Strategic Positioning: Making a 50-Year Decision for Your Hospital and Community
Propelled by the rapidly evolving environment, healthcare organizations are increasingly challenged to determine a sustainable path while preserving some form of independence. More difficult than it has been in years past, most providers are operating within razor-thin margins and increasing competition from other organizations as well as non-traditional providers. To remain viable in the future, leaders of health systems and independent hospitals must ask themselves, “How can we best position our organization to be the sustainable healthcare provider of choice for the community we serve?” While no crystal ball exists to answer this question, utilization of a deliberate and disciplined process will allow the Board of Trustees of the hospital to make the correct legacy decision for the community.

Determining your organization’s strategic position requires an understanding of what is needed to be sustainable in your particular market. Both form and function must be considered.

In some instances, sustainability may mean that remaining independent is the right choice for the community. The needed complement of the hospital’s core clinical priorities to enhance market competitiveness and maintain financial viability for the long-term will dictate the level of independence possible. Sustainability may require a change in structure, such as a clinical affiliation, a regional collaborative, an Accountable Care Organization (ACO), a clinically integrated network or a merger or acquisition.

In other circumstances, a change in scope of services may be beneficial. No one organization can be all things to all people. A careful assessment of the core services needed by the community it serves, coupled with an assessment of what your hospital can deliver well is necessary. For instance, an increased focus on ambulatory services may require a shift away from being a traditional acute care provider.

Ultimately, even the most fiercely independent organizations will likely embark on some form of collaboration to enhance coordinated care for their communities. Organizations that successfully collaborate engage in a strategic process to develop the following:

- a data driven rationale
- precise objectives for the community
- criteria by which the collaboration meets those objectives
- financial, operational, strategic, clinical and cultural impacts of various collaborative models
- the long-term impacts that the collaboration will have on the community and the organization

Not engaging in this kind of deliberate thinking will lead to failure. Headlines about hospital bankruptcies and closures serve as cautionary tales of what can happen when hospitals do not have a sustainable strategy. All of today’s hospitals – be they large or small – have little margin for error.

With such high stakes, the time is now for healthcare providers to carefully consider their strategic positioning in order to make the best 50-year decision for their hospitals and the communities they serve.
Market Forces Drive the Need for Strategic Positioning

The increased activity around strategic positioning stems from a wide range of market forces. Some driving forces include traditional considerations, which are more tactical in nature, including increasing market share; achieving operational efficiencies; improving scale and increasing financial stability – while other factors are more strategic, such as anticipating the impact of the ACA; improving quality and transitioning to value-based care. The need to pursue collaboration is rarely the result of one factor alone. Rather, the combination of several factors is what drives the need for healthcare organizations to achieve strategic positioning.

Environmental Factors Impacting Healthcare Organizations

Several market forces are driving the need to evaluate how hospitals will continue to provide high-quality care in a more demanding environment. Here are some key issues threatening the long-term sustainability of healthcare organizations throughout the U.S.

To remain viable in the future, leaders of health systems and independent hospitals must ask themselves, “How can we best position our organization to be the sustainable healthcare provider of choice for the community we serve?”
Environmental Factors Impacting Healthcare Organizations (cont.)

Gaining Economies of Scale

To expand across a broader continuum of care and reduce costs, gaining scale is paramount for hospitals. The cost of remaining independent can be mitigated with a partner, which in turn, helps the organization reduce unit cost and gain scale. Particularly, independent and rural hospitals struggle to access scale, which makes it difficult to gain affordable capital and recruit physicians, among other challenges. It is important for rural hospitals to plan for reduced revenue while ensuring they have the right mix of specialists available and increasing their primary care base to meet community needs. And while the climb may be steeper for community hospitals, nearly all healthcare organizations need to adjust to today’s changing environment by gaining economies of scale.

The Impact of Advanced Payment Models (APMs)

In today’s reimbursement era, the shift to value-based care and the implementation of the Affordable Care Act (ACA) has impacted hospital payments through quality incentive payments or penalties and how consumers access care.

