



Podcast: Humana CEO Mike McCallister: Letting the Consumer Drive Innovation

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In the wake of rising medical costs and lowered reimbursement rates for Medicare, health care companies are finding it increasingly difficult to balance quality service with strong earnings. At the same time, the proliferation of products in the industry has added a layer of complexity that threatens service levels and, in many instances, makes execution of services more difficult and costly for companies and consumers alike.

Mike McCallister, CEO of Louisville, Kentucky-based Humana, one of the United States' largest publicly traded health benefits providers, has grappled with these issues while leading the company through the rapid changes the industry has seen during the past several years. Today, the company is focused on moving away from the traditional "one-size-fits-all" health care delivery model adopted by most employers, to a consumer-centered model -- one in which product innovation is driven by consumer needs. Placing the consumer at the center is not easy, McCallister admits, because with innovation comes the potential for additional product and service complexity; the trick, he says, is delivering complexity only where consumers are willing to pay for it.

McCallister spoke with Wharton management professor Michael Useem and Stephen Wilson, engagement director in George Group Consulting's Conquering Complexity practice, about his company's take on health care delivery and the challenges of leading in a changing industry.

Useem: Looking back at how you have grown with the company since 1974, how you lead people and how you've led the company, can you offer a couple of thoughts on what it takes now, in year 2006, to lead a much more complex, diverse and much larger enterprise than at an earlier point in your career?

McCallister: I might disappoint you if I told you that I'm not sure it's any different.

Useem: Well that's a perfectly good answer. Could you elaborate a bit on that?

McCallister: Although there are a number of different tactical things you have to do given the scale, scope and complexity of what we are today versus what we once were, to me the principles have always been the same: You find the best people you can. You get a clear direction for the company. You delegate the right work to the right people, and then you get out of their way and let them do it while holding them all accountable for their performance. I know that's right out of Management 101, but that's what you do. Given the complexity of the business we're in today, there are a number of tactical ways you have to go about doing those simple things I described, but I think at the core they're all the same.

We've had to deal in more of a team environment than we once did. When Humana was a hospital company, the business operated as individual, local units with as many centralized activities as we could manage. As we tried to integrate health insurance and hospitals, it became more regional, or at least metropolitan-wide. When we went into being a pure employee benefits company in the mid-nineties, our structure became much more centralized because insurance is a financial institution more so than health care. The way we operate and run Humana has transitioned. We're more data-driven today than we once



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were and we have more challenges relative to applying technology in an effective way. Many of the agenda items are different, but the core principles of how you manage the enterprise are the same.

Useem: You have made hundreds, thousands of major decisions. Could you pick out one of your more difficult decisions and talk about it: What went into it? How did you reach the decision? What does it take on your part to make a good and timely decision?

McCallister: Well, I'll pick one that we made not too long ago. When we decided to set the strategy for this company after I became CEO in 2000, one of the most important decisions we ever made was to organize and drive this company around the simple premise that the consumer had to be at the heart of health care. Now there's a lot of talk around that idea today. Six years ago there wasn't anybody talking about it and there weren't many people going down that path. If you think about health care and the way it operates and has for a hundred years -- very paternalistic, no information -- it's a mother and father "may I" kind of environment. To have the consumer at the core of how it's organized seems so simple and seems so right -- except when you talk to health care people, who think it's crazy. That decision was a big one and has really guided everything we've done for the last six years with varying levels of success.... What's particularly gratifying is that the rest of the industry has now decided they're going to go down this path, too. We get the benefit of having been at it for a while, and we also take pride in the fact that we may have helped nudge the industry toward consumers.

Useem: Could you offer a word or two on what prompted that decision at that time? And, to whom did you turn for guidance or counsel on that one in particular?

McCallister: I didn't turn to anyone on the outside. After thinking about it myself, I engaged a handful of Humana's key people, and together we tried to figure out where we were going to take the company, how we were going to fix it and change it. Those key people had an incredible mix of knowledge from both in and outside the industry, and quite frankly there wasn't much going on outside that would have led us down the consumer path.

We were trying to answer a very, very big question: "What would it take to rationalize health care and the cost of health care in the US?" We started putting down everything that's been tried, everything that's failed, everything that's worked -- there haven't been too many things that have worked. When we started listing the history of it, all the various components, all the various approaches that people have tried to apply over many, many years, it quickly became clear that the one thing no one had ever tried was to get the consumer at the heart of this. But it didn't start with, "We think the consumer's great. Let's make a case for it." It was the other way around. We looked at a blank sheet of paper and asked ourselves, if we're going to try to do something about the cost of health care and health insurance, how do we do it?

