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A Capgemini Forecast
Healthcare's Top Business Issues and Responses for 2004

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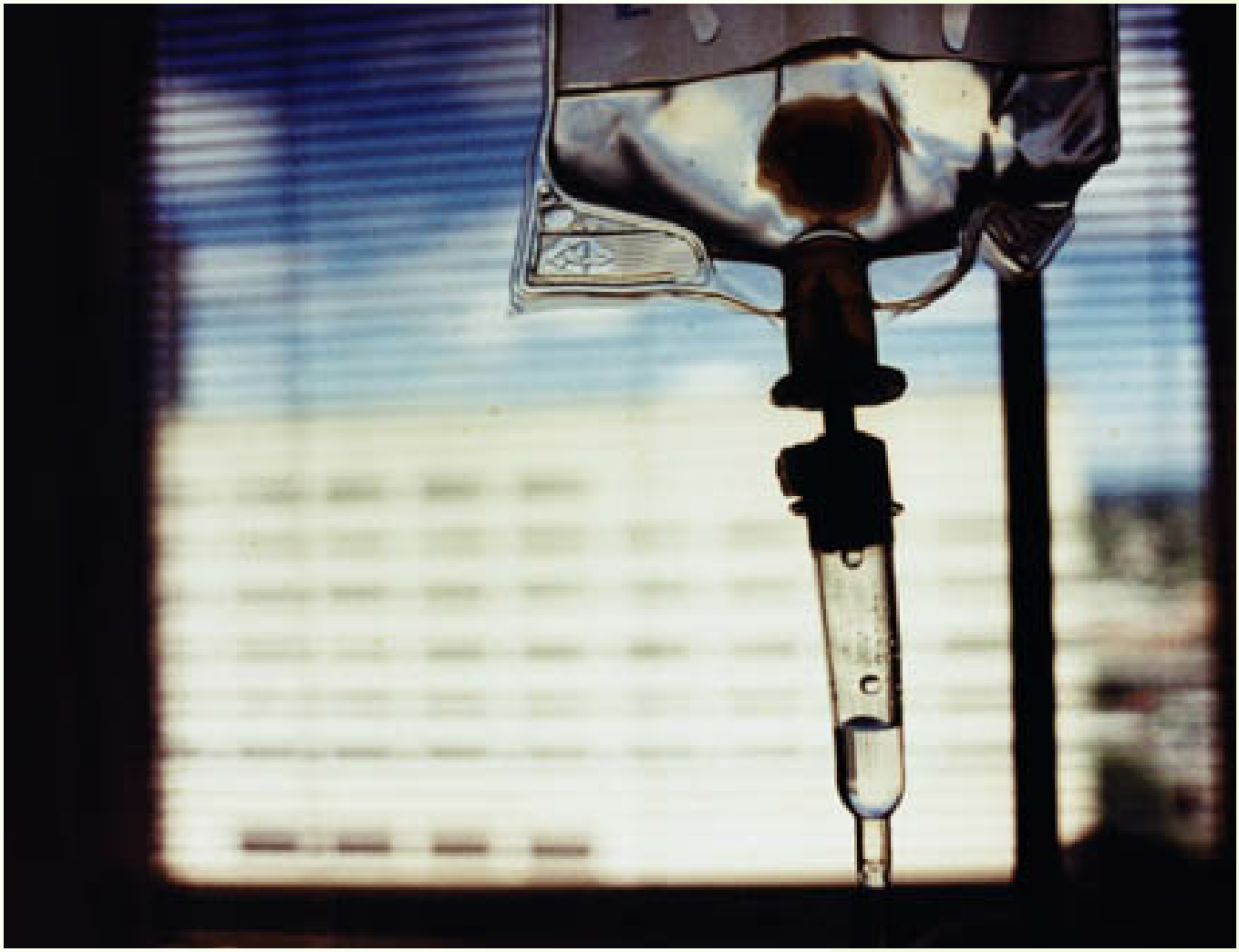


As we look forward to the coming year, we can see an economy starting to rebound, continued security threats at home and abroad, and preparations for the presidential elections. Health care will certainly be affected by these events, but will also experience its own unique set of issues. What lies ahead for the healthcare industry in 2004? To help you prepare, Capgemini U.S. LLC challenged our health care team to look ahead to the coming year. Our forecast of the issues that will face the industry and how healthcare organizations will likely respond is described on the following pages.

