

# Strategic Financial Planning



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## Using a Portfolio Model to Prioritize Your Service Line Strategies

By Nancy A. Lyle

Today, more than ever, effective prioritization and sound investment decisions are critical to healthcare organizations' long-term viability. A portfolio model can provide a framework for guiding strategic decisions by identifying and capitalizing on products that offer the greatest economic potential and market size, coupled with the internal business strengths of the service

line and organization. This article describes a portfolio planning model developed specifically for application to the health-care industry.

An organization's portfolio is the compilation of strategic business units (SBUs) that together form the company. In health care, SBUs are synonymous with service lines and/or product lines. Ideally, the organiza-

tion's portfolio should capitalize on its strengths while exploiting market opportunities. The two best-known portfolio models for strategic planning are the Boston Consulting Group's Growth-Share Matrix and the McKinsey/General Electric Matrix. These tools were first introduced in the early 1970s, and many adaptations of them are still in use today.

### Boston Consulting Group's Growth-Share Matrix



Source: Stern, C.W., and Stalk, G., eds., *Perspectives on Strategy from the Boston Consulting Group*, New York: Wiley and Sons Publishers, 1998.

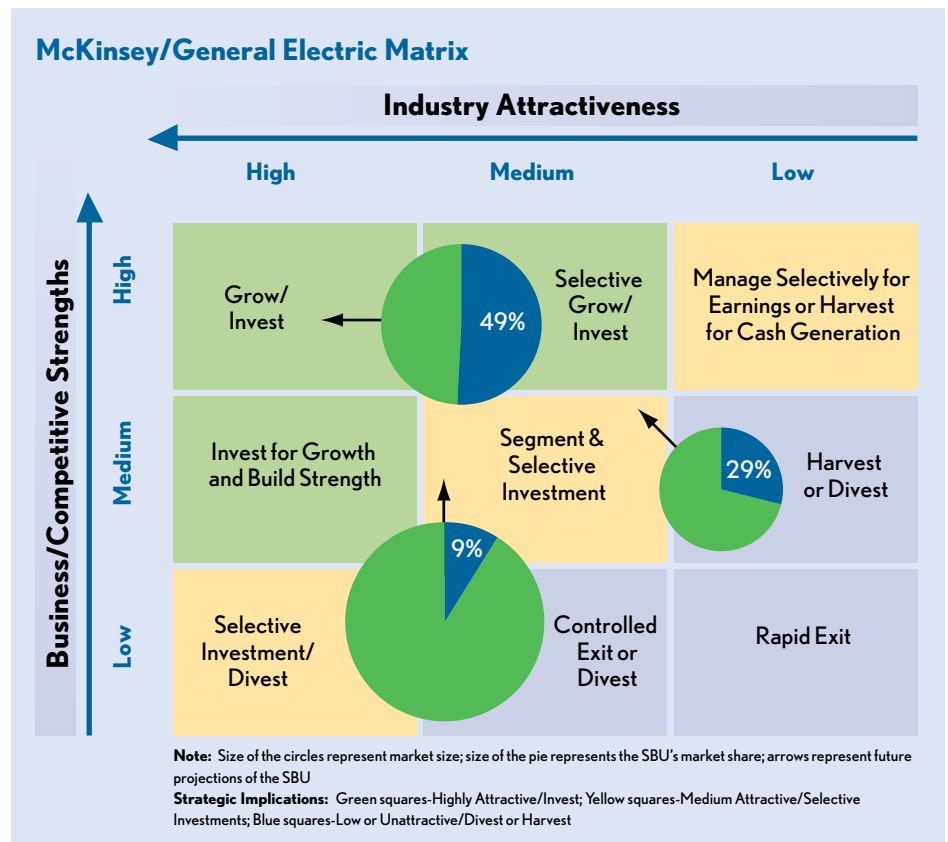
## Early Models

The Boston Consulting Group model was called the BCG Growth-Share Matrix. This simple model considers and compares two factors: market growth and market share relative to the largest competitor. In this model, SBUs or product lines are grouped into four categories: dogs, question marks, stars, and cash cows.

The strengths of the BCG Growth-Share Matrix include its simplicity and the ready availability of the data required for the analysis. On the downside, the model considers only two factors, thus limiting its strategic implications. Moreover, it assumes that an increase in market share will boost the generation of cash and profitability. This does not always hold true in health care, as some diseases have large markets yet do not generate significant cash (e.g., diabetes).

In 1971, McKinsey and Company developed a multifactorial model while working with General Electric in an attempt to improve upon the BCG matrix. This model uses weighted criteria to evaluate SBUs in terms of industry attractiveness in conjunction with business/competitive strengths. The scores are plotted on a nine-cell grid, in which each cell indicates a strategic proposition.