Useem: Was this a deliberation on the inside that took place over six months? A year? How much of your own time did you focus on this before you finally said this is a "go"?

McCallister: At the hundred-thousand-foot level it didn't take too long to agree the consumer was the way to go. Then we started bringing it down to fifty thousand feet and said, "All right, if the consumer's going to be the core of what we think, then what are the next steps we take to make that happen?" That took longer, probably more like a year in the making. Some great things came out of all those conversations. It's not on our strategy page, but as soon as we decided that the consumer was where we wanted to be, it was clear we were going to have to be an innovator as well, because it was going to take some innovations in the industry to bring the consumer to the center. Innovation is a core component of making that happen.

Useem: In focusing on the consumer, you in a sense opened up a Pandora's box. Every consumer has a slightly different set of needs, and so inherently the universe becomes more complex, more diverse. How have you coped, managed, led when you've invited greater complexity into the way

you do just about everything you do?

McCallister: First of all, one of the faults in all of health care as far as I'm concerned is an attitude that everyone's the same. A lot of the solutions around health insurance and health care tend to be "one size fits all." I would stipulate that the consumer world is very complex, that people need and want different things. For an employer or any buyer of insurance to pretend that they know what all their people need is outrageous. I start with the underlying principle that consumers are different. They all need different things and they want different things, and it's interesting that the rest of the economy responds to that every single day. Consumers drive everything -- except in health care, where people try to do top-down to these folks. I'll stipulate that it's complex, stipulate that maybe it's more difficult to meet a consumer where they are, but that's exactly what has to be done if you're going to engage consumers. If you don't get down to their individual level and meet their needs, find what they're going to respond to, the chance that collectively they're going to change anything is zero.

Useem: Has this affected how you run your office or the way you work with your top team?

McCallister: It's made the company's head spin, because you have people in two different camps. You have people in the old camp of the business, those who believe we have to do better at what we've been doing. Then you have those who are ready to go down a different path and try to find a different way. The friction between the two can be significant, and generates another level of complexity in what was already a complex business. The real trick there is to separate the good complexity from the bad complexity: If you're going to respond to consumers and try to meet them where they are, it will generate some complexity, but try to stay away from what's not important and what consumers won't pay for.

Useem: Are there other companies, or even other industries, that provided some thinking through, some guidance or some models for what you're doing now?

McCallister: There are probably some components from a number of places. I'll give you one: Dell computer has done a nice job of managing complexity and delivering complexity people will pay for. Although they provide a lot of selections, there's less complexity there than most people would think. There are any number of consumer products and other consumer brands where they have done things you never would have dreamed of on the backs of consumers. Starbucks is a great example. Who would have thought you could have sold consumers that kind of coffee? They responded to some need that was yet unidentified.

I can probably go on and on, but I looked at technology from the standpoint of its importance. Even in 2000 it was clear that people were going to do significant transactional work over the Internet, that people were going to seek out information on the Internet and they were going to use the Internet for comparisons and for better pricing on products. That was a big piece of this. Just imagine the information flow that would be necessary in health care to get people engaged and empowered. It's crucial that the Internet be the core process for that. All of the Internet companies that were responding to consumers were decent models to look at, certainly from an information-flow perspective.

Useem: If someone from another industry or maybe another company in the same terrain came to you and said, "Mike you've been through it. Are there a couple pitfalls to be avoided?" -- are there a couple of lessons that you would pass on to them?

McCallister: One that comes to mind, quickly, would be that in an era of technology expansion and explosion like we have today, I think any business in any industry really has to carefully achieve a level of standardization -- things necessary to fully maximize the technology uptake and productivity gains that are potentially out there. That was pretty natural in our business, because we have such high transactional work. I think you've got to quickly connect the process orientation with the application of technology.

Useem: Back on the pitfall side -- anything that you would have done differently or would tell someone, "Watch out for this going forward?"

McCallister: If you try to make any significant changes to your business or in your industry, you better get a backbone, because critics will come out of the woodwork. Be ready to withstand a fair amount of criticism from those who believe differently.

Useem: And you're speaking both in the industry at large and then in your own ranks, of course.

McCallister: Absolutely.

