UK Independent Hospitals

The next challenge

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Introduction

The UK private healthcare market has seen a rebound in 2021 and 2022 post-Covid-19, driven in part by a surge in self-pay patients. A record number of people are opting to pay for their treatment privately to avoid long wait times in the NHS and access the quality and expertise of the Independent Sector.

Despite the positive signs of recovery, the months and years ahead are likely to bring a number of additional challenges for the sector. The UK is facing the largest rise in costs in the last 40 years, which is coupled with a near-certain economic recession and a healthcare sector that continues to grapple with a shortage of staff. Without action, private hospitals could see their margins erode and growth constrained.

Teneo has worked extensively across the private hospital sector over the last 15 years, supporting our clients in addressing complex challenges. We bring a unique set of skills that combines teams across management consulting, financial advisory and strategic communications, while also merging deep sector expertise with specialist capabilities in a wide range of areas including revenue growth, pricing and packaging, cost optimisation and performance improvement.

Over the following pages, we outline some of the key trends in the UK independent hospitals sector, as well as four potential areas for providers to consider in order to navigate the market headwinds and position for growth.

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UK private healthcare post-pandemic

Private healthcare has seen positive signs of post-pandemic recovery

After a significant contraction in 2020 due to Covid-19, private healthcare activity has seen a rebound in 2021 and 2022. According to the latest data available from the Private Healthcare Information Network (PHIN), admitted patient episodes in private hospitals in Q1 2022 reached 200,000 which is higher than the levels seen in 2019.

This growth has, to a large extent, been driven by three key factors that we expect will continue to fuel demand in the private healthcare market in the next few years:

1. Long NHS waiting times

The percentage of patients waiting over 18 weeks to start NHS treatment has grown at a compound average rate of 2% per month since June 2021. There is insufficient workforce and funding to drive a material change in this trend in the short- and medium-term.

2. Restrictions to treatment offered by the NHS

Pressures on the NHS mean that future restrictions on care are possible. For example, recent guidance suggested that NHS patients who refuse two appointment times may be removed from its waiting list.

3. Rise of health consciousness

Health and wellness have become a more significant part of the national conversation in the last two years. 70% of the UK population reports being more interested in their health and wellness following the pandemic.

The shape of demand for private healthcare has seen some major shifts

The profile of demand for private healthcare has seen a significant shift during this period:

- Payor mix has seen a strong rise in the share of self-pay patients
- Uneven recovery in NHS services across UK regions and by specialty led to higher growth in certain areas

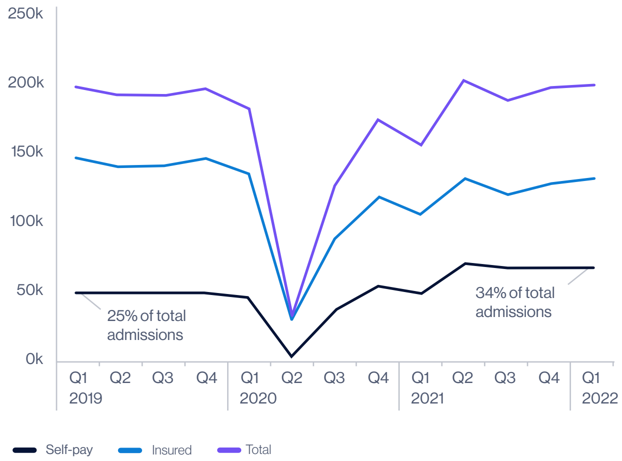
"Recovery in the PMI market has been slower, and overseas patient demand continues to remain suppressed despite the lifting of travel restrictions."

Payor mix

Self-pay has seen strong growth, swelling to over a third of admissions from 25% pre-pandemic. This rise appears to be consistent across socio-economic groups, with the proportion of people willing to fund their own procedures in households earning less than £40,000 a year rising by 54%, likely due to high NHS waiting times.

Meanwhile, recovery in the Private Medical Insurance (PMI) market has been slower, and overseas patient demand continues to remain suppressed despite the lifting of travel restrictions.