The grid is one of this model's strengths; another is its ability to consider multiple



Source: As adapted by Wilson, R.M.S., and Gilligan, C., *Strategic Marketing Management*, 3rd ed., Burlington, Mass.: Butterworth-Heinemann Publishers, 2005.

factors. Together, they allow for greater discrimination in terms of strategic implications. Additionally, the McKinsey/GE Matrix accounts for forecasting, size of the market, and market share. Limitations include the subjective weighting and scoring of the criteria, the complexity of the model, and the fact that composite scores can mask significant differences among SBUs.

Despite numerous adaptations of these

early portfolio models, the overall concept and rationale remains the same: prioritization, portfolio balance, and sound decision making regarding resource allocation to support future growth and financial performance. Over the past 10 years, portfolio models have been increasingly used in health care to evaluate and prioritize those service lines with the greatest economic potential and favorable market conditions. Healthcare variations

### TCG Portfolio Growth Model: Criteria for Weighted Scores

#### Market Appeal:

- > Size of market
- > Market growth/demand forecast
- > Price and reimbursement trends
- > Number and strength of competitors
- > Opportunity to differentiate
- > Stage in life cycle
- > Segmentation
- > Capital requirements and returns (net present value)

#### Business Strengths:

- > Marketshare and volumes
- > Relative brand strength/image
- > Contribution or profit margins
- > Quality outcomes
- > Competencies/physician talent
- > Strength of distribution channels
- > Technology/innovation
- > Breadth of line

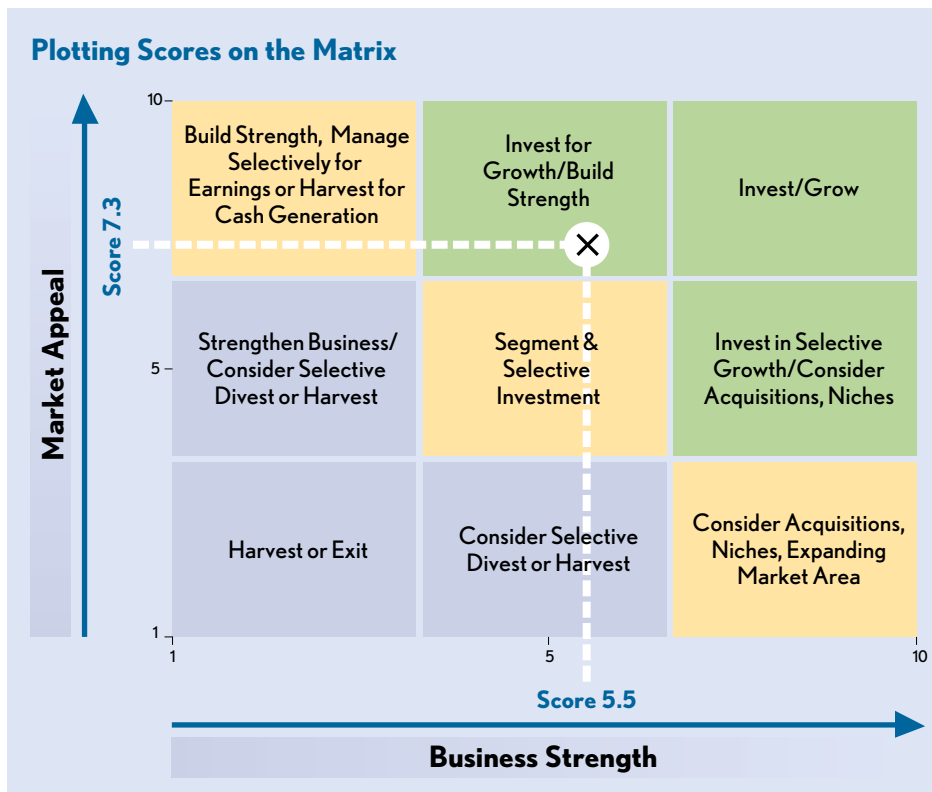
**Without a sound strategic plan, healthcare organizations may find that they fall victim to crisis management, ineffective execution due to lack of focus, and decision making heavily influenced by political pressures.**

### Examples of Relative Importance Weighting and Rating/Ranking Scores

Market Appeal Criteria	Relative Importance Weighting	Rate/Assign Points* (1 to 10)	Total Weight or Rank
Size of market	0.40	10	4.0
Market growth rate/demand forecast	0.30	5	1.5
Competition	0.15	8	1.2
Price and reimbursement trends	0.10	3	0.3
Distribution channels	0.05	6	0.3
<b>Weighted Rank</b>			<b>7.3</b>

Business Strength Criteria	Relative Importance Weighting	Rate/Assign Points* (1 to 10)	Total Weight or Rank
Market share	0.35	4	1.4
Contribution margin	0.25	10	2.5
Brand equity	0.15	4	0.6
Strength of assets	0.15	4	0.6
Distribution channels	0.10	4	0.4
<b>Weighted Rank</b>			<b>5.5</b>

Source: Triad Consulting Group, Inc.



