Leading Strategic Change at DaVita: The Integration of the Gambro Acquisition

In the summer of 2005, Kent Thiry, a 49-year-old Harvard MBA, ex-Bain consultant, and now the CEO of DaVita, thought about how he and his management team should address a set of emerging and important challenges. DaVita (publicly traded on the New York Stock Exchange under the symbol DVA) was a $2.2 billion annual revenue operator of free-standing and in-hospital kidney dialysis centers.

Thiry and his senior team were meeting to discuss the next steps the company should take to continue its organizational development and strategic evolution. They were especially focused on how to manage several looming challenges. DaVita was just in the process of completing a $3.1 billion purchase of Gambro, a large competitor. The acquisition would nearly double its size, from 700 to more than 1,200 dialysis centers and from 13,000 to 25,000 people. As such, it would cement its position as the second largest operator of kidney dialysis centers in the United States.

When Thiry came to lead the company in October 1999, the organization had been beset with financial, operational, regulatory, and morale difficulties. "The company was technically bankrupt," he said. "It was being investigated by the SEC, sued by shareholders, had turnover at over twice our current levels, was almost out of cash, and, in general, wasn't the happiest of places."[1] By 2005, the new management team had achieved a complete turnaround. The company's market capitalization had grown from $200 million to more than $5 billion, the clinical outcomes had become the best in the industry, the company's organic growth was the highest in the industry, and employee retention had improved dramatically, with a 50% reduction in turnover.

However, this had not been a typical turnaround. Instead, a closer look at DaVita's culture and leadership showed that the DaVita management team's focus had been on creating a strong and positive values-based organization where all levels of the organization had an emotional commitment to its success. The foundation was the Mission and Values, first created by 700 of the company's managers in 2000 and now widely practiced throughout the company. To the management team, the company's rebirth strategy was based on the belief that they had to create something larger than themselves in order to be successful. Thiry commented:

> At Vivra [another kidney dialysis company where many of DaVita's senior leaders had worked together], we implemented many people, team, and culture-friendly policies. They were consistent with my basic values, but the extra energy I brought to them was because they were a means to the end of having a successful company. This time it is different. This time the building of a successful company is a means to the end of building a healthy community. Because humans spend more waking hours at work than anywhere else, if you are a leader who purports to care about your team, it makes no sense to create a paradigm which concedes all that time needs to be spent in [a] relatively vanilla values or sterile emotional commitment environment.[2]

Because of this, Thiry and his team flagged several important challenges they believed needed to be addressed if DaVita was to continue its successful evolution of both operations *and* culture. The question was, How could they use the culture to achieve even greater operational excellence?

[1]http://www.redcoatpublishing.com

[2]Kent Thiry, email, November 27, 2005.

THE GAMBRO INTEGRATION

One immediate task entailed integrating Gambro into the DaVita way of managing and its culture. Gambro was significantly more hierarchical and formal than DaVita, and did not have a strong people-oriented culture. Prior to the merger, DaVita had been disparaged inside Gambro, with Thiry described as "a compliance maverick, reckless, and egotistical." Ironically, Gambro had itself purchased Vivra in 1997, then a smaller, publicly traded dialysis company led and transformed by Thiry during the 1990s. As the leader of the combined organization, Thiry's goal was to be respectful of Gambro, its people, and its capabilities, while maintaining DaVita's unique culture and way of management.

PERSONAL TOUCH IN A GROWING ORGANIZATION

Prior to the Gambro integration, DaVita operated in 37 states. Its growth, size, and diverse locations made it increasingly difficult for Thiry to personally touch the many teammates on a regular basis. This presented a key challenge: How to personally impact teammates as he had during his first five years at the helm? Affectionately called "KT" by many teammates in the company, Thiry was, by everyone's estimation, extremely charismatic and energetic. More than that, Thiry was the primary architect of and cheerleader for DaVita's unique culture and values. The company reflected the vision shared by Thiry, Joe Mello, and a few others such as Doug Vlchek. Mello, DaVita's COO, and Vlchek, DaVita's chief wisdom officer, had worked with Thiry before and had joined DaVita in 1999 to help drive the organizational change initiative.