Figure 1: Number of UK private hospital admissions by payor type



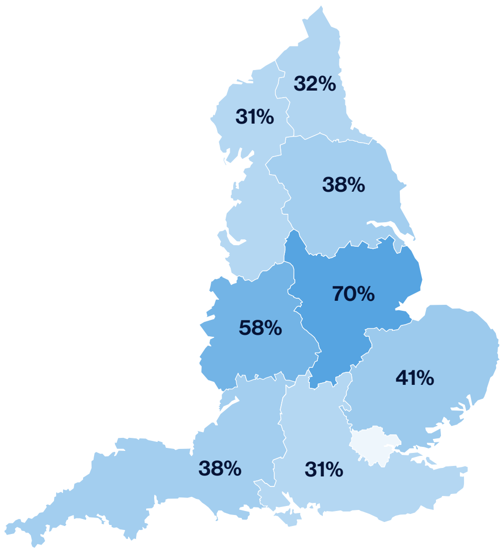
Source: PHIN

Geography

The pace of NHS recovery has varied by region, meaning demand for private healthcare has been uneven across England.

Self-pay market growth has been concentrated in regions which historically represented smaller markets, such as the East and West Midlands. This growth appears to be driven by the emergence of new customer types who previously would not have sought private care.

Figure 2: Increase in self-pay admissions by region, 2012-2021



Source: PHIN

Challenges facing UK private healthcare providers

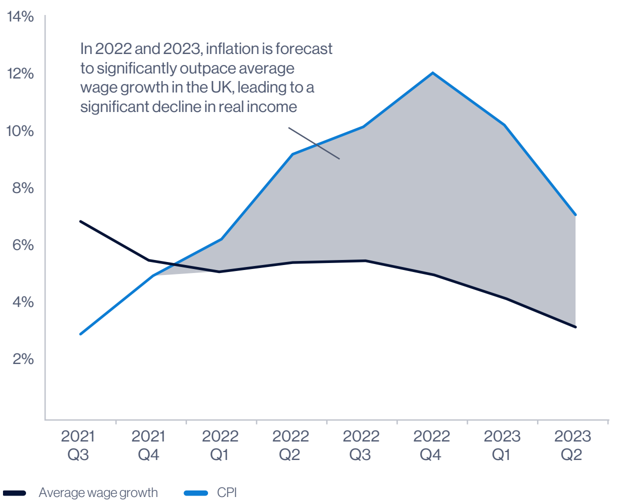
Despite the accelerated demand for private healthcare post-pandemic, the industry is now facing new challenges

Despite the positive signs earlier this year, a number of new and continuing market headwinds, including the cost of living crisis, rising costs and workforce shortages, are predicted to put a strain on private healthcare providers in the coming years. Without action, private hospitals could see their margins erode and growth constrained.

1. Cost of living crisis

UK inflation is currently at record levels, with drivers such as the Russia-Ukraine conflict, rising fuel costs and the weak pound expected to continue into 2023, potentially leading to a confidence-led recession. With wage growth unlikely to keep up with the high levels of inflation, UK households are predicted to see a significant drop in their disposable income, falling by up to 10% in the next two years.

Figure 3: Historic and forecast CPI and average wage growth, UK



Source(s): ONS, OBR, Bloomberg, Teneo research and analysis

This is likely to severely damage consumer confidence and reduce spending.

While a number of factors (including NHS waiting lists) are likely to continue to fuel self-pay demand, evidence to-date and from past recessions suggests that consumers are likely to cut back on non-essential spending. While out-of-pocket healthcare spend is likely to be less impacted than discretionary areas, it is likely that there will be some negative impact on the self-pay market due to these macroeconomic pressures:

- The drop in disposable income and higher costs of borrowing may reduce the pool of people who have short-term access to sufficient cash for self-pay treatments. It is becoming clear that economic pressure will greatly impact the young and those on lower incomes, two groups that have been key contributors to the recent growth in self-pay demand.
- At the same time, to counter the impact from the large increases in their cost base, private providers will likely need to consider volume versus margin trade-offs.

Private hospitals are faced with a tricky balancing act. With self-pay demand accounting for a higher proportion of admissions and revenue than pre-pandemic, they will need to think carefully about their self-pay customer base. This includes identifying the right go-to market and pricing strategy that supports future self-pay growth, while avoiding significant margin pressure.

