HSG | PRESERVING YOUR
HOSPITAL'S INDEPENDENCE

TABLE OF CONTENTS

INTRODUCTION — 2

CHECKLIST — 3

PRIMARY CARE DEVELOPMENT — 4

BUILDING SPECIAL CAPABILITIES — 5

SFHS: CASE STUDY — 6

INCREASING GEOGRAPHIC REACH — 7

DEVELOPING PHYSICIAN LEADERS — 8

MUNICIPAL HOSPITAL: CASE STUDY — 9

ENHANCING CARE MANAGEMENT — 10

DIRECTING RELATIONSHIPS WITH LOCAL EMPLOYERS — 11

WHY YOU MIGHT STILL WISH TO MERGE — 12

ACCOUNTABLE CARE / CONCLUSION — 13

ABOUT THE AUTHOR — 14

Building high performing physician networks so health systems can address complex changes with confidence.

HSG

INTRODUCTION

In HSG's strategy work with hospitals, a frequent topic of discussion is **alignment with a healthcare system.** Often, we are asked to evaluate alternative partners. Other times we advise clients whether or not they should join a system.

The push for consolidation is an obvious focus in the industry, with AHA data showing more than 250 independent hospitals have joined systems within the decade. There are passionate voices that believe there is no choice. However, many CEOs and board members are just as passionate in their desire for local control.

Often, the decision to stay independent is the easier route. But remaining independent is not easy. Hospitals that wish to remain independent must have a robust bottom line if they have any hope of building the war chest needed to survive. Independence requires a focused strategy with a bias toward profitable growth. It also requires a leadership team that is efficient at implementing those strategies.

From our perspective, seven strategies must be considered if independence is your goal. The mix and prioritization of these strategies is also key. That in essence is what we help clients define in a strategic planning process.

In addition to selecting the right strategies, the relationship between the CEO and the board is critical. That relationship must be based on trust and confidence; if it is weak, the odds for success are poor. Tasking the CEO with preserving independence and community control is fraught with risks. The board must understand those risks and recognize the complexity of the task at hand.

In this white paper, we outline HSG's experience with positioning hospitals to remain independent. With a focused strategy and steady leadership, it is possible. But it is difficult and we always caution client hospitals to give some thought about their options and be open to consolidation if or when that becomes best for the community.

We hope this document is helpful as you think about how your organization slowly moves forward. If you have questions or comments, or need help defining your strategic plan to remain independent, please call. In discussions with Boards and CEOs, we always learn and gain new insights.

Sincerely,

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CHECKLIST

BOARD PREPARATION

_____ Does the board understand the complexity of the market and the risks of independence? Affiliation?
_____ Does the organization have a clear, detailed strategic plan to support the independence objective?
_____ Is the board supporting the CEO in pursuing the preservation of independence?

PRIMARY CARE STRATEGY

_____ Does the organization have a primary care strategy?
_____ Are you recruiting to meet the growing needs of your population?
_____ Does your primary care plan address recruitment and retention? Care models? Roles of advanced practitioners? Compensation incentives?
_____ Do you have a sustainable employment model?
_____ Do you have a system to measure and improve retention of primary care referrals?

SPECIALTY CAPABILITIES

_____ Have you analyzed volume leakage from the organization and the community?
_____ Have you identified the key specialty strengths you can build upon?
_____ Does the organization have practice management skills?

GEOGRAPHIC REACH

_____ Has the hospital evaluated and prioritized outlying markets as targets?
_____ Are you concentrating resources to ensure success in target markets?
_____ Can you accommodate referrals from outlying physicians?

PHYSICIAN LEADERS

_____ Have you identified the roles you need physician leaders to fill in the next five years?
_____ Do you have a system to assess physicians' ability to fulfill these roles?
_____ Do you have a formal program to educate and develop your physician leaders?
_____ Do physician leaders understand their role in preserving the hospital's independence?

CARE MANAGEMENT

_____ Is your physician culture focused on improving care management?
_____ Do physician leaders have clearly defined roles in this arena?
_____ Are you focusing on issues outside the hospital walls, across the continuum?

PRIVATELY INSURED

_____ Are you engaging employers in your community directly, at the executive level?
_____ Do you have a strategy for direct contracting?
_____ Are you leveraging your employed physicians by having them consult with employers?

ACCOUNTABLE CARE

_____ Does your clinical integration plan focus on the infrastructure needed for accountable care?
_____ Are your physicians evaluating/experimenting with care models such as medical homes?
_____ Is your organization evaluating at least one at-risk model?

