the different models for generic biologics."

Similarly, Cipla's model — which focuses on developing different delivery models for molecules where safety and efficacy are well-established — requires leaders with a unique mindset. "We're trying to do things to improve a patient's quality of life or compliance, such as combining three drugs into one inhaler so the patient gets the full treatment in one dose," Lulla said. "This is a different mindset from a more discovery-oriented one."

As they recruit executives from other industries, companies will have to look for people open to being "retooled" for the generics industry. Those who bring functional expertise, but are unable to adapt to the unique generics culture, are unlikely to excel. Executives from branded pharmaceutical businesses have the right skills and expertise for many roles — and more are available in some markets due to consolidation in the pharmaceutical business. However, to be successful in generics, these executives must be able to move in a fast-paced environment, work within tighter margins and understand that innovation doesn't just come from the lab, but from the whole value chain. Meanwhile, executives from retail or FMCG companies are attractive based on their proven ability to work within a fast-paced environment that is focused on customer service, but have to adapt to the demands and constraints of a regulated environment. OTC and other consumer healthcare executives, who already straddle the consumer and regulated worlds, may have an easier transition to generics.

An overarching challenge for generics companies will be to find the leaders with the mindset to adapt to the generics business — whether they come from traditional pharmaceutical companies or from outside of life sciences entirely. "The generics business is built around entrepreneurship and speed of action. We try to make decisions in short order, not in a month's timeframe. Some people can easily make that transition, and others do not. The talent is out there. The question is, can they assimilate into a new culture?" said Bisaro.

U. Mark Schneider, president and CEO of Fresenius Group, agrees that generics has a distinctly different pace than other healthcare segments. "In generics, there is a greater sense of urgency and a unique culture. It's more entrepreneurial. Generics companies don't have the same long-term horizon as branded pharmaceutical businesses. It's all about fast decision making and achieving a high hit rate — playing hockey rather than chess. They are also much more cautious about spending and watch selling, general and administrative costs like a hawk." Generics company executives said their leaders are empowered to experiment and make decisions, without lengthy approval processes or "decisions by committee." Marth uses a basketball analogy to explain the expectations on Teva's leaders. "We have a philosophy that if there are three seconds left in the game and you have the ball, take the shot. I tell that to our customers. I tell it to our employees. I want you to take the shot. I didn't give you the ball to pass it. You're never going to get punished here for having tried and failed, but you have to be accountable."

Conclusion

The traditional path to success in generics will not be the way of the future. The business today is more complex and requires strategic and sophisticated leaders who operate with a sense of urgency and an eye to continually improving efficiency.

Because of the industry's fast growth and the changing nature of the business, generics companies will have to look outside the sector for new talent. Sources of talent include the retail, fast-moving consumer goods and traditional pharmaceutical industries as well as businesses with strong manufacturing and supply chain operations, such as electronics or automotive. The challenge will be to incorporate the ideas and best practices these new leaders bring, while maintaining a culture that promotes the speed and efficiency so critical to the success of generics companies.

How can companies in this dynamic and growing industry make sure they have the right talent? We offer several considerations below.

> Understand that executives from other industries will have to be "retooled" if they are to be successful in the generics industry. Pharmaceutical executives have the technical knowledge and understand the regulatory aspects of the role, but may be less prepared for generics' fast pace and sense of urgency. Meanwhile, executives from less-regulated industries may be comfortable with the industry's speed and thin margins, but have to adjust to operating within regulatory frameworks.

> Companies must identify the core capabilities of leaders who are able to transition between industries and recruit executives who have a demonstrated track record of successful transitions. Individuals who have had to be agile under new conditions, such as an international assignment, often have the mindset required to make the transition.

> Changes in the pharmaceutical business may make it easier for generics companies to recruit and transition pharma leaders in the future. As Schneider explained, "The pharmaceuticals and generics industries once represented the extremes of entrepreneurship. Today, pharma leaders regard the pace, flexibility and entrepreneurship of the generics industry very highly. The readiness of both sides to learn from each other has increased."

