Power in Partnership?

Community Hospitals Evaluate Relationships as a Pathway to Financial Viability
SUMMARY

Healthcare organizations today face unprecedented challenges. Various economic pressures are causing hospitals to consider the pros and cons of forming relationships with other institutions.

THE SITUATION

Partnership has become a growing trend in the healthcare industry. Between 2010 and 2015, the number of announced hospital mergers and acquisitions increased by 70 percent.

According to the PricewaterhouseCoopers US Health Services Deals Insights Q2 2017, the number of hospital mergers and acquisitions in the second quarter of 2017 increased by 15 percent year over year, and deal value increased by 12 percent. Hospital deals were valued at $2.2 billion in that period.

Looking forward, 61 percent of healthcare leaders expect to see more deals during the next three years and at a quicker pace.
WHAT DRIVES MERGER ACTIVITY?

Healthcare policy reform and economic pressures push hospital leaders to consider relationships with other hospitals and organizations. Some of the most important catalysts for the growing trend in partnerships include:

**Value-based reimbursement** has shifted financial risk away from payers and toward hospitals, which are now responsible for improving patient health across the population. This responsibility will require hospitals to make strategic investments in new population health initiatives.

**The increased importance of technology in healthcare** to meet Meaningful Use requirements, improve care and maximize efficiency, pushes hospitals to invest in health IT and analytics platforms.

**Positioning institutions for long-term financial sustainability** means hospitals must improve their operational and financial performance. Some community hospitals lack the resources to optimize complex processes like revenue cycle, supply chain and productivity without outside help.

**The demographics of many rural communities** are comprised of a stagnant or shrinking population of residents who are older, poorer and sicker than the U.S. population as a whole. This patient base is more costly to treat and relies on Medicare and Medicaid for health coverage. Recent reductions in reimbursement rates by these government payers have hit community hospitals hard.

These drivers and many other factors increase a hospital’s need for investment capital at a time when margins are tighter than ever before. Healthcare systems are able to reduce the financial burden of these investments by distributing the cost across several facilities that serve a larger patient population. Larger healthcare organizations may also have ready access to the capital needed for strategic investments. Leaders of independent community hospitals today see that forming relationships may be required to ensure their long-term success.
EVALUATING RELATIONSHIPS

Before considering relationships, hospitals must first look at the reasons for their financial challenges, and how things might look years ahead.

Sometimes, cost-saving opportunities are identified that empower a hospital to make operational improvements and maintain independence. Other times, a hospital can transfer management responsibilities while maintaining its independence. There are other times when fully partnering with another entity is desirable or inevitable.

Responsible action is more favorable than waiting until the last possible moment. Throughout the process, it’s important for hospital boards and executives to think proactively, work together and define optimal scenarios up front.

A THOUGHTFUL METHODOLOGY

This process enables community-based hospitals to stay in the game and, at its best, brings about the proverbial win-win situation.

Step 1: Consider Partnership Options. When a partnership is the recommended path of pursuit, there are different types of partnership arrangement options available, short of total acquisition. Generally speaking, the more money you want the other organization to risk on your behalf, the less power and control you get to keep.

Education of the hospital boards is critical so that board members—representatives of their community—understand the different types of relationships and arrangements that are available. Sources are available to guide boards through the process of finding suitable partners and preparing them to negotiate the relationship to their best advantage.
Some of the Relationship Options Include:

**Affiliation:**
An affiliation agreement transfers neither risk nor governance: The smaller organization maintains control, and should it fail, the larger organization does not take a hit. The benefit to smaller hospitals of such an agreement is that it allows them to leverage the larger organization’s purchasing power and use its facilities and physicians.

**Clinical Affiliation:**
This specific level of affiliation enables the smaller facility to offer specialty care through telemedicine and/or access to specialty physicians who rotate and offer services on certain days at the smaller hospital. In return, the smaller hospital agrees to transfer its more complex cases related to that specialty to the larger clinical affiliate partner.

**Merger:**
A merger of equals occurs when the parties combine assets to form a new company. This type of partnership tends to work when both parties perceive that each will be made stronger by coming together. Mergers also take place that afford a lesser ownership stake, such as 20 percent, to the party that brings less to the partnership.

**Management Relationship:**
At times the local hospital board may want to maintain governance and control over the hospital while abdicating day-to-day management responsibility to an outside third party. Short-term, or interim-management relationships may occur when a local CEO leaves the organization and no suitable replacement is readily available. Long-term management relationships occur when the board wants an experienced reliable third party to oversee the day-to-today operations of the facility.