PRIMARY CARE **DEVELOPMENT**

A stong primary care base is critical to preserving your hospital's independence. It is the strategy that pays dividends, whether your hospital is being rewarded for volume or value. Primary care physicians help to control the flow of patients to your services and specialists and are key to managing utilization.

An abundant supply of primary care providers also improves healthcare access for the community. Many hospitals are focusing on access, such as commitments to same-day appointments. Without an adequate supply of primary care physicians, this is impossible. Physician recruiting and onboarding must become core competencies for hospitals.

To augment the physician community, the use of advanced practitioners is growing in many markets. Either through use of nurse practitioners or physician assistants, non-physicians are gaining acceptance as primary care providers.

The tight market for primary care creates a quandary for many hospitals. To successfully recruit, they must compensate physicians with more than the physician could earn in private practice. Our advice, is for hospitals to bite the bullet and make that investment. It requires a sustainable employment model, recognizing that most markets will likely not break even.

Having the providers being in place is a big part, but not the only part. In our experience, these operational issues are critical:

- Ensure primary care practitioners (PCPs) are working hard through appropriate compensation incentives. For example, a primary care provider who sees only 10 patients a day won't help your bottom line or the community. It is essential to set standards and expectations around volume. Utilizing scheduling templates that drive those expectations and financial incentives for the front office staff are also beneficial. If frontline workers have an incentive to fill the schedule by going out of their way to accommodate patients, the health system will benefit.
- Ensure PCPs are spread out geographically to maximize access. Since one of the objectives is to grow patient volume, we advise widely distributing the growing base of physicians.
- Ensure your PCPs refer to your specialists and services whenever appropriate. Generating the expectation that referrals will remain in the systems and build the system's volume, will help you meet your objectives as well. Of course, patient needs must come first, but many referrals can likely be directed internally. Data to manage this process is helpful, and we can to provide that data.

BUILDING SPECIALTY **CAPABILITIES**

The **second** element for building volume is to minimize referrals out of your system. This is not feasible if you do not have the physician and service line capabilities.

Hospitals that we have seen successfully remain independent have focused intently on ensuring their physician force is solid and can support referrals. Their strategic planning processes focus on investments in key service lines to stem the tide of lost business.

In making judgments concerning where to concentrate and/or where to invest, you should focus on these questions:

- What are the community needs and can we feasibly address those needs?
- Can we fill the gaps and do a better job of providing the service?
- Can the service be profitable?
- What service line strengths we can build upon?
- What services can we "own" and develop a strong market share and brand that will benefit the facility going forward?

Building the number of specialists is key. Equally important is improving the quality of those specialists. We have seen clients effectively address these challenges by working with tertiary centers to enhance local services as well as working independently. The former is fraught with potential challenges, as the tertiary center is likely motivated by the desire for patients; the results depend on where that line is drawn.

Boards of directors often struggle with this strategy as it often requires significant subsidies. The average subsidy of a specialist in the U.S. is about $200,000 a year.

We have seen clients forced into mergers because of their physician practice losses. Building a strong management infrastructure can help you avoid that path.

PURSUIT OF THIS STRATEGY MUST ALSO BE **ACCOMPANIED BY GROWING OPERATIONAL CAPABILITIES** AROUND MANAGEMENT OF THE PHYSICIAN GROUP.

SFHS CASE STUDY

Executive Summary

Saint Francis Healthcare System is located in Cape Girardeau, MO and is anchored by the 307-bed Saint Francis Medical Center. In 1999, they were number three in consumer preference in a two-hospital community, with an ADC of 124. After 16 years of aggressive strategic action and effective leadership, the organization has grown to be the largest player in town, with tertiary services that serve the five-state region and an ADC of over 200.

Challenge

In 1998, Saint Francis had only 32% of their home county market share and had services and facilities befitting a community hospital. The challenge was producing growth that would sustain the organization and allow it to build excellent regional services that could compete with those in St. Louis and Memphis while increasing local consumer preference.

How HSG Helped

HSG completed a number of projects to help management define and implement their strategic growth plans. Those included strategic plans in 2002, 2008, 2011, and 2014. We also worked with management on physician manpower planning, strategies for a JV surgery center, development of satellite outpatient facilities and managed care issues.