Rapidly accelerating the shift toward paying providers for quality, in 2015, the U.S. Department of Health and Human Services (HHS) set a goal to tie 30% of fee-for-service Medicare payments to quality through advanced payment models by the end of 2016 and to tie 50% of payments to these models by the end of 2018. In addition, HHS also set a goal to tie 85% of all traditional Medicare payments to quality by 2016 and 90% by 2018.
Accelerated Growth of Advanced Payment Models

Further, as of March 2016, HHS announced that nearly a year ahead of schedule, an estimated 30% of Medicare payments are now tied to advanced payment models.

In addition to advanced payment models, trends in merger and acquisition and bond rating data further underscores the need for healthcare providers to position their organizations for sustainability. In fact, in 2014, there were 79 hospital mergers, down from 94 in 2012 and 58 physician practice groups merged or were purchased, down from 65 in 2013.

Hospital consolidation was moderate through the first half of 2015, when hospital mergers and acquisitions were down 6% from the first half of 2014. However, during the same time period, physician medical group deals increased 50%. There is also a new trend regarding the focus of hospital acquisitions. Merger activity has moved away from dominant health systems acquiring weaker ones and towards health systems acquiring community hospitals to provide guaranteed referrals. These increases in acquisitions demonstrate that organizations are seeking to achieve clinical and economic scale in order to ensure a sustainable future.

Merger activity has moved away from dominant health systems acquiring weaker ones and towards health systems acquiring community hospitals to provide guaranteed referrals.
Strategic Positioning – Making a 50-Year Decision for Your Hospital and Community

**Hospitals Have Absorbed Nearly $136 Billion of New Cuts Since 2010**

Impact Of Hospital Cuts Since FY 2010

<table>
<thead>
<tr>
<th>Billions of Dollars</th>
<th>Medicare (FY 10)</th>
<th>Medicaid (FY 10)</th>
<th>Hospital (FY 10)</th>
<th>Total (Final FY 10)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$135.6 billion</td>
<td>$71.3 billion</td>
<td>$61.6 billion</td>
<td>$0.7 billion</td>
<td>$203.9 billion</td>
</tr>
</tbody>
</table>

**Impact of Reduced Reimbursement and Reducing Cost of Care**

- Hospitals have faced repeated cuts to Medicare and Medicaid payments since 2010, due to both legislative and regulatory changes. This chart shows the ten year impact of these cuts on hospital payment.

- Cumulative reductions in Medicare and Medicaid payments to hospitals are at an estimated $460 billion from 2014 through 2023. And reductions from ACA initiatives alone account for 85%, or $390 billion of this total.

- Additionally, a new study from the University of North Carolina suggests that rural hospitals in non-Medicaid expansion states were less profitable and operated in markets with less-dense populations and more poverty compared to hospitals in Medicaid expansion states – therefore less likely to remain financially viable.

- In fact, the data to the left shows the clear positive impact of Medicaid expansion on revenue within the Ascension health system, which includes 131 acute-care hospitals and more than 30 senior care facilities in 23 states.

**Accelerated Growth of Advanced Payment Models (cont.)**
Accelerated Growth of Advanced Payment Models (cont.)

Significant Decreases in Inpatient Services Utilization

Inpatient care volume has rapidly declined since 2011. In fact, projections show that in all U.S. markets, the rate of inpatient admissions per 1,000 patients will decline from 103 in 2012 to 88 by 2021.

Along with declining inpatient utilization, decreased Medicare and Medicaid payments is also a key reason hospitals need to cut costs. 62% of healthcare providers cite Medicare or Medicaid payments and 48% attribute the decline in utilization as the main drivers to control costs in their markets.

Challenges Associated with Value-Based Purchasing Programs Instituted with ACA

Through the hospital inpatient Value-Based Purchasing (VBP) programs, hospital readmissions and hospital acquired conditions, CMS penalizes hospitals based on performance. In the inpatient VBP program, CMS effectively redistributes $1.5 billion in payments to high performing hospitals from low performing hospitals. The readmissions and hospital-acquired-conditions programs penalize poor performing hospitals by reducing Medicare payments.