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popular for their simplicity include:

- > Market share plotted against annual market growth rate (on a bubble chart, the size of the circle is often used to indicate financial performance, such as contribution margin or profit margin per case/discharge)
- > Market factors (e.g., market share, volumes, market size) using weighted scores in conjunction with financial performance

However, as with the original BCG Growth-Share Matrix, these models consider only market and financial factors, thus restricting the extent to which the data can be interpreted for strategic purposes.

#### A Multifactorial Healthcare Portfolio Model

A new, healthcare-specific model, known as the TCG Portfolio Growth Model, was developed by the author to refine the portfolio analysis process and integrate vital clinical, financial, and marketing factors. It has been used at the service line level and for product offerings within the service line (e.g., the diagnosis-related group and procedure level).

Building on the early portfolio frameworks, the TCG Portfolio Growth Model uses weighted scores to consider external market factors (market appeal) against internal business criteria (business strengths) (see sidebar).

Limiting criteria to five for each group, paying particular attention to factors that have the greatest relevance in specific markets, strengthens the model's ability to distinguish service lines with high market appeal and high business strengths. Each criterion is assigned a weight indicating its relative importance, with the total value equal to 1.0 for market appeal and 1.0 for business strength.

Once relative weights are established,

products or service lines are rated on each criterion using a score from 0 to 10: 0-3 weak, 4-6 average, 7-10 high. To ensure objectivity, it is recommended that parameters be explicitly defined prior to assigning rating scores. Once the score is assigned, it is multiplied by the weight factor to determine overall ranking; these scores are then totaled for both market appeal and business strength.

Following the rating and ranking process, the total scores for each service line are plotted on a nine-cell matrix, with business strengths on the horizontal axis and market appeal on the vertical axis.

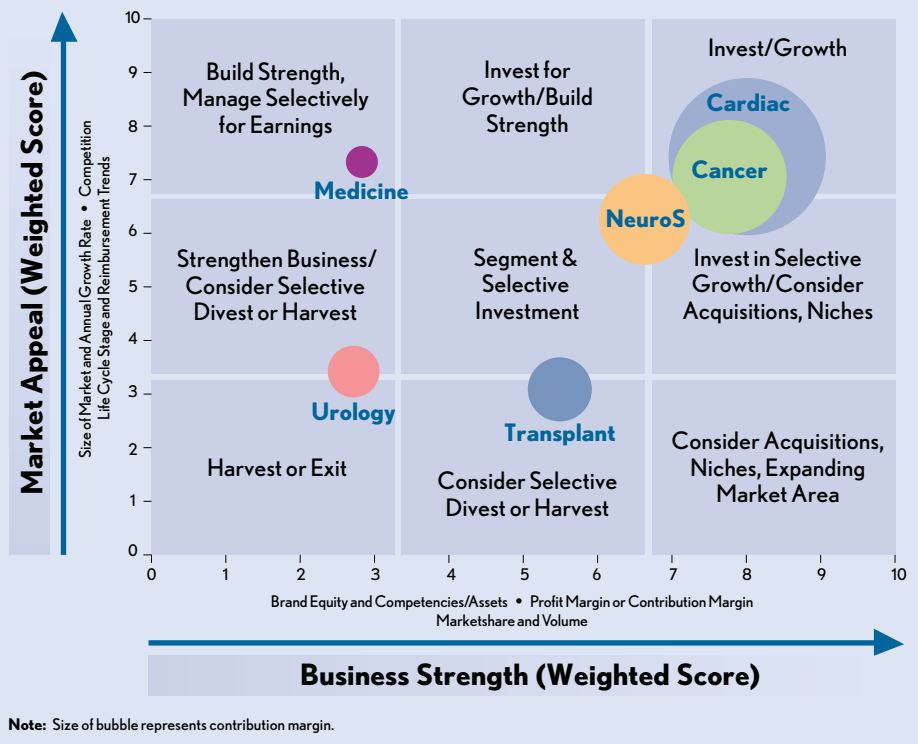
SBUs or product lines are then grouped into nine cells or categories, based on the weighted score for each major category. Each cell in the matrix provides guidelines for strategic direction, prioritization, and resource allocation.

*Attractive or growth service lines (or products).* Service lines that fall into the Investment and Growth cell have appealing markets (high growth, significant size market, favorable reimbursement trends, limited competition, and capital resource requirements with favorable returns) along with strong business strengths (market share and volumes, brand equity, quality outcomes, competencies and physician talent, profit or contribution margins). This cell represents the most attractive service lines; healthcare organizations should prioritize these service lines for investment and resource allocation with a focus on growth.

Service lines that fall into the Invest for Growth and Build Business Strength cell have high market appeal and average business strengths; they should focus on growth strategies while improving their operational capabilities.