About the authors

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Talent at the intersection of consumer and life sciences

Eric Leventhal — New York, with contributions from Mark Broer — London

The healthcare industry is on the precipice of enormous change that will play out in the months and years to come. The Merck/Schering-Plough and Pfizer/Wyeth deals stand as Exhibits A and B for the next round of life sciences industry consolidation. But an important and relatively unexamined subtext to these macro-industry trends is the future role of consumer businesses in the context of Big Pharma.

Historically, the consumer divisions of Big Pharma have been relegated to mere footnotes in company earnings announcements or press releases, especially when compared to the "star" status afforded to the much larger and highly profitable prescription drug businesses.

However, as blockbuster drugs go off patent, regulatory processes grow more complicated and pharmaceutical companies seek external partners to rebuild their pipelines, the perception of consumer health divisions has changed. Many Big Pharma companies now see their consumer businesses — ranging from over-the-counter drugs, nutritionals/supplements, oral healthcare and dermatological products — as valuable and consistent sources of cash flow and profit, off-setting the peaks and valleys of the Rx business. While they may not enjoy the profit margins of prescription drugs, the consumer businesses don't require nearly the same lead time or upfront investment in research and development. And, in fact, the aggregate net sales of consumer divisions within the world's top 15 Big Pharma companies amount to a very meaningful $40 billion.

To further explore the evolution of the consumer healthcare business and the industry's talent needs, consultants in Spencer Stuart's Consumer Goods & Services and Life Sciences practices interviewed senior industry executives to explore the changing landscape and define how these changes impact the leadership profile.

Building a portfolio for growth

Shortly after taking over as CEO of GlaxoSmithKline, Andrew Witty made it clear to the company and its investors that a strong and growing consumer healthcare business would be a core element of GSK's strategy. Although it represents just 15 percent of the company's overall revenue, the consumer business had built a track record of double-digit growth. In addition to providing a steady stream of revenue and profits, the consumer business serves as a platform for growth in emerging markets, where drugs are sometimes sold by pharmacists without a prescription and paid for privately.

"While the pharmaceutical business is an extremely good one, there is a real opportunity to be more diversified in terms of where we source our earnings," said Tim Wright, who leads GSK's Future Group, which oversees the innovation and marketing efforts for the company's seven global consumer healthcare brands.

GSK is not alone among Big Pharma companies in elevating their consumer health businesses, which are becoming more global and more strategic to their parent companies. And as these businesses play a more important role, companies have increased their investment in people and infrastructure to support them, building more sophisticated teams and, in many cases, restructuring to create autonomous, stand-alone consumer organizations.

These new business units require different leaders than the consumer healthcare leaders of the past. Traditionally, consumer talent was spread across global operations and was deeply embedded in regional teams, which primarily focused on the Rx business. Local consumer executives were commercial leaders whose main role was to manage relationships with distributors and partners. Ideas were imported from corporate headquarters and the goal was to execute these ideas well in the field. Much smaller than the Rx business in any single region, the consumer business often didn't receive the management focus and support it needed to grow. Many companies we interviewed have evolved to a new model in which regional or country general managers run the consumer business as a stand-alone unit within their respective geographies and report to a global consumer leader. Even at the country business unit level, these leaders oversee full cross-functional teams, including sales, marketing, finance, human resources and supply chain. Beyond supporting ideas and programs generated from headquarters, regional and country leaders are expected to generate their own new product and business development ideas — and share them globally.

Emerging profile: Characteristics of the new consumer healthcare leader

In light of their higher profile in the organization and the increased demands they face, consumer healthcare leaders today must possess a broad set of high-level skills and capabilities, including the following:

A strategic mindset

Consumer healthcare leaders face new expectations because of their businesses' aggressive growth targets and global strategies. They are responsible for the key strategic decisions within their regions and contribute to discussions about which brands have the potential to be global and which are likely to remain regional or local.

