

REPORT OF THE COUNCIL ON MEDICAL SERVICE

CMS Report 12 - A-98

Subject: Consumer-Driven Health Care

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1 Changes in the health care market as well as trends in national policy are quickly propelling the
2 U.S. health care system toward a market-driven consumer orientation. After more than 20 years of
3 consumer-based argument, advocates of Medical Savings Accounts (MSAs) achieved national
4 legislation enabling a limited demonstration of the concept as well as inclusion of MSAs as an
5 option in the new Medicare+Choice program. Many are now advocating fundamental tax reform
6 on the grounds that removal of the tax preference for employer-provided health benefits called for
7 in both the major national sales tax and flat income tax proposals will remove the barrier to moving
8 toward an individual-based system presented by the current income tax system.

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10 More members of Congress are announcing their support for changes that will empower
11 individuals in the health insurance and health care markets. For example, Rep. Bill Thomas (R-
12 CA), Chairman of the Health Subcommittee of the House Committee on Ways and Means and
13 administrative chairman of the Bipartisan Commission on the Future of Medicare, has proposed
14 restructuring the tax code to replace the tax preference for employer-provided health benefits with
15 a tax credit for individuals who buy their own insurance coverage. Speaker of the House Newt
16 Gingrich (R-GA) has announced his support for Rep. Thomas's proposal.

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18 In the current market, health plans are yielding to consumer demand for choice. Plans with point-
19 of-service options are the fastest growing segment of the market. Some plans have abandoned the
20 gatekeeper concept and allow subscribers to self-refer to specialists at will. Managed care plans are
21 coming under increasing consumer pressure to cover the cost of alternative medical therapy, and
22 more than 42% of health maintenance organizations (HMOs) provided such coverage in 1996.
23 Surveys of consumer satisfaction are now commonly regarded as legitimate measures of health
24 service quality. In a separate report to this meeting of the House of Delegates, the Council on
25 Medical Service recommends adoption of policy on individually selected, purchased and owned
26 health insurance that will continue to place the AMA at the forefront of advocating changes in
27 legislation and the structure of the market that will foster consumer-driven health care.

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29 The advent of consumer-driven health care will require many physicians and their organizations to
30 adopt new market strategies and competitive tactics. Much recent literature has been devoted to
31 changes that will be necessary. For example, Market-driven Health Care by Regina Herzlinger
32 contains many management principles and examples applicable to a re-oriented medical service
33 market.

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35 The Council on Medical Service believes that many of the basic issues surrounding consumer-
36 driven health care deserve more elucidation. Of particular importance is the structure of consumer
37 demand to which physicians must tailor their supply response. While the structure of demand is
38 well understood by those competing in the employer-dominated benefits market, it may not be as

1 well understood by physicians who will have to compete in a consumer-driven medical service
2 market. This report, which is submitted for the information of the House, attempts to describe the
3 structure of demand that will drive a consumer-driven market, as well as some of the marketing and
4 product design implications.

5 6 THE CONCENTRATION OF DEMAND FOR MEDICAL SERVICE

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8 The most important feature of the medical service market is that a small proportion of the
9 population accounts for most of health service expenditures each year. This pattern of
10 concentration has remained stable since the 1920s when it was first observed and described.
11 Concentrated demand is a pattern in many markets and provides the basis for most product
12 marketing strategies in those markets. In the market for medical service, 10% of the population
13 accounts for 75% of annual health spending. Twenty-five percent accounts for 90% of annual
14 spending. Such highly segmented and concentrated demand will necessitate consumer-oriented
15 strategies that are highly focused on specific parts of the population.

16
17 Medical expenditures are also concentrated within many subgroups of patients. Only about 12% of
18 Americans are hospitalized each year, but they spend 40% of health care dollars. (Within that
19 group, 15% incur 45% of total hospital charges.) About 80% of the population visit a physician at
20 least once per year, but only 6% of them account for 30% of the charges for service. Similarly,
21 62% of the population acquires at least one prescription for medicine each year, but 6% of them
22 incur 34% of the charges for prescription drugs.