## Portfolio Analysis Application in Healthcare

The market size or contribution margin can be represented by the relative size of the circle, along with an arrow indicating the future forecast.



Source: Triad Consulting Group, Inc.

Service lines that fall into the Invest in Selective Growth/Consider Acquisitions or Niches cell are those with average market appeal and impressive business strengths. These service lines should identify key growth segments while considering further specialization, niches, and/or mergers/acquisitions to gain access to new markets.

*Average service lines (or products).* Service lines that fall into the Build Business Strength, Manage Selectively for Earnings, Mergers, or Harvest for Cash Generation cell are competing in appealing markets (e.g., size and growth) with low business strengths (minimal margins, low market share, poor quality or competencies). Healthcare organizations should focus on building business strengths, particularly those products within the service line that generate the greatest margins. Further

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capital investments should be rigorously evaluated in terms of returns.

Service lines that fall into the Segment and Selective Growth/Investment cell are competing in markets with average appeal along with average business strengths. The service line should focus on growth

in selective products or segments while strengthening the business line to maximize profitability (e.g., supply chain, revenue cycle, brand equity, or enhancing quality outcomes).

Service lines in the Consider Mergers/Acquisitions, Niches, or Expanding Catchment Area cell are competing in markets with minimal appeal; however, they have impressive business strengths. Organizations should cautiously invest in growth, particularly those products and services that offer the greatest opportunities for ROI. Consider further specialization, niches, mergers/acquisitions, and/or market area expansion.

*Vulnerable service lines (or products).* Service lines in the Strengthen Business, Consider Selective Divest or Harvest cell are competing in average markets with low business strengths. The organization may want to consider divesting select products and services that have minimal margins or little relevance to core mission. In some cases, the organization may want to strengthen the business line to improve market position as well as maximize profitability.

Service lines that fall into the Consider Selective Divest or Harvest cell are competing in markets with minimal appeal and they have low business strengths. The organization may want to consider harvesting for cash generation if the investment requirements outweigh the potential return on investment.

Service lines in the Harvest or Exit cell have nominal business strengths in an unattractive market, and therefore are the least attractive SBUs. Organizations should consider harvesting and/or divesting unless relative strengths can be improved.

### Strength and Limitations

The strength of the TCG Portfolio Growth

Model is its ability to consider multiple factors that often distinguish success in the healthcare marketplace. Its flexibility allows organizations to customize the criteria based on what is relevant to their respective markets. Bubble size can be used to account for and communicate demand projections, contribution margins, or size and share of the market. The portfolio framework can be applied at the service line level to assist in organizationwide strategic planning and priority setting, or it can be used to evaluate DRGs or procedures within a service line. Lastly, the model uses an integrated approach that considers clinical, financial, and marketing criteria deemed vital to overall market and financial success. The result is a balanced view, useful for strategic planning and prioritization purposes.

It is important to note that the composite scores of this model can conceal significant differences among service lines. To minimize this limitation of the tool and capitalize on data-driven decisions, organizations may want to concurrently view data subsets collected in the portfolio analysis process by service line. Again, considering more than five factors within each group can become too complicated. Lastly, if parameters for assigning rating scores have not been explicitly defined, the scores may be viewed as subjective, thus calling into question the validity and reliability of the model.

### Interpretation and Use of Portfolio Data

The portfolio model provides overall rating and ranking information on market appeal and business strengths that can help organizations identify and prioritize service lines. While this includes guidance on top lines for growth and resource allocation, a portfolio model cannot by itself provide enough detailed data for the purpose of formulating specific service line strategies or tactical plans. Business plans must be developed for each service line to formulate and refine specific clinical, financial,

and marketing strategies. For market and financial success, strategy formulation should focus on market alignment, innovation, differentiation, and solving marketplace issues.

Healthcare organizations face challenges in using portfolio analysis models that are specific to our industry, particularly when it comes to vulnerable service lines. In other kinds of companies, it is relatively easy to “divest” or “harvest” a product or service that is underperforming or is at the end of its life cycle. However, in health care, which consists of predominantly public and not-for-profit organizations, these types of investment decisions raise issues of public interest, community need, and tax benefits, not to mention politically charged emotions regarding the haves and have-nots.

Certainly prioritizing service line investments and determining the fate of underperforming service lines, or those with limited returns, represent some of the most challenging decisions healthcare leaders face today. However, with limited resources available, the future of their organizations depends on their making precisely these tough decisions.

Without a sound strategic plan, healthcare organizations may find that they fall victim to crisis management, ineffective execution due to lack of focus, and decision making heavily influenced by political pressures. Portfolio models, in conjunction with other strategic planning tools, can guide the organization in prioritizing and making investment decisions, identifying market opportunities, and ensuring long-term financial performance. ☞

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