To achieve its goal of becoming a top-10 player in the consumer healthcare space, Merck's consumer business plans on roughly doubling its current revenue, said Peter Shotter, president of Merck Consumer Health Care for Merck KGaA. "To do that, we need people who are good at what they do and have the courage of their convictions. Of course, the sort of leadership team you have in a business like ours is going to be very results-driven. They're going to have good customer orientation and consumer orientation. They're going to have strong strategic skills in terms of where to take the business," he said.

Because they tend to have smaller organizations than the traditional Rx business and the products have a shorter time-to-market, leaders of consumer healthcare businesses must possess a sense of urgency and ownership. "Our top leaders own key issues. They roll up their sleeves and dig in. They're not people who ask for an analysis and wait two months. That sense of urgency and the ability to go deep is something we look for," said Larry Allgaier, global head of Novartis OTC.

Business development skills

Business development, including M&A, partnerships and joint ventures, has emerged as a core competency for consumer healthcare leaders at many companies.

"My expectation is that our country business unit managers will all be business development hunters in addition to running our business day-to-day," said Brent Saunders, president of Schering-Plough Consumer. "They should be looking for and proposing local product business development. We may not do them all and they may not find anything worthwhile, but I expect them all to try."

Local knowledge and relationships

Consumer healthcare leaders also require an external orientation and knowledge about the local market and regulatory framework. "There is an

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ambassadorship, a consistent collaboration with regulatory authorities, with NGOs (nongovernmental organizations) and with the key opinion leaders," said Ashley McEvoy, formerly the president of J&J's McNeil Consumer division and now worldwide president of Ethicon Products. "In many of these countries, you can't do business by yourself — you have to enter into a partnership with a local company — so you need good business collaboration, leadership and influencing skills. Leaders also have to be able to build a team of highly entrepreneurial creative leaders because in many of these regions, they are not getting fed from centralized global resources."

Schering-Plough's country managers are expected to become "insiders" in their country, said Saunders. "That means they develop relationships with customers. That means they do local business development. That means they know the key regulatory people within their country or have access to ask questions to the appropriate regulatory officials to move things forward. They need to understand the marketing needs and requirements of their local system," he said.

Ability to influence local consumers and professionals

A core skill for consumer healthcare leaders — like leaders of any consumer business — is the ability to understand consumer preferences and behaviors and apply consumer insights to the business, executives said. Leaders of consumer healthcare businesses also have to have strong commercial skills.

"You have to focus on the consumer marketing skills, of course, but also the trade marketing skills. Those are commercial skills, driving point-of-sale visibility. It's the combination of those two areas that are the core," said Shotter.

McEvoy added, "I like to say that, if you open up the doors to the back office, we're a mini pharmaceutical company. We're regulated like a drug company, but our front end is very consumer-like. We show up in consumers' medicine cabinets, so we have to think about things like what the packaging looks like. To be successful, you need the marketing acumen of a consumer-driven company and the ability to inject consumer insight into R&D. General management must have a fine balance of both."

Consumer experience wanted

The skill-set that has emerged for general managers in the consumer healthcare product arena suggests that, as companies continue to build their leadership teams, the consumer packaged goods (CPG) industry will provide a good source of talent. We believe that one of the key factors that should pave the path for transition between CPG and consumer health is the ongoing convergence of sectors such as OTC, nutrition and supplements, personal care and beauty, and functional food and beverage, all of which are chasing the same consumer end benefit of "wellness." This convergence has lowered some of the traditional hurdles that made it difficult for executives to change sectors, and made expertise in one category more transferable to another.

The executives we interviewed agreed that a strong background in sales, marketing and general management within consumer goods provides an excellent foundation for consumer healthcare leadership. It has long been held that CPG experience helps executives develop critical skills in strategic planning, P&L management, competitive analysis, the ability to understand and apply consumer insights to initiatives and strong advertising and brand building.