Healthcare's Top Business Issues

In short, the healthcare industry will experience increasing financial pressures in 2004. They will be manifested in several ways:

Increasing costs.

For the past few years, health costs have risen as a proportion of GDP, and are now at record levels. Cost inflation affects employers through rising insurance premiums, consumers through higher deductibles and co-payments, and providers through greater medical and administrative expenses.

Scarce labor.

Long a problem in health care, this issue will grow even more acute as the economic recovery generates more job opportunities in other industries. The shortage encompasses nursing and other ancillary clinical areas, information technology, and business office support.

More demanding consumers.

Consumers are demanding more information about outcomes, quality, and costs. As consumer-directed health plans and cost sharing grow more common, consumers will have greater influence in selecting and directing their own care. Healthcare organizations will need to develop consumer relationship strategies through technology, process, and culture changes.

Competition eroding profits.

Specialty providers are "carving out" premium business, drawing profits away from the core delivery system. Though the federal government has proposed a moratorium on development of new specialty hospitals and expansions of existing ones, providers will still need to respond through differentiated services of their own, or alliances with specialty facilities.

Limited access to capital.

In order to improve their cost position, healthcare organizations need to make major infrastructure and technology investments. But investments required to compete for scarce labor, fulfill information technology needs, and replace aging physical plants are outpacing revenue growth and constraining capital. Access to capital will likely be even tighter in 2004, as the overall economic recovery draws investors to other areas.

The reasons for these financial pressures are varied and well known: an aging population; demanding, vocal consumers; increased utilization, particularly for pharmaceutical and hospital outpatient services; increased regulation and benefits mandates; rising malpractice awards and premiums; variations in practice and medical errors; new technological advances such as drug eluting stents, genomics for health screening, and specialty pharmaceuticals…

Analysis

So if financial pressures have plagued the industry for years, what will be different in 2004?

Put simply, what is "new" is the magnitude of the problem. The costs are higher and frustration levels greater than ever before.

Depending on their specific market conditions, some healthcare organizations will weather the financial pressures, while others will struggle to remain viable. Some managed care organizations will gain market share, and others will be acquired. Some hospitals will see an increase in volume, and others will struggle with low occupancy. All, however, will sharpen their focus on business and financial management.

The impact will not be confined to healthcare organizations. The business economics of healthcare will become much more mainstream in society. Individual consumers and employers will feel the repercussions.

The proportion of the US population without health insurance has climbed to over 15%; over 43 million people are continuously uninsured and 20 million are periodically uninsured during the year. The numbers are rapidly increasing because of soaring cost and job losses. Many states are also cutting back on subsidies for health care, further increasing the number of people with no coverage. And the problem is not confined to "the poor" any longer. The vast majority of the uninsured — 80% —are in a family where at least one member is employed.

Employers still pay for the bulk of health insurance costs. Though consumers' out-of-pocket costs actually have fallen as a percent of health care spending, their hard dollar expenditures have increased. As a result, consumers perceive that they are getting a decrease in benefits.

According to surveys recently conducted by a number of research organizations, Americans are more concerned about paying for health care than they are about paying their mortgage or rent, losing money in the stock market or even having job security. Among those surveyed, 8 out of 10 say it is more important to provide universal healthcare than to contain taxes. Most say they would forgo a pay hike in exchange for maintaining their current levels of health insurance. A majority favor increased government intervention (versus competitive market solutions) to address rising costs.

Consumers have become so frustrated with rising drug costs that some state legislatures have begun to reimport drugs from other countries, and the federal government is exploring the safety of reimportation. Though drug reimportation is unlikely, in and of itself, to make a significant impact on expenditures, it certainly signals a new level of response to pharmacy costs.