The strategic plans focused on:

1. **ENHANCING** name recognition and top-of-the-mind awareness through aggressive and well-coordinated marketing efforts.
2. **ALIGNING** employee engagement to improve patient and physician satisfaction through a unique Service Quality Award.
3. **GROWING** the number and quality of physicians employed by or aligned with the medical center.
4. **EXPANDING** regional referrals through aggressive referral management programs and responsiveness.
5. **EXPANDING** facilities to include all private rooms and facility homes for key service lines including Orthopedic, Heart, Cancer, Women's, Level III NICU and Neuroscience.
6. **AGGRESSIVELY EXPANDING** relationships with primary care physicians throughout the region, with employment of significant groups over time and development of supporting outpatient facilities.
7. **COLLABORATING** and partnering with other providers to help achieve mutual goals.
8. **IMPROVING PATIENT SATISFACTION** with results consistently at the 90th percentile.
9. **IMPROVING PHYSICIAN SATISFACTION** with consistent ranking at the 95th percentile.
10. **IMPROVING EMPLOYEE SATISFACTION** measured at the 95th percentile, recognized by Modern Healthcare 6 years in a row for Best Places to Work in Healthcare.

Results and Impact

The key to the organization's success and its ability to remain independent has been its financial success. In the last five years, net operating margin has varied from a low of 2.9% to a high of 9.74%. All, after providing 50% of any excess operating margin over 3% to employees through the Service Quality Award program. Remarkably, the organization has 440 days' cash on hand.

That cash situation also allows the organization to invest in new physicians and resources to improve care quality. For example, they developed relationships with the Cleveland Clinic and MD Anderson to improve the quality of their cardiac and cancer services. All of these efforts have led to the organization being a great resource and making a sustainable difference in Cape Girardeau and the five-state area they serve.

INCREASING GEOGRAPHIC **REACH**

While demographic shifts such as an aging population have helped slow the change, the outpatient health care trend is unmistakable. In this environment, fewer inpatient facilities will survive. No successful hospital can endure without expanding its geographic reach.

Traditionally, hospitals have focused on increasing referrals to specialists to facilitate growth. This strategy requires a sales force of liaisons to identify opportunities, a base of specialty physicians that are responsive to the referring doctors, and intake systems that allow easy access for new patients. **Hospitals have grown their admissions by up to 15% with this strategy alone, bringing in millions of dollars of new revenue that contribute to both the overhead and increase profits.**

Some successful hospitals are becoming more aggressive, tying the geographic growth strategy to acquire remote primary care practices outside their home markets. These acquisitions are often based on physician dissatisfaction with their local hospital and this strategy requires a willingness to be aggressive. It's not "collegial" to acquire another facility's referral base, but if you want to remain an independent, it may be necessary.

Critical mass is also a key element of the strategy. Primary care doctor expansion paired with specialty clinics create a stronger offering.

A foray into a new market will not likely give you access to 100% of the healthcare dollars in that market. Basic inpatient needs may still be addressed at the local level. But a strong investment can give you access to physician dollars, a significant piece of outpatient dollars, and inpatient dollars for specialty services that can be referred back to the home base.

Recent (and likely growing) changes to reimbursement on site make nearby satellite facilities harder to justify. That makes building critical mass even more important. For this reason, you are wise to define satellite markets you can tackle and "own" rather than a smattering here and there.

One client has focused on three substantially sized communities 40-50 miles away from their main facility. In those communities they have invested in physicians and outpatient facilities. They have also invested in building relationships between the newly-acquired primary physicians and specialists at the home base. The resulting profits from this activity support their desire to remain independent.

WHEN YOU CAN CONSOLIDATE SIGNIFICANT OUTPATIENT FACILITIES WITH THESE PHYSICIANS, **YOUR POSITION IS FURTHER STRENGTHENED.**

DEVELOPING PHYSICIAN **LEADERS**

IMPROVEMENTS IN CARE MANAGEMENT AND POPULATION HEALTH CARE CAN ONLY BE LED BY PHYSICIANS.

Organizations that thrive and remain independent must have strong physician leaders. The challenges your organization faces from healthcare reform, and the challenges you face from private insurers and employers, will primarily be addressed by better clinical management.

Good physician leadership programs have some common elements:

- Defining the roles that physicians must fulfill.
- Assessing the leadership potential of physicians, avoiding the assumption that any physician can be a leader.
- Engaging physician leaders in practical education, such as working through real case studies, not just didactic education.
- Providing classroom education focused on industry knowledge, management knowledge, and leadership theory.
- Emphasizing how the physician enterprise meshes with the organizational strategy.
- Driving physician leaders to work collaboratively to define behavioral norms and set the culture for the physicians.

Unique to your goal of preserving independence is the need for physicians to focus on their role in that objective. Many physicians are supportive of the goal to be independent but may not understand how physician actions affect that goal. It is important to spend time making it clear.