TEAMMATE MORALE AND COMPENSATION

Maintaining the culture and sense of community within DaVita was not easy, even before the acquisition of Gambro. Taking care of dialysis patients is a difficult job. One out of every five dialysis patients dies each year, creating not only a difficult work environment but also a lot of emotional strain. With the company's turnaround receding into the past, numerous employees—or "teammates" as all are called at DaVita—had rising expectations for wages and working conditions. The company's ability to raise salaries was constrained by the high volume of patients—about 79%[3]—who were covered by government programs such as Medicare and Medicaid but whose reimbursement rate did not cover the cost of treatment.

Because of financial constraints, dialysis providers could not afford to pay high overtime rates. As a result, many of DaVita's patient care technicians, who typically earned between $11 and $14 per hour, worked two jobs in order to generate sufficient income. One manifestation of the pay challenge was the barrage of questions that Thiry and Mello would get as they traveled the country conducting "town hall meetings." Town hall meetings were an opportunity for teammates to ask questions of senior leadership, in person. It was quite common for teammates to ask why their wages were not higher and why productivity expectations were so high and always rising. Moreover, DaVita competed for nurses in labor markets with nursing shortages. Many other organizations had chosen to just throw money at the problem of attracting and keeping nurses, something DaVita could not afford to do.

OPERATIONAL EFFICIENCIES AND PRODUCTIVITY IMPROVEMENT

The fifth challenge was to continue to drive productivity improvement and to think about ways to fundamentally reengineer the business. As Mello noted, the company had made great strides in enhancing labor productivity over the past several years. But

[3]From 2004 DaVita Annual Report, p. 4.

there was always the looming threat of reduced reimbursement from the government for dialysis services. This revenue stream represented approximately 60% of total company revenue.[4] Mello talked about the challenge of doing things that would materially and fundamentally enhance the company's cost structure so DaVita could be largely impervious to what might happen in its environment.

As Thiry prepared for the meeting with his executive team, he thought about what the company should do about these challenges and maintaining the culture his senior team had worked so hard to build. He wanted the team to come up with some ideas about how to address the challenges facing the company, and of course, to do so in a way that was consistent with its values and culture.

A BRIEF HISTORY OF DAVITA (1994–1999)

DaVita was the new name given in 2000 to Total Renal Care (TRC), a company originally founded by Victor Chaltiel. Chaltiel had sold a former company for a good profit, with the business model of leveraging cost savings obtained through large-scale purchasing and distribution systems for drugs in the Medicare reimbursement program. Based on his success, he planned to do the same thing in the domain of kidney dialysis centers through roll-ups of smaller chains and individual centers. One of Chaltiel's strategies was to apply strict business principles and reap their rewards upon entering the traditionally not-for-profit domain of kidney dialysis centers (run by hospitals and physician specialists). He focused on growth through acquisition through the 1990s. The Internet bubble focused many analysts on top-line revenue growth, which provided TRC with a high stock price that allowed it to continue making acquisitions at a fast pace.

Unfortunately, Chaltiel and his team failed to integrate their acquisitions, leading to some operational incoherence in TRC. One example noted by Harlan Cleaver, DaVita's chief information officer, was that there was no uniformity in a critical patient data form used to record and monitor patient care during dialysis, and little standardization in reporting and work methods across centers. This absence of standardization made routine management activities, such as transferring personnel and patients across centers, much more difficult if not impossible.

Cash flow issues created serious problems. Mello commented that another operational weakness of TRC was insurance reimbursement—a critical problem for a company whose revenue was entirely dependent on it. Insurers and the government would frequently question charges and demand additional documentation. They would occasionally unilaterally reduce the reimbursement amount, and delay payment until they received answers to queries and requested documentation. Medical service providers such as DaVita needed to pay close attention to billing and collections to avoid a cash crunch.

Finally, senior executives paid scant attention to the dialysis centers themselves, which were seen more as an avenue of corporate growth where patients and caregivers were economic units in a bigger financial structure. This headquarter-centric, financially oriented operating culture did not win friends among the health care practitioners who worked hard in the field to deliver quality care.