Continued cost inflation contributes to a groundswell of support for legislative change. In preparation for the upcoming national election, discussions of healthcare reform will grow more heated and all of the major candidates will develop healthcare proposals. We are likely to see expansions in Medicare's prescription drug coverage, and proposals to address coverage of the uninsured. This will produce at least modest increases in health care spending.

Few – if any – politicians are likely to risk a platform that includes major cost reductions in health care. And there is still no clear consensus regarding how costs should be controlled. So although we will approach a "critical mass" in voter desire for some sort of universal healthcare, major, comprehensive health care reform certainly will NOT happen in 2004.

Healthcare Organizations' Responses

We expect healthcare organizations to adopt a variety of specific strategies in response to financial pressures in 2004. At least for the coming year, financial pressures will continue to mount. Healthcare organizations will need to take action.

1).
A new level of business rigor in technology investments.

Historically an under-investor in technology, healthcare companies are, for the first time, making major commitments to information systems. The technology is evolving to be portable, accessible, and reliable. Standards are being developed. Compared to other industries, healthcare is expected to show the strongest IT spending growth in the coming year, according to industry analysts.

Leading drivers include the needs to improve patient safety, reduce the cost of delivering care, and integrate systems so that clinical information flows seamlessly across the continuum of care. Over 60% of surveyed hospital CEO's plan to invest in some type of clinical/ CPOE system in the next two years.

For payors, priorities will include: claims, billing, membership, integration of front-end with legacy systems, etc. But despite pressing business needs, health executives will be reluctant to make any investments without a demonstrable payback.

Future technology changes are uncertain, and many technological functions – particularly for outpatient services – are still under development.

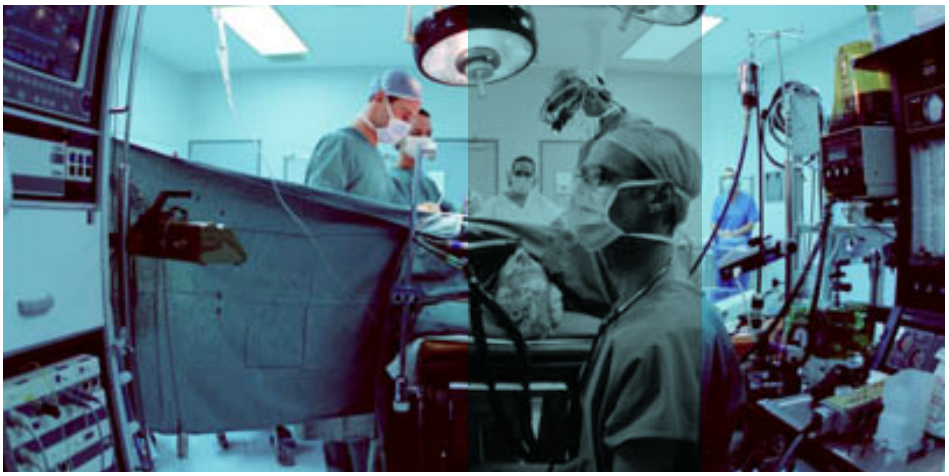
Executives will be concerned about picking "the right" solutions – selecting long-term survivors, or platforms that will enable them to keep their options open. Executives will need to look at the total cost of ownership, including not only hardware and software costs, but investments in process-related changes as well. Financial pressures will intensify their need to justify system investments with a measurable return on investment.

2).
Transformation of clinical care through technology.

Increased IT investments create an opportunity for technology to begin affecting care delivery. For hospitals, there will be a heightened emphasis on using IT to improve patient care and safety (e.g., bar coding on medicines, electronic medical records, prescriptions). Some insurers will offer higher reimbursement for providers that demonstrate quality outcomes – that can only be achieved through technology.

Managed care organizations will start to move from being a transactions processor to an information manager, by leveraging transaction information to better manage financial and clinical resources.

As vendor solutions and health information standards are developed over the next few years, the impact of technology on care delivery will become more pervasive.



3).
Detailed redesign of core business processes.

Heightened financial pressures will necessitate that healthcare organizations scrutinize all areas of their operations for any opportunities to minimize costs.