Debra Sandler, worldwide president of McNeil Nutritional, Johnson & Johnson, said executives with consumer marketing training often have "the longest runway" as leaders. "What makes them the strongest? They are trained to communicate effectively. They are trained to analyze situations quickly and put together an effective plan. The really good marketers are able to do that in a cross-functional way. They understand the business from varying viewpoints and recognize that all of the functions have to move along in the same direction. Some other functions, by contrast, often see themselves as independent."

And, in fact, entrepreneurial CPG executives are more likely than in the past to see consumer healthcare businesses as an attractive career path because of the wellness trend and the increased prominence of consumer healthcare businesses. In some cases, consumer healthcare businesses offer a faster track to senior positions, said Christian Neu, president of Danone Baby Nutrition. "There is more flexibility here than in some CPG companies, and one can take on more responsibility earlier in their careers than at others."

Avoiding the pitfalls

Classically trained consumer executives bring valuable business and marketing skills, but consumer healthcare businesses must recruit thoughtfully and carefully integrate CPG leaders. One of the biggest challenges for these leaders can be a lack of appreciation for the different regulatory aspects of the role compared with pure consumer businesses. Some former CPG executives can grow impatient by the longer product development and approval cycles for consumer healthcare products.

"A lot of times, consumer product people come into consumer health with great ideas about how they're going to hit a home run, not recognizing that the regulatory scheme is incredibly complex compared to the standard CPG world and requires a lot of forward thinking," said Saunders. "For example, if you have a great idea for a product in China, you may have to wait two, three or four years to get the regulatory approval to launch that product. So, you have to have much longer thought horizons. You have to build your pipeline strategically and you have to be patient. Once you get approval, it's a very dynamic environment and, because you have to operate in a very complex regulatory scheme, good planning is critical to success."

Potential conflicts also arise because of the difference between the way traditional CPG companies approach "health" and the process consumer healthcare companies undertake to demonstrate a health claim, said Sandler. "CPG companies do not have the same hard-core clinical and regulatory framework. Food companies may use GRAS (generally recognized as safe) ingredients. And while these are in fact safe for consumption, healthcare scientists and lawyers often have concerns about these types of ingredients because they do not always have the body of scientific evidence preferred for pharmaceutical products. They're concerned when food marketers walk in the door because they feel strongly that they don't understand how it's done in real healthcare."

Can companies avoid the pitfalls when recruiting executives with a traditional consumer background?
Consumer healthcare executives shared best practices for recruiting and assimilating consumer executives into their organizations.

Clearly communicate the differences between a classic consumer company and a consumer healthcare business.
During the interview, emphasize the impact of the regulatory framework on the product development process and timing and marketing approaches. Convey the importance of respecting the scientific and regulatory processes.

"Consumer-trained executives sometimes become frustrated when they join a more regulated market because those fast-to-market initiatives are more limited in over-the-counter, particularly in countries outside the U.S., where regulatory approvals almost approach a drug approval in length. So, we have to be careful when we hire people from the consumer world to make sure they understand that," said Gary Balkema, worldwide president of the consumer care division for Bayer HealthCare.

Thoroughly vet candidates for their cultural fit and orientation

In general, CPG executives who transition successfully recognize the different challenges they could face in learning to work within the regulatory framework, but also have a performance-focused, roll-up-your-sleeves orientation and a mindset open to learning. It's important to make sure candidates represent a good fit with that culture.

"One of the things that I try to probe for during the interview process and reference checks is whether the candidate is a self-starter — whether the person can stand on his or her own two feet and can take ownership for a business or grow a business without a lot of hand-holding and one-on-one interaction with headquarters," said Saunders.

Successful executives often demonstrate these capabilities in overseas assignments, where they typically do not have the same level of support as in headquarters. "I really like to see success on the ground in an international market far away from headquarters. How did the person overcome obstacles or build capabilities without all the functional help that is available at headquarters? I peel into those examples where people had to get creative and solve problems without a lot of money," said Allgaier. Beyond that, Allgaier looks for what he calls "the Novartis edge." "It's more performance-oriented. It's higher agility, the ability to instigate and lead and manage change to overcome barriers."