Finally, physician leaders must be respected by their peers. This often comes down to their clinical skills and judgement. It is hard to lead if your peers don't believe you're a good doctor. But respect alone does not make a good leader.

MEMORIAL HOSPITAL CASE STUDY

Executive Summary

Memorial is a 262-bed, sole community hospital in the Midwest. In 2012, HSG was engaged to complete a strategic plan. The plan was built by a board, executive staff, and physician planning committee, and has resulted in a financial turnaround. That turnaround allowed Memorial to remain independent in an otherwise consolidating market.

Challenge

The hospital is located 53 miles north of a major metropolitan area. The market is attractive to the metro area systems, and historically significant outmigration had been experienced. Proximity made some outflow inevitable, but that was exacerbated by a number of issues with the hospital and its medical staff.

How HSG Helped

With the planning committee, a strategic planning process was designed to gain input and set priorities for the organization. The first element was intensive analysis of the market, competitors, the hospital itself, and the healthcare environment. Over five meetings, we developed a plan that improved the current situation, as well as defined the critical elements for long-term success. We also analyzed the data and determined how to proceed with a broad number of constituencies.

The result was a plan with four areas of focus.

1. **BUILD THE PRIMARY CARE BASE** Through recruitment and use of extenders, progress was made in the local market. The organization also decided to reach out to primary care providers in nearby communities, using that strategy to forge relationships and bring more patients to the hospital.
2. **FACILITIES** Unfortunately, the existing facility was older and did not meet patient needs. Through facility expansion, the hospital added a new bed tower (which led to all private rooms), medical office buildings, and new outpatient facilities.
3. **SERVICE DEVELOPMENT** Growth in specialty services was the third focus. That involved significant specialist recruitment and investment in service expansion, with a focus on stemming the tide of patients leaving the community for care.
4. **CUSTOMER SERVICE** Focusing on patient satisfaction with the care received and interactions with the staff and hospital was the final area of focus.

Results and Impact

Over the life of the plan, financial performance improved from breakeven to operating margins of 7%. Fueling the movement was consistent growth in patient revenue – from $209 million in 2012 to $249 million in FY2015. While inpatient volume was flat, the growth in outpatient volume was positive.

The financial resources generated helped preserve the hospital's option to remain independent. However, there is ongoing evaluation of the ability to keep up with capital needs, even with a 7% margin. If an affiliation is pursued, it will be from a position of strength.

ENHANCING CARE MANAGEMENT

One of your phsyician leaders' key responsibilities is improving the way care is managed. This focus is crucial to survival in a fee-for-value market.

Can you create a common vision among the physicians that care management is an important issue to tackle? Are they willing to be mutually accountable? If your physicians are not up to this task, it's time to consider joining a system that has resources to help drive this agenda.

Care management has traditionally been limited to the hospital in many organizations. Reform is forcing that definition to expand. Providers are being held responsible for care across the continuum. This requires development of new relationships with other providers, integration of quality systems into physician offices, and new, more broadly defined quality metrics.

Physicians need education about the changing reimbursement systems and changing incentives. With that knowledge most understand the need to focus on care management. The reality that insurers will seize the initiative if physicians do not is an additional incentive.

THE KEY FIRST ELEMENT IS THE PHYSICIAN CULTURE.

DIRECTING RELATIONSHIPS WITH **LOCAL EMPLOYERS**

A FINAL ADMONITION:
DO NOT LET INSURERS STAND BETWEEN YOUR ORGANIZATION AND THESE PROFITABLE PATIENTS.
IF YOUR ORGANIZATION IS NOT COURTING THESE EMPLOYERS, YOUR ABILITY TO REMAIN INDEPENDENT WILL DECLINE.

Independent hospitals have to be profitable. If you do not produce and retain cash to fund investments, you will not be able to operate independently. The best place to focus is on the source of patients who produce those profits: the privately-insured.

Hospitals make most of their profits from the privately insured. Profits from governmental payers are few and far between. Given this, relationships with employers and direct contractors are critical strategies to preserve independence.

This strategy provides contact with these profitable payers, removing the insurer as the middle man. It will give you influence with both the employer and their employees. Those employees tend to be your most mobile population, as well as the most willing to leave town to pursue other healthcare options.

Providing an employed PCP as an employer advisor is a great vehicle to grow that influence. As your physicians focus on care management and gain insights into how to improve care, they can share their insights with local employers. Ideally, they can help the employer with benefit design and other mutually beneficial issues.