2. Rising costs

A challenging labour market, record energy prices and high inflation are all expected to cause significant cost increases across the industry in the short- to medium-term.

Energy costs

The energy crisis has led to significant bill increases as global energy shortages caused significant increases in wholesale prices, with further price rises expected in 2023:

- Electricity spot prices (£/MWh) are expected to be £359 by end of Q4/2022 (up 270% from Q1/2021), rising to trend around £555 in 2023 and £673 in 2024;
- The price of natural gas (£/Thm) is expected to reach £235 by end of Q4/2022 (up 103% from Q1/2021), rising to £356 by Q3/2023.

Source: Trading Economics

Figure 4: Example forecast hospital energy bill increases in 2023 vs 2022 actuals

↑ **86%**
Great Ormond Street Hospital

↑ **130%**
Sheffield Children's Hospital

↑ **110%**
Leeds Teaching Hospitals

↑ **214%**
Nottingham University Hospital

Source(s): Company accounts, BMJ

Labour costs

High inflation and workforce shortages are also likely to increase labour costs across the industry, as healthcare providers are forced to increase wages in order to attract and retain staff.

- NHS staff are currently seeking an above-inflation pay increase for next year, which may increase private providers' staff costs further as they seek to compete for recruits.
- Workforce shortages have also driven higher use of staff supplied by agencies, which incurs significantly higher costs.

Other costs

Inflation is expected to compound the effects of labour and energy cost pressures. Costs are expected to increase across the full healthcare supply chain, which will lead to further increases in medical equipment, pharmaceuticals and other supply costs for private hospitals.

While inflation is expected to peak in Q4 2022, rates are expected to remain higher than usual, and prices will therefore continue to rise throughout 2023. It is unlikely that hospitals will be able to pass these cost increases to payors fully:

- PMI providers are continuing to seek value for money and lower their prices paid.
- While we expect self-pay patients will continue to seek private treatment, affordability will be a key consideration.

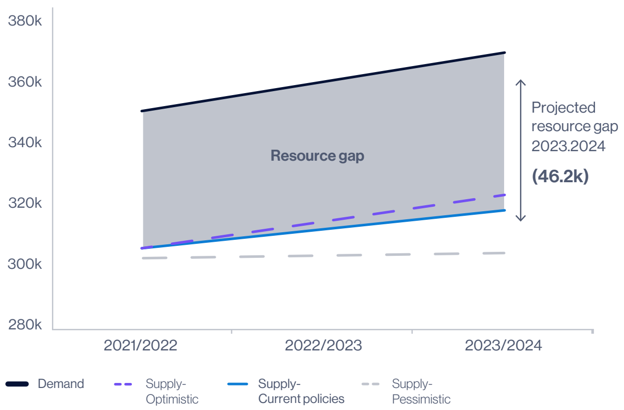
As it is unlikely that the market will support raising prices to cover this increase in costs fully, private healthcare providers will also need to focus on optimising their costs to protect profitability and manage case mix where possible.

3. Staffing shortages

The UK healthcare industry is also facing a number of challenges around resourcing. In particular, there is a growing shortage of consultants and nurses in the aftermath of Brexit and Covid-19. More difficult international recruitment has also exacerbated the long-term difficulties in healthcare staffing.

- A recent report by the Commons Health and Social Care Select Committee suggested England is short c. 12,000 doctors and 50,000 nurses.

Figure 5: Nurse (FTE) supply and demand projections in the NHS HCHS[1] in England



Source(s): Commons Health and Social Care Committee

[1] HCHS = Hospital and Community Health Service

"The cost of living crisis may drive more doctors and nursing staff towards the private healthcare sector to complement their salary."