Look for appropriate transition roles

When recruiting an executive from a pure consumer background, brands and businesses with a lower regulatory threshold may provide a smoother and more gradual transition into the consumer healthcare business.

"Our product line spans dietary supplements and analgesics, right through to products that might be Rx in some markets and over-the-counter in others, such as CardioAspirin. The easiest transition is into the more traditional over-the-counter medications and nutritional supplements businesses, compared to joining an Rx/OTC switch project, where you would want someone who has more seasoning in and understanding of the very complex regulatory side of the business," said Balkema.

Set the right tone from the start

Once an executive has joined the company, it's important that he or she quickly learns the internal and regulatory processes. Bayer instills this orientation immediately by emphasizing that the medical, regulatory and marketing people are a team. "None of the three can be successful unless they work together. If they are not all in sync, nothing happens," said Balkema.

Setting the tone can happen through training or through mentoring relationships. At Danone, newcomers spend at least two to three weeks at headquarters to meet people and learn about the company. "I think most people adopt quite readily when they have this perspective. They understand that there are some things they can't change," said Neu, adding, "You can drive 200 kilometers an hour on the highway, but you have to stay on the road. Regulations have to be seen as fixed."

New marketing and general management executives can help build collaborative relationships with R&D and regulatory teams by showing an interest in the science and regulatory aspects of the product development. "There often is a perception that executives from consumer companies are going to want to cut corners and they're not interested in true science. But the minute you do a little bit of

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homework and read the clinical, you show you're interested in their point of view," said Sandler.

Conclusion

Life sciences companies, especially Big Pharma, have begun to focus more energy and attention on their consumer health businesses. As the broadly defined healthcare sector continues to evolve and consolidate, we believe consumer health businesses represent an exciting career opportunity for top talent from a variety of consumer backgrounds. By paying close attention to cultural fit and ensuring new executives receive appropriate training and mentoring, companies can ease their transition to the more highly regulated business.

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Healthcare reform on the agenda: A discussion with American Hospital Association Chairman Thomas M. Priselac

Jack R. Schlosser — Los Angeles

As in many other countries, healthcare reform emerged as a prominent issue on the national stage during the 2008 U.S. presidential election, as concerns about healthcare accessibility and the impact of rising healthcare costs on families, businesses and taxpayers pushed the issue to the front burner.

The American Hospital Association (AHA) and its 2009 chairman, Thomas M. Priselac, intend to play a prominent role in the national discussion about healthcare reform during the coming months and years.

Active in the healthcare industry for more than 30 years, Priselac has been president and CEO of Cedars-Sinai Medical Center since 1994, after having served as executive vice president for six years. He joined Cedars-Sinai in 1979 from Montefiore Hospital in Pittsburgh. Priselac has been extremely active in the broader healthcare community, serving in board roles in organizations such as the Association of American Medical Colleges, the Hospital Association of Southern California, the California Hospital Association and the Council of Teaching Hospitals of the Association of American Medical Colleges. He also serves as an adjunct faculty member of the UCLA School of Public Health.

Spencer Stuart consultant Jack Schlosser spoke with Priselac in late March about his new role, his vision for the U.S. healthcare system and the implications for healthcare leaders of the dramatic changes to come.

We're seeing momentum behind healthcare reform. In your view, what should the healthcare system look like in about 2012?

Priselac: First, to provide some context, I would say that 2012 would represent just the beginning of the next phase of the evolution of the American healthcare system. The system is an enormous ship — representing 16 percent of the nation's GDP — and meaningful change by definition will take time. And, in fact, many of the initial payment reform proposals that the Obama Administration is talking about would only begin to take effect in 2011. So, changing the American healthcare system is going to be a long and arduous process that would be underway in 2012. Then, it may take decades to see how the changes will affect various health status indicators.

What are the discussions about reform focused on now?