WHY YOU MIGHT STILL WISH TO MERGE

While we find boards generally have a strong interest in independence, there are situations where it's smarter to merge.

GROWING CAPITAL NEEDS Intense growth capital requirements are one challenge. In addition to funding the hospital, IT, physician enterprise and outpatient networks are demanding cash. Bigger systems can acquire capital at lower interest rates, and their size helps them negotiate better rates with insurers.

ACCESS TO MANAGEMENT TALENT The changing market is creating new needs for executive talent. Expertise in population management, physician network management, and IT are some of the more pressing issues. The accountability for clinical outcomes is also driving the need for greater physician leadership. All of these capabilities are scarce, and systems have a leg up due to their size.

ECONOMIES OF SCALE The ability to spread fixed costs over a bigger base and acquire needed resources less expensively are attractive. Moody's data shows that bigger systems are able to drive higher operating margins (about .7% differential for a $4 billion top line system vs a $500 million system). Part of that is economies of scale that spread fixed costs over a larger base.

ACCESS TO PHYSICIANS Many mergers happen because the smaller facility is struggling to attract doctors. Access to residents make recruitment easier. Bigger size breeds a feeling of security.

POPULATION HEALTH IMPERATIVE The data systems, infrastructure, and knowledge required to manage population health is expensive to assemble. This factor alone is driving many of the linkages we are seeing among hospitals in the marketplace.

PHYSICIAN EMPLOYMENT LOSSES Some organizations are struggling with losses and assembling the resources to turn those losses around. That alone has driven mergers.

NEED FOR DIVERSIFICATION Diversification in your portfolio is a good thing, as one bad investment cannot ruin you. Health systems, with facilities and resources in multiple cities, provide some diversification as well. A collection of facilities can help insulate hospitals from bad performance in one market, at least for a while.

DRIVE FOR ACCOUNTABILITY The growth in accountability is intimidating to many organizations. Uncertainty and the ability to address accountability effectively as an independent hospital, are driving some mergers.

Before you decide that independence is the only viable path, your board should consider the risks of pursuing that strategy. If you have a potential partner that performs well, and that you trust, a merger with them may be worth considering in the long run.

ACCOUNTABLE CARE

Defining your approach to accountable care is the final strategy, as the ability to manage risk grows in importance. We know that **PROVIDERS ARE INCREASINGLY BEING HELD ACCOUNTABLE** for cost and quality. It is important that your organization "put its toe in the water" and begin to develop knowledge and a strategy to deal with this issue.

That may be an MSSP model ACO, or bundled prices through a governmental program like CJR, or with private insurers. Our recommendation is to dive into this arena, begin to understand the issues and challenges, and work with your physicians to increase their market savvy. One size does not fit all, but ignoring this issue will put your independence at risk over the long term.

One other advantage, if you decide to pursue a locally-owned clinical network, is that in, many markets, big players are working to establish statewide or regional networks. If an independent hospital has developed a network with its physicians, it will find ready-made partners among these larger networks.

CONCLUSION

Based on your community and competition, other approaches may be needed; this is not intended to be a static list. Strong **MARKETING** programs to build the hospital's image may be essential. **FACILITY INVESTMENT** may be required to ensure a competitive facility and has been a common element in many facilities that stay independent. A focus on **PATIENT SERVICE AND SATISFACTION**, implied in many of the strategies recommended, is also important.

When working with clients, our objective is to help them define the approaches that best ensure their goals are achieved. Our efforts focus on helping them tackle these strategies in a coordinated manner, prioritizing what is important for their market and helping the organization better allocate resources.

The strategic financial plan deserves special mention. Without a workable, implementable financial plan, all you have is a theory. Thus, prioritization and allocation of available resources becomes crucial.

If your board and management wish to preserve independence, it is hard to conceive of how you can do it without building most of these capabilities. If HSG can be helpful in defining the priorities or building support for this effort, please let us know.

DAVID W MILLER, FACHE

MANAGING PARTNER

HSG Managing Partner David W. Miller primarily focuses on **strategy development,** including strategic plans for hospitals, health systems, and employed physician groups; affiliation/merger strategies; physician alignment strategies; primary care strategies, and service line planning. He also provides board and medical staff education and retreat facilitation.

Before co-founding HSG in 1999, David spent four years as a Partner with the Galvagni-Miller Strategy Group and fifteen years as an executive with Norton Healthcare in Louisville. David is a Fellow of the American College of Healthcare Executives (ACHE) and he holds a Master's Degree in Health Administration from The Ohio State University and a Bachelor's Degree in Management from Virginia Tech.

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