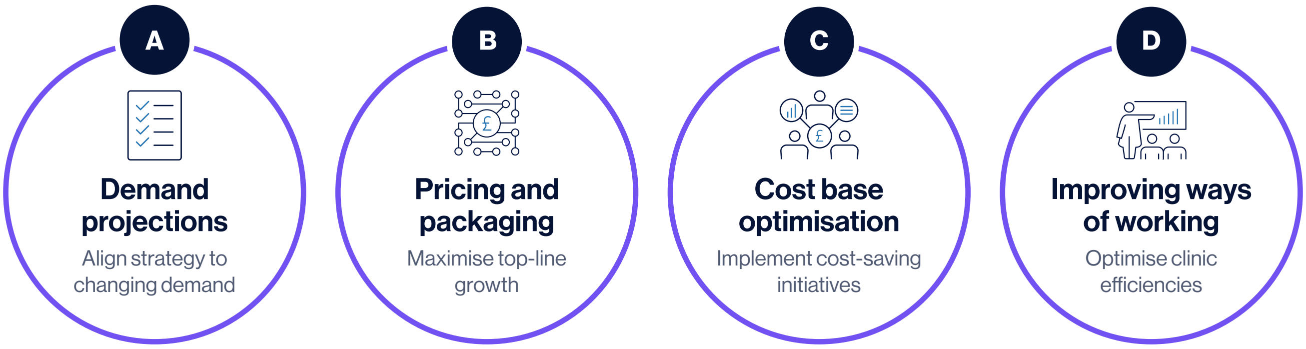
The cost of living crisis may drive more doctors and nursing staff towards the private healthcare sector to complement their salary. However, with a number of new entrants in the space and the increasing resource gap in the NHS, the competition for workforce is only expected to continue to increase. Most private hospitals are ranking workforce shortages as a key risk.

This has several implications for private providers, including:

- Increased importance of retention and recruitment of staff in order to serve demand, with a focus on building an attractive employer value proposition, combining pay and benefits with accessible training and development, a strong culture and increased flexibility.
- A growing imperative to address inefficiencies in ways of working to reduce overtime and/or increase capacity of the existing workforce to serve demand in the longer term.

Responding to current market challenges

Four example areas for independent hospitals to consider in response to the challenges currently faced by the sector



A. Demand projections

Different treatment specialisms, payor types and geographies attract different fees and margins and therefore carry different values for private hospitals. The post-pandemic changes seen in the demand profile for private healthcare services can directly impact future revenues and margins of providers. At the same time, ongoing cost inflation means margins will continue to be squeezed moving into 2023.

It is therefore important for providers to understand what their current and future demand profile looks like, and how they can target the strongest growth in the market and the associated impact on margins. Understanding how the demand profile will change will help providers define an effective strategy to drive financially sustainable future growth.

Historic demand profile

To support this, providers will need to build a comprehensive and accurate picture of their past and current patient volumes as well as their associated revenue, costs and margin, while also understanding variations by location, specialty and payor type. This will serve as a baseline for forecasting future demand, as analysing average prices and margin by location, specialty and payor type will help identify low- and high-value activities and geographies to support future decision making.

Future demand and financials

With the historic baseline established, providers will then need to consider the likely changes to their overall demand and its split (e.g. by location, specialty and payor type) in light of macroeconomic factors, competitive changes, NHS backlogs and PMI forward books, among other things. Providers need to understand the implications of the changing profile on the financial performance of the business.

Data analysis to design strategic responses

In light of the forecast changes, providers should revisit their existing strategies or define new strategic responses to ensure they have the right mix of location and activity to support sustainable growth in the future. This could include, but is not limited to:

Demand projections

- Exit low value specialties

Organic growth planning

- Expand high-growth areas
- Align capacity to demand

M&A / Divestiture planning

- Exit low-value locations / focus acquisitions in high-value areas

Pricing review

- See next section

B. Pricing and packaging

Given the opportunities and challenges facing the UK healthcare market, designing and implementing an effective pricing and packaging strategy has never been more important. With the growing share of self-pay activity, providers will need to identify innovative and ambitious approaches to capture these customers, which will be driven by different purchasing behaviours than the historical self-pay market. Maximising value from self-pay should be based on four key pillars, which must be underpinned by a clear, evidence-based view of target patient personas.

Target segment identification

Identify areas with high demand, where there are, for example, high volumes and long wait lists.

Outline the personas and customer journeys for core segments with the highest self-pay potential.

Price point and model

Develop a holistic self-pay commercial strategy covering key proposition and monetisation levers:

- Patient journey strategy
- Price strategy
- Price level(s)
- Price model
- Billing approach

Effective patient messaging

Construct clear, compelling messaging aligned to patient needs and self-pay value proposition.