Managed care organizations will attempt to achieve greater economies of scale in back-office functions through additional mergers. Driven by continued declines in health insurance coverage for employees, providers will implement tighter front-end identification of co-payments and deductibles, to address patients' financial responsibility earlier in the revenue cycle.

Hospitals will look at creative capacity management solutions to facilitate better patient flow, including modifications to patient admission and placement, throughput and bed control procedures, and discharge planning processes.

Additionally, supply chain performance is moving rapidly onto the agenda of hospitals' executive suites, with significant reviews and commitments to creative solutions including new collaborative partnerships in strategic sourcing, logistics and product acquisition management.

4).
Outsourcing of non-core functions.

Healthcare organizations are struggling with where to find gains in efficiency and service in light of increasing costs and decreasing reimbursement. Many have outsourced functions like IT, food service, and laundry/linen.

Industry analysts estimate that 75% of US hospitals currently outsource at least one function. In some cases, however, redesign/rebuilding of functions like IT may be more cost effective than outsourcing for the organization. There is increasing interest in outsourcing non-core business processes, such as revenue cycle management.

Outsourcing provides a way for healthcare organizations to scale operational capabilities, in some cases taking advantage of offshore/near shore resources, and address the labor shortage (which has moved far beyond nursing to include technologists, therapists, and medical records personnel).

5).
Protracted efforts to comply with HIPAA requirements.

The deadline for healthcare organizations to comply with the privacy and transactions and code sets requirements of the HIPAA regulations was October 16, 2003. However, Medicare has already given itself an extension. Commercial health plans have put contingency plans into place. All 42 Blue Cross Blue Shield plans have agreed to accept non-conforming transactions after the deadline (for an unspecified time period). Industry analysts estimate that fewer than 50% of providers have achieved true compliance with transactions and code sets.

Throughout 2004, healthcare organizations should expect to deal not only with security requirements (which have a deadline of April 21, 2005), but also with privacy, document management, and integrating applications for secure communication among members, care managers and physicians.

Healthcare Organizations' Responses

6).
Collaboration between payers and providers at an operational level.

Substantial regional consolidation has provided many health systems with an exceptionally strong negotiating position. Managed care organizations see the need to create less of an adversarial and more of a "partnership" relationship with providers, but not through capitation or risk-based joint ventures, since those approaches have not been successful. Instead, payers and providers in some markets will collaborate to mutually improve their operational performance. They will begin to establish more efficient linkages for eligibility, enrollment, denial management, registration and scheduling processes to reduce time and administrative costs.

For example, by working together, they can eliminate rework from resubmissions, and reduce bad debts resulting from inaccurate eligibility, coordination of benefits (COB) or claims information.

7).
Proliferation of "new" benefits models.

In an attempt to reduce health costs, employers are demanding new types of benefits, and payers are responding. These "consumer-directed health plans" include increased cost sharing, tiered benefits levels, defined contribution, and savings accounts. Although these models may eventually change behavior in the average consumer, few have been shown to have impact on the small percentage of patients who consume the largest amount of health care.

A few of the more innovative health organizations will recognize the need to demonstrate true value, not just cost-shift, and develop more progressive reimbursement methodologies using outcomes and incentives to decrease utilization, e.g., episodic reimbursement. But for most, consumer-directed health plans will simply serve as a marketing strategy to attract and retain accounts – particularly small employers who are feeling the brunt of premium increases.