Priselac: It's important to make a distinction between reforming the financing of healthcare as opposed to reforming the payment system. Those are two separate but related issues that people sometimes blur when talking about reform. The outline and framework for reforming the payment system is actually in place and beginning to take more shape. The payment system of the future increasingly will be characterized by doctors and hospitals being more at risk for the quality, volume and cost of medical care that's provided. The emerging ideas for the payment system include bundling medical services in a combined price — either services within a hospital or hospital services combined with the services of a subacute unit or skilled nursing facility for some defined period of time immediately after the patient is discharged. For chronically ill patients, there would be the notion of an "episode of care," where there would be a fixed price within which physicians and hospitals would be responsible for providing for the care of a diabetic patient or a congestive heart failure patient for a defined period of time, be it three months, six months, a year.

Distinct from that is reform of the financing system, which gets to questions such as who should be covered, how it's paid for, what's the role of government in financing healthcare through the tax system, what's the role of employers and whether there should be individual or employer mandates. Healthcare financing is where the ideological battles have erupted.

Have we reached a tipping point in favor of one direction or another?

Priselac: The forces for change are more aligned now than they have ever been and, again, when it comes to reforming the payment system, that ship has launched. We're moving away from fee-for-service medicine, which is how physicians have been paid in this country for the better part of 50 years. It is pretty universally viewed as inherently inflationary. The questions that remain are on the financing side and, there too, the forces for change are more aligned than ever. However, while the current economic situation is contributing to the momentum for reform, I don't think we should underestimate the ideological divide that exists in the country, starting with the fundamental question of whether everyone should have insurance or not.

Talk about your vision for reform.

Priselac: I would like us to come to the conclusion that we want to figure out a way to responsibly finance the coverage of all Americans, which means coming to agreement on a basic benefit package and then finding a way to finance coverage through a blend of government financing, individual contribution and employer contribution so that we can address the economics of healthcare and make coverage affordable to people based on their overall socioeconomic status.

The payment system also should promote value and properly incentivize doctors and hospitals to provide the right care in the right setting, in the right way. Any new payment system also should recognize the diversity of types of hospitals in the country and provide adequate payment for what I'll call the public good that is provided through hospital systems, specifically areas such as emergency services, trauma care, teaching and research — all of the things that have broader public good and are sometimes not recognized as part of the payment system.

Based on this vision, how will the healthcare experience be different for healthcare stakeholders than it is today?

Priselac: If we're successful in reforming the healthcare system, two things will emerge. First, everyone involved — doctors, hospitals, purchasers, individuals, etc. — will have a better sense of the value that's being produced for the care that's being provided because there will be more transparency related to costs, quality and outcomes. People will have a better sense of what they're getting for what they're paying.

Second, all of us will come to realize the limits of what the healthcare system by itself can have in improving various health status indicators. When people talk about the value of the American healthcare system, they often look at measures such as life expectancy and neonatal death rates. If we can do a better job articulating the effectiveness of the healthcare system, people will come to realize that many of those health status indicators are, to a significant degree, a function of broader socio-economic issues that are beyond the ability of the healthcare system itself to impact directly.

What do you see as the obstacles to the kind of reform you're talking about?

Priselac: In light of the broader economic challenges, there is tremendous pressure to control costs as effectively as possible. So, if I have a concern about reform, it's that, on the way to developing the kind of system that meets the tests I was describing, there will be budgetary pressure that will cause people to essentially make arbitrary cost reductions that will work against achieving the goals of a reformed healthcare system. In other words, the short-term budgetary pressures may overwhelm everyone's good intentions to redefine a system that has the characteristics many people agree it should have.

Based on the changes and challenges impacting the healthcare system, what are the implications for healthcare leaders? Will they need different competencies or functional expertise in the future?

Priselac: Many of the key leadership characteristics that are important for success today, including integrity, a collaborative leadership style and superb communication skills, will become even more important tomorrow. Frankly, I'm not sure there's actually been enough discussion or appreciation for the scope and scale of transition that is likely to occur in the American healthcare system in one way or another, and transitions can be particularly challenging for people in leadership positions. That's why those leadership characteristics are so important for healthcare leaders, whether they're physician leaders or hospital executives.