Launch, test and iterate the self-pay messaging – assessing efficacy and using feedback to refine.

Bundling treatments and services

Price can be set per-item and per-service, or combined as a 'fixed fee.'

Consider 'bundling' services, such as pre- and post- treatment care, or supplementary services via partnerships.

Target segment identification

An attractive self-pay opportunity requires both favourable 'push' (e.g. long wait times) and 'pull' (e.g. superior patient experience) factors in order to drive patients away from the NHS and towards a particular private provider.

Providers should identify segments that have strong 'push' factors in place, and therefore the highest levels of latent demand, and focus their efforts on attracting new self-pay patients in those areas.

Price point and model

After identifying the target segments, pricing should be based on strategic objectives that help drive patient uptake and commercial value, while also accounting for differences in dynamics across care categories.

Drivers of patient value perception and decision-making, alongside business and competitive pressures (e.g. type of treatment required, price sensitivity, etc.), should first be outlined and aligned in order to confirm how they impact pricing considerations.

Price levels should then be informed by customer and competitor research, alongside an internal understanding of historical pricing performance and profitability.

There is also an opportunity to differentiate pricing across the patient base and increase affordability and uptake for some whilst protecting value and risk for others.

Price differentiation can be executed through varying list prices, discounting approaches, promotional levers and/or service bundling in order to align pricing with value in different circumstances.

Effective patient messaging

Once areas of latent demand are identified and the pricing strategy is agreed to, deploying the correct messaging becomes vital to raising patient awareness and converting new patient types.

By using patient personas to focus strategy development on patient attitudes, concerns and experience, a provider's messaging can be tailored to best capture demand.

Bundling treatments and services

While many providers already offer 'fixed price' treatments that bundle, for example, surgery costs and consumables, there is space to expand this approach further. Packages, including via partnerships, are another way to better meet the needs of patients, improve their experience, capture a higher share of wallet and increase the spend per patient.

C. Cost base optimisation

As outlined earlier, rising costs and greater instability are expected to continue increasing into 2023. While improved pricing can help mitigate some of the impact from the rising cost base on margins, it is unlikely that providers will be able to fully pass on the cost increases to customers. As such, providers should look to conduct a comprehensive review of their existing cost base to identify areas to optimise performance and increase profitability.

There are several levers that private providers can pull to drive cost efficiencies, including:

Maximise the utilisation of hospital capacity

- Ensure optimal throughput of inpatients whilst maintaining high-quality patient care
- Identify and remove bottlenecks and root causes of delays to accelerate patient pathways and provide overflow capacity to support local healthcare providers

Optimise stock management

- Reduce excess stock and expiry of drugs and control consumption to avoid shrinkage or waste
- Ensure current storage and management of stock is effective
- Re-evaluate delivery models to optimize stock holding and align availability with patient requirements to reduce the amount of cash tied up in stock on site

Enhance billing process

- Improve billing processes to ensure pre-authorisation of care provided, improve accuracy and timeliness of invoices and on-time collections, and reduce disputes
- Reduce manual or paper-based processes to expedite billing and improve accuracy
- Negotiate with insurers to maximise rates and payment terms

Improve procurement to reduce spending on suppliers

- Consolidate suppliers of products and services, and de-duplicate and change products to drive improved pricing
- Evaluate consumption to reduce waste
- Introduce centralised procurement systems, and refresh delegated authorities and controls, to ensure transparency of buying behaviours and improve price negotiations and payment terms

Improve utilisation of current estate

- Reduce excess capacity through relocation, re-purposing and redevelopment of hospital estate
- Evaluate capital projects and maintenance requirements to identify reprioritisation and cost / benefit cases
- Explore opportunities for additional revenue streams from underutilised property

D. Improving ways of working

With rising labour costs and increasing workforce shortages in the healthcare sector limiting clinical capacity, there is a growing imperative for providers to look for more efficient ways of working in their operations.

While there are some common inefficiencies that we see across healthcare organisations, each organization can expect to face unique challenges specific to their group. Therefore, each provider needs to start by identifying, analysing and prioritising the underlying causes of inefficiencies to know where to direct their efforts.