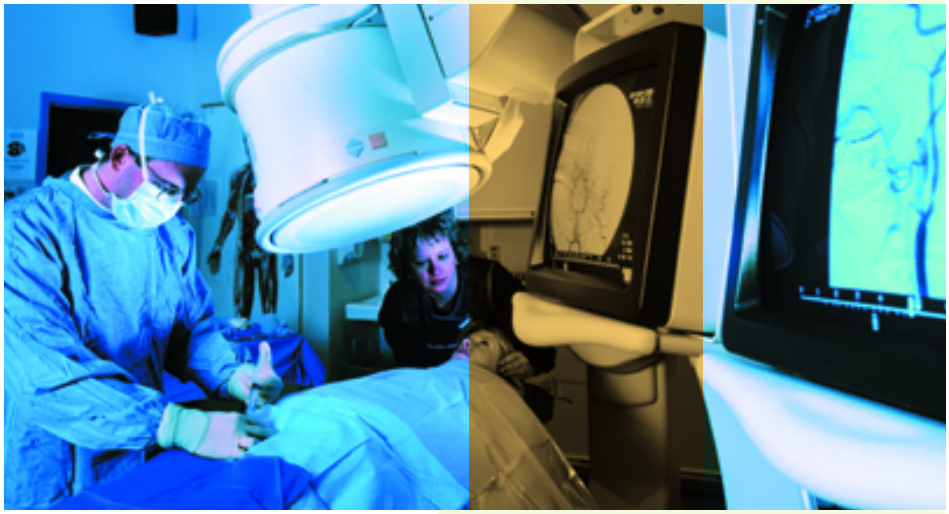
8).
Redirection of medical management efforts.

With efforts to reduce administrative costs largely exhausted and medical costs continuing to rise, healthcare organizations are taking a new view of medical management. They are looking at advanced care management, or population health management approaches. This involves the use of predictive modeling techniques to identify "at risk" patients who are about to incur large claims.

Technology enables prioritized outreach to these people to prevent complications. Employers (typically) offer support programs to modify patients' behavior and thus avoid costly hospitalizations or procedures down the road. The effect is to reduce the amount of inpatient and acute care, while increasing the amount of outpatient care, office care, non-physician based interventions, and drug utilization.

Organizations that are adopting this approach – which goes way beyond diabetes, heart disease, and asthma to include acid-related stomach disorders, low back pain, osteoporosis, fibromyalgia, incontinence, and irritable bowel syndrome – are generating a 3:1 return on their investment, and reducing their medical expenses by 2-3 percent.

Summary



9).
Emphasis on organizational ethics and institutional governance.

Shock waves from corporate financial scandals in other industries are rippling through healthcare. In a high-profile case, the federal government is investigating billing practices of a healthcare system. This will affect the entire industry from an investor perspective. Even not-for-profit hospitals are now feeling the impact.

Burned by the unexpected bankruptcies of several prominent not-for-profits, municipal bondholders are examining hospitals' books with a critical eye and demanding more detailed financial reporting. In this era of disclosure and financial transparency, healthcare CFOs must be able to clearly substantiate what makes their organizations creditworthy. Many will look toward revenue cycle solutions to strengthen their financial position and improve their bond ratings. Others will undergo business reorganizations and board management changes due to the Sarbanes/Oxley legislation.

10).
Community approaches to new biological threats.

The US healthcare system is confronting new challenges from diseases such as SARS and bioterrorism. Despite much national media attention, the industry is still in the early stages of responding. The federal government is funding a myriad of activities that impact the disaster preparedness agenda. While these funds are targeted primarily towards terrorism preparedness, they will ultimately drive improvements that can be used on a daily basis absent of a terrorism event.

Ultimately, there is an opportunity for healthcare organizations to provide leadership in the planning and execution of community-based disaster preparedness and response initiatives.

In short, the coming year will pose a variety of new challenges for the health industry. But it also offers the chance for innovative health organizations to transform themselves. Tomorrow's leaders will seize the opportunity to adopt a new business-oriented philosophy and approach to management. To succeed, industry players will need to do more than react. They will need to proactively incorporate these issues into their strategic plans and continuously reinvent their operations.

Capgemini Health

Capgemini Health is the global leader in professional services to the health industry, delivering broad-based and results-driven solutions for today's business challenges.

We are the only company with the diversity and dedicated experience and resources to address many sectors of the health industry, including hospitals and health systems, academic health centers, post acute care facilities, physician groups, managed care organizations, life sciences organizations, and health-related technology companies. Our professionals include clinicians and former industry executives, who collectively bring hundreds of years of healthcare experience to clients.