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24 Medicare enrollees comprise 15% of the population and account for 20% of total health spending.
25 Within that group, however, 10% of enrollees account for 70% of Medicare expenditures. Less
26 than one-half (46%) of the noninstitutionalized population have one or more chronic conditions,
27 but they account for 76% of medical care costs. Persons with chronic conditions account for 69%
28 of hospital admissions and 80% of hospital days. They account for 96% of home care visits, 83%
29 of drug prescriptions, and 66% of physician visits.

30 31 PRODUCT DESIGN AND PACKAGING

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33 The significant concentrations of health care expenditures present product design opportunities for
34 physicians in an era of consumer-driven health care. The Council has previously reported on some
35 of the versions of the product designs that have begun to appear as the market evolves. Examples
36 include:

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- 38 • “Carve outs,” which are entities that market specialized services such as outpatient surgery,
39 services for cancer patients, or services for heart disease patients to payers who wish to
40 contract-out the responsibility for providing specific services or treating specific groups of
41 patients.
 - 42
 - 43 • Chronic disease management firms that contract with facilities and physicians to provide
44 proprietary protocols and customized care plans as well as ancillary services for comprehensive
45 management of patients with specific illnesses.

46 At this time, such products are focused primarily on the life-cycle cost of treating particular
47 conditions. Four of the seven diagnoses with the highest charges to public and private insurers are

1 related to chronic heart disease, including ischemic heart disorder, cerebrovascular disease, acute
2 myocardial infarction, and congestive heart failure. The total spectrum of heart disease comprises a
3 \$160 billion market, or approximately 15% of national health expenditures. The annual direct cost
4 of cancer treatment approaches 10% of national health expenditures, while arthritis costs amount to
5 about 5%. Such a focus is not particularly patient-oriented but is designed to capitalize on the large
6 extent of the markets for disease-specific services afforded by the concentration of certain health
7 care expenditures.

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9 To become patient-oriented, these concepts must be repackaged. This means, for example,
10 packaging and marketing not only disease-specific sets of services, but also combining these
11 packages with a broader range of services designed to maximize convenience for the patient in
12 meeting all of his or her health care needs, both chronic and acute. Accounting for expenditures for
13 the purpose of assessing service demand should not be restricted to only the cost directly associated
14 with treating a particular disease, particularly chronic diseases. For example, diabetes affects only
15 about 5% of the population, and the direct cost of treating diabetes is about 5% of national health
16 expenditures. However, in total, diabetes patients account for more than three times the direct cost
17 of treatment, or more than 15% of total health expenditures, if their total health care consumption is
18 counted. The case of diabetes illustrates the market leverage that can be gained from serving the
19 entire spectrum of services demanded by a chronic disease patient rather than just the disease-
20 specific services.

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22 While this concept may sound like an HMO, it is not. Contemporary HMOs are organized around
23 an insurance product, while the patient-oriented provider organization may market to a population
24 owning a variety of insurance products varying widely in coverage and cost-sharing requirements.
25 The fact that many employees are currently choosing health plans that allow them more freedom of
26 choice than allowed by the more stringent forms of managed care indicates that those who most
27 need service will be willing to pay for it.

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29 In the current employer-driven health system, distinct pools of employees comprise market
30 segments. Physicians who do not have access to particular employee pools are denied the
31 opportunity to compete for patients from those pools. Each employee pool is a heterogeneous
32 group of patients and forces the service response to be heterogeneous and diffuse. In a consumer-
33 driven system, physicians can compete to attract patients from across all insurance pools and can
34 target well-defined populations within them. This affords the development and marketing of
35 highly focused product lines that can be offered more efficiently, effectively, and competitively.

36 37 CONCLUSIONS

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39 The Council believes that the transition to consumer-driven health care will likely produce a
40 repooling of consumer demand from employer-based insurance pools which present a
41 heterogeneous spectrum of demand, to concentrated pools of homogeneous demand segmented by
42 disease type. The new pools of concentrated demand will provide opportunities for physicians to
43 package and market services focused on the needs of specific populations. Focusing on specific,
44 well-defined sets of consumer demand will afford improvements in the efficiency and cost-
45 effectiveness of health care. Service, convenience and patient satisfaction will likely become the
46 most important competitive factors in a consumer-driven system.