In 1999, Total Renal Care ran into severe financial difficulties, having just recently merged with another large competitor that had also been built in a rapid fashion. The board of directors turned to Thiry, who was in the process of leaving a private-equity–funded managed care company where he had been for two years post-Vivra in 1997. He was eagerly anticipating time off with his family. When headhunters called to see if he wanted to

[4]From 2004 DaVita Annual Report, p. 4.

interview for another CEO position, he always replied, "No." Thiry was within 90 days of his "retirement" when TRC called:

> I still remember the call. After my assistant told me who was on the phone, I picked it up with the intention of giving the same 'no' answer. As I started to listen, all the positive memories of my first time in dialysis, at Vivra, came flooding back. It had been the most powerfully positive time of my professional life. I have no idea what I said in that phone conversation. All I know is I went home that night and asked my wife Denise if it was okay to interview. She was livid. What about my alleged interest in more time with the family? What about the fact that this was a turnaround located in another city [Thiry lived near San Francisco and TRC was headquartered in the Los Angeles area]? The difficulty of the decision felt like a terrible burden at the time. It turned out to be a gift. Never before did I have to think so deeply about why I wanted to do something. After agonizing for a few weeks, we decided I would give it a try. There is a saying I love—we use it at DaVita all the time: 'Begin with the end in mind.' I started at DaVita with more of an end in mind than any other beginning in my professional life.

Before accepting the job offer, Thiry reached out to a set of people who had been with him in his previous dialysis venture, people whom he trusted, liked, and respected. He recruited Harlan Cleaver, who was now living in Denver, to be the chief technology officer and David Barry to be COO. He reached out to Doug Vlchek, whom he had hired into Vivra, to lead the organizational change and culture-building efforts. Thiry recalled, in reference to the musketeer imagery he loves, asking them something like, "Will you ride again?" They all accepted. When Barry left in the first year for personal reasons, Thiry brought in Joe Mello, who had also been with him at Vivra.

When Thiry arrived at TRC in October 1999, the company was a mess. It could barely make payroll, was in default on its loan covenants, and was paying penalties to the banks. Highly leveraged from its many acquisitions, it was essentially on the verge of bankruptcy. The stock had fallen from nearly $50 to $2 a share. Systems were nonexistent or in chaos, and the organization's employees were dispirited and unhappy. It was not at all clear that financial survival was possible.

KEY SUCCESS FACTORS FOR A DIALYSIS COMPANY LIKE DAVITA

There were four critical factors for organizational success along both financial and clinical outcome dimensions.

Attention to Detail

The first factor was painstaking attention to operational details and compliance with government regulations. For instance, a company that charged the government, through the Medicare program, for services that were not actually delivered and/or were not documented could face accusations of fraud and suffer financial penalties as well as delays in payment. Legal problems could also arise from actually delivering care or medicines that patients did not need, as well as for improper relationships with drug companies or physicians that might entail kickbacks for patient referrals or purchases of pharmaceutical supplies. Proper record keeping and ethical behavior were vital to the ongoing success of dialysis companies.

Managing Financial Outcomes

The opportunity to make a financial difference in operational results rested largely on small but important behaviors and decisions. One such activity was carefully using supplies to avoid waste and maintaining appropriate stock levels so that inventory costs were not unnecessarily high, yet avoiding emergency ordering. Another activity was the reuse of dialysis filters and maintenance of the dialysis machines

to ensure both long life of the equipment and lower cost per treatment.

Possibly even more important was the activity of efficient labor-hour management, given that the proportion of labor costs in the total cost structure equaled one-third to one-half of the treatment cost. As Mello pointed out, in 2005 DaVita would do about 7,000,000 dialysis treatments. Each .01 savings in labor hours per treatment achieved across the company was worth about $1.8 million; this savings went directly to the bottom line.

Achieving Good Clinical Outcomes

Attention to detail during the dialysis visit and strong personal relationships among the DaVita staff and patients drove the achievement of good clinical outcomes. First, attention to detail also mattered a lot for obtaining good clinical outcomes. For example, it was important to take care while putting the patient on the machine, monitoring the treatment as it was occurring, and taking the patient off the machine at the end of the session. It was also critical to monitor the patient's health status generally so that treatment issues could be foreseen and addressed. Good clinical outcomes also enabled DaVita teammates to take pride in working in a company that provided the best care in the industry, an advantage in recruiting and retention.