Gartner, Inc. recently named Capgemini the #1 Top Consultant and System Integrator, and the #1 top Outsourcer worldwide in the health provider market. Kennedy Information, Inc. also ranked Capgemini #1 in the provider, payer and life sciences categories in a recent report entitled "The Global Healthcare Consulting Marketplace." These rankings further confirm Capgemini's leadership in healthcare consulting.

Our clients tell us that what makes Capgemini different is the unique, collaborative way in which we help them take advantage of opportunities and solve their problems. Collaboration has long been a recognized cornerstone of our approach to business and is part of our DNA. We have now formalized this core strength into The Collaborative Business Experience – our commitment to your success.

Backed by decades of industry and service experience, the Capgemini Collaborative Business Experience will help you achieve measurably better, faster, and more sustainable results. We provide the talent and tools you need to stay ahead of the competition. The bottom line: Collaboration makes you stronger, by combining what you do best with what we do best.

Capgemini is uniquely positioned to collaborate with you. We don't just serve health organizations. We come from and represent the health industry. We commit the following capabilities to solving our clients' problems:

Top talent and unparalleled experience.

We have a team of 1600 people dedicated to the health industry worldwide. Our proven solutions are delivered by executives with real-world experience running health companies. Our staff includes former CEOs, CIOs, and COOs of hospitals and managed care organizations, as well as former executives from research-based life sciences companies, and former government decision-makers. We have more clinicians on staff than any other consultancy – including physicians, nurses, coding specialists, laboratory and radiology technicians, pharmacists, and dieticians.

Knowledge transfer and proven solutions.

Through organization-wide cost, revenue and system performance initiatives, we've achieved financial improvements ranging 5-15% for some of the largest health organizations in the country. We have a portfolio of proprietary tools to deliver proven results and speed cycle times, including advanced facilitation techniques, demonstration centers and development laboratories. At Capgemini, we have been a pioneer in developing collaborative practices such as our Accelerated Solutions Environment (ASE), which helps companies create rich strategic and technology solutions in record time.

Unbiased technology orientation.

We have a network of world-leading technology partners, including Eclipsys, IDX, Trizetto, Microsoft, Oracle, and PeopleSoft. Our IT professionals have expertise in all of the major packaged systems used by the health industry. We have full resources in place to run an IT organization, the depth and breadth to advise, consult or outsource.

Thought leadership and involvement in the industry.

Hailed by Gartner for our ability to capture "mind share" through thought leadership, Capgemini has a long-standing tradition of investing a portion of its yearly profits into Research and Development work — a commitment that helps the firm bring deep market insights and innovative solutions to its clients. In the managed care arena, our professionals authored a leading text on the industry, *The Managed Care Handbook*. In the provider market, we recently published *Innovating Clinical Care through Technology*, the first comprehensive book regarding clinical information systems. And we literally wrote the book on collaboration between health organizations, *Enabling Collaboration Between Payors and Providers*.

In addition, Capgemini's professionals hold a leadership role in the health industry, including chairing HIPAA-related committees; testifying before the National Council on Vital and Health Statistics; and actively participating in a variety of industry professional associations including: AAHP, AHA, ACHE, AONE, HFMA, HIMSS, CHIME, HRDI and NCPDP.

A focus on value and results.

We can help our clients use a variety of tools that give a full picture of potential opportunities, assigning value not just to production or financial capabilities but also to the benefit of intangibles, such as improving patient safety, helping you grow/ improve your service quality, technical capabilities, market share, professional resources, clinical expertise, operational productivity and reputation – all in a manner that ultimately maximizes ROI and profitability. Then we collaborate with clients to ensure that projects are well grounded and achieve the results they expect at each stage of delivery, and that it does so even when circumstances change over the course of the project.

Range of health-specific solutions

Working hard to address the full scope of operational and technology issues, including:

- Business Strategy and Transformation
- Clinical Transformation
- Revenue Cycle
- Supply Chain Management
- Health ERP Packages
- Payor Services

About Capgemini

Capgemini is one of the world's largest providers of Consulting, Technology and Outsourcing services. The company helps businesses implement growth strategies and leverage technology.

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