Given the challenges presented by the economy, we're seeing greater demand across industries for executives with hands-on operational experience who have the skills to improve efficiency. Are you seeing this in healthcare?

Priselac: Skills in operational effectiveness, both in terms of quality and cost, will become more important for people in leadership positions moving forward. When it comes to the question of how to reduce the cost of healthcare and improve efficiency, there are two broad components. One is the individual efficiency of the various departments and functions within a hospital or a physician's office. The second big bucket is how those different functions interact — the total resource utilization across the healthcare spectrum, including the physician's office, hospital, skilled nursing, home care, etc. The payment system of the future will require highly skilled people who understand the practice of medicine sufficiently and understand the organization and delivery of services sufficiently to be able to optimize the utilization of those resources across that entire spectrum.

If you want to control the cost of healthcare in the U.S., there are two big levers; you reduce the unit payment or you get more effective use of the resources being consumed. My own belief is there is plenty of opportunity to manage the use of resources more effectively to create better value for people who are receiving healthcare and allow institutions and doctors to receive unit payment levels that can keep them viable and strong. A healthy delivery system will be important in a reformed system if we want to avoid problems in access, quality and innovation.

What are the implications for governance in this new chapter in the healthcare history book? Do you see any specific trends?

Priselac: There's no question that the governance requirements for a hospital board or health system board today are every bit the same as those that exist in any other kind of business setting. The days of the traditional community board with everything that implies are long gone. At the same time, the demand for accountability is growing and increasingly applies to doctors, hospitals, governing bodies and everybody in the healthcare delivery system. Governing boards won't be exempt from those expectations and, in fact, they will be viewed as a key steward of healthcare resources in a local community.

The president often talks about investing in healthcare technology as a priority. What's your view on the state of IT adoption by the healthcare industry?

Priselac: As a general rule, I would say that the adoption of healthcare IT mirrors the phenomena of winners and losers that has evolved in the healthcare system over the last several years; where organizations have the resources and the capital to finance healthcare IT, the adoption is taking place.

It's important to recognize the enormous cost of healthcare information technology; in fact, the cost of implementing an electronic medical records system in a large hospital can easily exceed the cost of building a new bed tower. Secondly, the same institutions are faced with other large capital challenges, whether it's acquiring new equipment and technology, or replacing or renovating facilities. In that vein, the proposal within the new stimulus plan is a positive sign. For the first time, real money is being put on the table for hospitals and physicians to acquire information technology and funding is linked to whether or not doctors and hospitals make use of it for its intended purpose.

As you move into your role as chairman of the AHA, what are your top priorities?

Priselac: The AHA's role is, first, to advocate on behalf of hospitals and the communities they serve for the kind of healthcare system that promotes high-quality, cost-effective care that can improve the health status of the country and, second, to provide advice, counsel and leadership to the membership in terms of meeting the challenges they face in the field. My own priority is to see the American Hospital Association continue to be an active participant and contributor to the reform dialogue. The AHA needs to be a strong voice for what we believe are the right things to be done within the broad reform principles people can agree upon.

Beyond the big question of reform, there are myriad "blocking and tackling issues" that represent opportunities to improve the effectiveness and efficiency of the healthcare system, whether it's dealing with regulatory barriers or individual legislative initiatives.

Finally, the AHA is rolling out an initiative called "In Pursuit of Excellence," the purpose of which is to provide resources and a tool kit that can help institutions frame their strategic initiatives in a way that they're responsive to the increased call for improved quality, safety and efficiency. I see a direct link between a hospital's ability to demonstrate the work it's doing to improve in these areas and our collective success on the advocacy front. If we want to have credibility, we need to show the public that we understand their issues and we're taking meaningful steps within each of our organizations to address those issues.

About the author

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