**Corporate Member Substitution:**
For privately held, not-for-profit hospitals, a larger entity becomes the corporate member of the local community hospital in order to maximize the benefit that the local hospital can obtain as a result of being part of a larger organization. These are often noncash deals in which the larger hospital provides clinical resources and takes on the financial liabilities of the smaller hospital. The local community hospital continues to be overseen by the local hospital board.

**Acquisition:**
Sometimes finding a buyer vs. a partner is the best course of action, if not the only option. Acquisitions involve selling all assets to the buyer who assumes full responsibility for the hospital’s performance. When missions are compatible, acquisition can help a hospital continue to serve its community. Positive synergy created by acquisition may also help a hospital strengthen its financial and operational performance, expand services and improve quality of care.
Step 2: Define Needs. If your hospital seeks a partner, it’s critical to ensure the agreement terms are as advantageous as possible. It’s vital that the hospital board understands the process of finding suitable prospects and the preparation necessary to negotiate the relationship to their best advantage. Many hire consultants to guide them because the process is complex and the stakes can be high.

Maximize Your Partnership Potential

Assess market position. Community hospitals should understand their market demographics and market dynamics. For example, look at the level of patient migration from your communities to other institutions and why that is occurring. A professional market assessment can help identify a hospital’s strengths and areas where a partner could help. This analysis may even point to some potential partnership candidates.

Assess finances and profits. Hospitals should conduct an operational assessment of the organization to understand where profit comes from and where improvement opportunities lie. Specifically, an evaluation of revenue cycle, supply chain, information systems and productivity should be included in this process.

Involve the board from the onset of the relationship. Educate the board on why the change needs to happen and the dynamics within the healthcare industry. The hospital’s medical staff and physicians should also be involved in discussions.

Think strategically. Finally, community hospitals need to understand their strategy. You have to understand what it is you’re asking for, as well as what you’re willing to give up to achieve the partnership you have in mind.

Hospitals need to take stock before seeking out partners to identify their own strengths and where resources and support may be needed, then determine which resources are needed to ensure long-term success. A debt-saddled hospital might need a partner to take on its debt, for example, or an aging hospital may need guaranteed capital for facility upgrades. Conversely, a hospital that does not need a major capital infusion but still wants to benefit from the economies of scale available as part of a larger organization might benefit from the affiliation or corporate member substitution model.
**Step 3: Boost Appeal.** Identify and address factors that will turn off prospective partners before approaching prospects or distributing RFPs. It makes common sense that if you’re going to sell something, you want it to be in its best condition when it goes on the market. The same holds true when you are seeking any type of relationship.

For this process, it’s helpful to look at areas such as staffing, supply chain and the revenue cycle to make the biggest impact.

**Turnaround Initiatives may include:**

- Conducting a coding audit, pricing analysis and chargemaster review
- Renegotiating managed care contracts
- Optimizing reimbursement from federal and state programs
- Reducing supply chain spend
- Conducting an IT platform cost-of-ownership analysis
- Implementing productivity improvements to monitor labor expenses and maximize staff productivity

The characteristics of community hospitals that are likely to capture acquisition interest include:

- Organizations with room for quick fiscal improvement
- Stable market demographics
- Physician recruitment or alignment opportunity
- Ability to make improvements with limited capital investment
- Minimal managed care in market
- Niche player
- Market leader
- Opportunity for higher margins
- Willingness of the hospital board and leadership to surrender some degree of control

**Step 4: Consider Partners.** Use a request for proposal (RFP) process to seek partners that provide the needed resources but also have a shared mission and compatible culture. The goal is to bring about benefit for both parties.

Most strategic partnerships help the combined organization improve both the quality of care and the bottom line. A strong majority of healthcare leaders cite both financial/operational and clinical/care delivery as primary reasons to consider a partnership. The potential benefits of relationships also include:

- Improved geographic coverage
- Improved clinical integration
- Improved care-delivery efficiency
- Expanded services
- Enhanced clinical talent
CONCLUSION

Community hospitals are desperately needed by the communities they serve. In addition to providing important healthcare services, a community hospital is often a leading employer and vital economic engine for a small town.

The financial strain to remain open has increased significantly for community hospitals. In some cases, it may be best to identify a partner that can provide the resources necessary for your hospital’s long-term sustainability. Whether through affiliation, management, corporate member substitution, lease or acquisition, pursuing a partner may make the most sense for the health and well-being of both the hospital and community.

How Can CHC Help?

CHC works with hospital boards to assess whether a relationship with another institution makes sense, and if so, what type. If you are evaluating the power of partnership, contact CHC today.

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