Useem: With complexity comes a required focus on that diverse terrain that takes up more time, more energy. How has this increasing focus on the consumer -- and all the complexity that it has brought -- affected your ability to be innovative and still come up with great solutions to the problems that consumers face?

McCallister: Two big issues to me. We organized a separate innovation group because I believed it was going to take that, given the fact that we were an old company that had been around a long time. We were going to require some separate people to be innovative because it wasn't going to come naturally elsewhere. That generates another couple of issues. One is that the innovative types aren't always caught up in what's actually doable, so a natural friction ensues. It's not just a question of what's actually doable from the standpoint of building out and delivering something, but what the market will eat, so to speak, as well as the execution of some of the innovative things that can come up. It's hard in a company that's fighting over resources to fund innovation, especially if it doesn't have short-term payback, because the people who are trying to make the trains run on time every day get a little frustrated with that burning of resources. But you have to get committed to some level of burn to keep an innovative engine going.

Useem: I wanted to give my colleague here, Stephen Wilson, an opportunity to ask some questions.

Wilson: Mike, one of the impacts of product and service complexity is that it can impair execution service levels. So as you go towards consumer-driven health care, what are the implications for the back office for execution, and how would you rate the overall industry in that regard?

McCallister: I think we in the industry allow our complexity to be the wrong kind at the wrong place. We allow our customer-employers to drive complexity as opposed to letting consumers drive it, which is the right way. Our industry has poorly controlled bad complexity relative to the historic sales model to employers. I think we're early in figuring out exactly what complexity we're going to be able to manage and put in front of consumers directly ... we'll have to see how that plays out. I think the complexity that we manage, tolerate and make good at the consumer level has big potential. Ongoing complexity in the back office from an old model is absolutely non-value-added.

Useem: Mike, let me quickly add a question onto that one. Could you just identify an example or two that shows the difference between a consumer-driven need as opposed to an employer-driven need? How have you worked with that difference?

McCallister: Employers are trying to satisfy the health insurance needs of lots of people in one fell swoop. That causes them to go with a "lowest common denominator" concept. In other words, what would it take to satisfy as many of these people as I can possibly satisfy? It's just that simple, and

the driving force there will be, "What will it take for me as an employer to have everybody feel pretty good about working here?" -- which is important, because no one wants to lose people over benefits.

On the other hand, if you go to a consumer-driven model, you're letting the individual consumer decide what their blend of risk tolerance is, what their economics are, the type of things they want from health insurance, how important different levels of benefits are for them -- in the context of their overall family environment. I could have two employees standing next to each other: One just won the lottery, and the other one is barely making ends meet. As far as their relationship to me goes, they're doing the same job and making the same money. It's as simple as letting the individual decide the coverage, [based on] short-term versus long-term economics -- the risk tolerance they have, versus an employer trying to do it on a broad basis for a lot of people.

Wilson: What is the role of management in this industry, particularly in driving innovation while keeping complexity at bay?

McCallister: You have startup companies that are totally innovation driven. That's pretty straightforward and pretty simple. We've had companies in our space that just stayed consistent with their old approaches, and that's pretty simple. The trick is when you start putting them together and managing all of the organizational implications, as well as having a reasonable focus: What are you all about as a company, and how are you going to approach the market? We've been through all those issues and difficulties and we continue to get better at it.... I think that management's job is to balance all those horses, keep the organization pointed in the right direction. Senior management has to be the leader relative to driving innovation, because they have to make the organization feel comfortable with it.

One of the things we've tried to develop around here is a learning organization. When we first started that process, I got reactions like, "I don't know what you're talking about -- a learning organization?" And so we've worked on that over the last few years and developed it. We've come a long way. I think that goes hand-in-hand with innovation. Innovation requires people to learn different things -- it requires a culture built around the idea that learning is okay. I think we've come a long way there.

Useem: Looking ahead to the next couple of years, what do you see as one of the bigger challenges coming along for you, personally, either inside the company or as your own market changes?

McCallister: Well, I have a big piece of work in front of me as we speak, and it's specific to the Medicare program. We are a major player in the expansion of the Medicare program, so we have millions of new customers. Inside a highly politically charged business we have a big job to execute on the concept of consumer engagement, because the Medicare program essentially operates as a retail consumer business on a scale we've never seen in our industry. We have a wonderful opportunity in front of us to take much of what we've been trying to execute relative to consumer engagement, information, the use of technology, etc., and apply it to a very large, new business. That's very exciting. We hope to take these ideas much further down the path with this population over the next couple of years.