Second, achieving good clinical outcomes depended not only on the patient's commitment to treatment but on the emotional tone and bond between the center's teammates and the patients. Patients sometimes missed their dialysis appointments because they found the treatment unpleasant, the logistics of setting up appointments too difficult, or they became depressed by the likelihood of success. However, according to various DaVita clinic teammates, one important factor affecting patient compliance was the extent to which patients trusted and felt comfortable with the dialysis center and its staff. Emotions are contagious, and to the extent that DaVita could create positive, genuine emotions on the part of its workforce, those positive emotions might influence the attitude of patients. This could thereby improve the patients' survival, not only through their positive mental attitudes but also by affecting their compliance with the difficult regimen of living with late-stage kidney disease. As one administrator said, "It's important that the teammates like their jobs and smile and relate in a compassionate way to patients, because that makes the patients feel better about being here."

Employee Attraction and Retention

The final critical success factor was the attraction and retention of teammates. DaVita competed for nurses with hospitals, doctors' offices, other health care providers, and, of course, with other dialysis companies, and the chronic nursing shortage in the United States meant there were always unfilled positions. Hospitals typically paid more per hour than DaVita or its competitors.

Patient care technicians (PCTs), the largest category of employees, typically earned less than $15 an hour. Many worked two jobs, with their second job often being for another provider of dialysis services. PCTs were often tempted to leave for better-paying opportunities, either with other health care providers or to find different occupations.

Retention of teammates was important because turnover was costly, entailing finding and training replacement people, and possibly paying overtime labor rates if a center was temporarily short-staffed. High turnover could also impair clinical outcomes, because a nurse's or PCT's experience in doing dialysis and working in a team enhanced patient care outcomes. Being an employer of choice was not just part of DaVita's mission, but was also important for business success and better patient care.

THE TURNAROUND (1999–2005)

With an acute awareness of these critical success factors, Thiry and his colleagues set about the task of turning the organization around. The first order of business was the business itself. Over the next four years, the organization worked to fix billing and cash flow problems, restructure outstanding debt, bring the information systems up to speed, hire people who could "get stuff done" ("GSD" remained a popular acronym in the company, and being "good at GSD" was a high compliment), and invest in continuous improvement projects and training.

It was a difficult time for the company. For a time, the government stopped paying DaVita for laboratory tests because of issues in record maintenance and documentation. The company had to decide what to do with the patients whose lab tests were not being reimbursed. The team decided to continue performing tests that it felt were essential in delivery of care and to appeal the decision to an administrative law judge to attempt to obtain the denied funds. Four years later, after winning six successive judgments, the government paid DaVita over $90 million. Harlan Cleaver, the chief information officer, described the process of bringing order to the system and establishing common practices, measures, and information systems across the centers. His first step was to standardize the paper-based system used to keep track of patient care in the various centers. As he pointed out, it made sense to start with that patient record system because the issues were of standardization, common practices, and alignment, without the added complication of computers on top of everything else.

The second order of business was getting the philosophy right. Thiry and his colleagues recognized that what they said and did in those first months would set the tone for the ensuing years at the company, so close attention to building the kind of culture and organization they wanted proceeded in parallel with the business turnaround efforts. Thiry described early meetings of the executive team in which they would spend time discussing basic issues, such as whether they could make payroll and their ongoing negotiations with the banks, and then they would turn to talk about the core values, culture, and operating philosophy they wanted to instill. When Thiry and Vlchek would start talking about Mission and Values, many of the executives were very skeptical about the value and intent of this activity when the company was in such dire straits. Thiry believed that without a clear statement of Mission and Values, the operational turnaround could not be sustained.

A big part of the new philosophy was to recognize that the centers, where patient care was delivered and where most DaVita teammates worked, were key to the company's success. To emphasize the importance of the centers, Thiry had all senior managers, himself included, "adopt" a center and drop by occasionally. Thiry's center was in Hayward, California, and long after his last visit, people in the center were still commenting on his attention to them.

The company later replaced the adopt-a-center program with the practice of having everyone hired in or promoted to the vice president level or above go through "Reality 101," which entailed spending a week in a center helping to do the day-to-day work. Executives participated in activities such as machine set-up prior to dialysis, machine teardown and disinfection post treatment, helping with blood pressure monitoring, or whatever tasks they felt comfortable in actually performing. As Thiry explained, it was important not to push people to do things they felt uncomfortable or unskilled at doing, but it was also important for people to experience what it was like to get up at 4 o'clock in the morning to get to a center at 5 A.M. so it could be open for the first patients at 6 A.M., and to see what life in a center was about.