There are a number of unique barriers (such as a complex regulatory framework, self-employed consultant staff, the complexity of operations and high potential risks) that make it more difficult to address inefficiencies in the private healthcare space. These will need to be taken into account when considering solutions.

Common inefficiencies of healthcare providers

High proportion of clinical staff time spent on admin	**Inefficient workforce planning or rotas**	**Lack of demand management/ uneven demand patterns**
Suboptimal staffing ratios	**Duplication of tasks**	**Lack of delegation**
Fragmented day structures/ poor diary management	**High proportion of no shows/ DNAs/ cancellations**	**Manual processes/ lack of automation**
Lack of data to support strategic decision-making	**Lack of proper equipment**	**Lack of integration between systems**

There are a variety of potential ways to address inefficiencies (non-exhaustive):

Task reallocation

Task and role review

Activity transfer

Training and development

Digitalisation

Automation/tech enablement

Data analytics to support decisions

Organisational changes

Management structure review

Centralisation/ decentralisation of development

Process improvements

Process review and simplification

Best practice guideline development

Operational changes

Infrastructure improvements

Improved rota management

Improved forward planning

Most organisations will likely be looking to implement a range of solutions to address inefficiencies. These often vary between smaller, tactical steps to multi-year-long organisational change programmes.

In particular, the potential use case for digital technologies in healthcare organisations is wide-ranging. Healthcare organisations have historically lagged behind other industries in adopting new digital solutions, meaning there is likely a large untapped potential in adopting more innovative technology.

More efficient ways of working can not only enable private hospitals to increase the capacity of their existing workforce, they can also improve patient care, reduce employee churn, lower agency costs and increase patient satisfaction.

Nevertheless, each programme needs to be planned carefully. There must be a clear identification of the potential benefits and risks, a realistic implementation plan that considers the organisation's capacity to change, clear communication and a robust change management approach.

How Teneo can support

We support our private healthcare clients in responding to various market challenges. We distinguish ourselves through our:

- **Deep healthcare expertise**
  Teneo has a strong understanding of the private healthcare sector. We understand the key drivers of value in the industry, having completed numerous market reviews.
- **Best-in-class cross-functional teams**
  Our healthcare sector experts work closely with functional specialists from across Teneo with deep expertise in pricing and packaging, performance improvement, demand forecasting and financial advisory. Overall, we bring together a breadth of capabilities to deliver comprehensive solutions to the most complex problems.
- **Rigorous analytical approach**
  Our recommendations are based on rigorous analysis of underlying data and trends, building on our powerful analysis and benchmarking tools and our financial skill set. Our work is supported by specialist data analysts for complex quantitative analysis.
- **Collaborative working style**
  Teneo has developed a style of working with our clients that combines collaboration and buy-in, while not providing too much of a distraction from the day-job. This enables us to design strategies and solutions that suit each client and are deliverable by the organisation.

Example areas of Teneo expertise (non-exhaustive)

	Future growth strategy	Pricing and packaging	Cost review	Ways of working
Analysis	• Historic demand and margin analysis	• Full pricing review and competitive analysis	• Detailed cost review and benchmarking	• Identification of inefficiencies
Opportunity identification/strategy development	• Demand forecasting and scenario modelling • Strategic response development	• Pricing strategy and list price recommendations • Market proposition development • Benefits modelling	• Cost saving opportunity identification and initiative development	• Opportunity prioritisation and short-list generation • Benefits and saving assessment
Implementation planning and support	• Implementation planning (including key activities/milestones/KPIs/timelines), project management support, KPI tracking, stakeholder engagement and communications support			

Example project experience

Pricing design for a healthcare service provider

Completion of a review of market fundamentals and the client's pricing and sales processes, resulting in a successful pricing improvement with key customers

Third-party cost review for a private hospital group

Contract review, cost reduction and process redesign for a leading private healthcare provider to reduce third-party spend and introduce more efficient business processes

Workforce efficiency improvement for a vet care provider

Identification and implementation of opportunities to improve ways of working and development of a new target operating model to free up clinical capacity, as well as identify significant cost savings

Back office function review for a large NHS trust

Assessing and re-designing processes and delivery of back office and support service functions across the trust's hospitals to increase efficiency and improve quality of outcomes

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