Hospitals are expending financial resources in performance improvement and monitoring activities that exceed any penalties being accessed by CMS and some other payors. The programs are designed to provide payment incentives for hospitals to improve and avoid payment penalties, but approximately 50% of hospitals will always be penalized due to CMS methodology. As a result, hospitals will continue to expend precious resources.
Access to Clinical Resources

It is important for organizations to identify any gaps within existing services to improve care delivery across the continuum. Additionally, organizations should also identify new clinical opportunities to meet the community’s changing needs.

Providing Patients with the Right Clinical Resources

Similar to improving access to the right clinical resources, achieving physician alignment is a critical component to delivering value-based care. Hospitals and health systems must work with their medical staff to make the hard decisions on how to deliver the right care at the right time in the right place, using affordable medical resources.

1. Fill Existing Care Continuum Gaps

- Enhance performance of existing services
- Address disruptions in care pathways through investment in additional support services
- Improve community perception and patient access

2. Expand into New Clinical Programs

- Invest in crucial procedures, technologies, clinicians, and facilities required to support a new program
- Target underserved, specialty procedure reservoirs facing future demand growth
- Assess site of care considerations that affect new facility investment plans
- Measure total overall viability and profitability of new program
How Should your Organization be Strategically Positioned?

To determine how your organization may thrive in the long-term, Quorum recommends a deliberate and disciplined process. The following carefully crafted process has been developed through our extensive experience in assisting community-based hospitals preserve their mission and achieve a sustainable strategic position:

1. Perform an objective, data-driven Gap Analysis to compare the current state to what is needed for future success. The following chart depicts components that may be considered:

![Specific Analysis Diagram](source: Quorum Health Resources)
2. Conduct interviews with key stakeholders to ascertain the following:

- What are your organization’s financial strengths and weaknesses?
- Can you achieve a 10% or greater EBITDA margin in a reasonable timeframe?
- What did the hospital’s debt capacity and liquidity analysis determine?
- What is your community’s demand for healthcare services?
- What are your service area’s outmigration patterns?
- What did your service line performance analysis determine?
- What are your “core services”? Are these the right mix to be successful in the long-term?
- How well are you aligned with providers? Is an enhanced vehicle needed to nurture a closer relationship?
- Do you have the right providers in place to grow your business and deliver quality and safe patient care?
- Do you have the leaders, facility and infrastructure in place to be successful?
- How will you differentiate yourself in the market to your consumers?
- What should be your principal operational focus in the next three years? What level of independence is desired by the various stakeholders?

Achieving a Sustainable Margin

![Graph showing the percentage of investment and non-investment grades over years 2011 to 2015. The graph indicates a trend towards higher percentages in the investment grade and lower percentages in the non-investment grade, with some years showing negative values.](image-url)
3. “Did we answer the strategic question about remaining independent?”

- Establish primary objectives that the hospital seeks as a result of the collaboration.
- Develop specific elements of the collaboration, including any “deal breakers” or “must-haves.”
- Evaluate current and potential future opportunities.
- Consider all options against objectives and criteria.
- Select the alternative, which closely reflects objectives and criteria.

**OBJECTIVES**

The collaboration process begins with the establishment of the primary objectives sought as a result of the collaboration.

**CRITERIA**

Upon setting the objectives for the collaboration, specific criteria must be established including any “deal breakers” or “must-haves.”

**OPTIONS**

Once objectives and criteria are established, consideration of both current and potential future options may begin.

**EVALUATION**

A structured evaluation of options is performed against the objectives and criteria.

**DECISION**

Once a thorough evaluation is complete, a decision can be finalized as to which collaborative option(s) most closely achieves the objectives and criteria.
Evaluating Strategic Alternatives

Healthcare providers are increasingly exploring strategic options. While transaction volumes have ebbed and flowed over the past decade, consolidation activity has reached a frenzy. Healthcare deal volume rose by 22% in 2015, to 936 transactions compared with 765 in 2014. It is important to note that many of smaller deals or less integrated structures go unreported, leaving the tally incomplete. Regardless, the collaboration trend is predicted to remain strong in 2016 and in the coming years.

There is no single answer to which structure will be the best vehicle for the next 50 years. Given the significant variation in community circumstances, this determination must be made on a case-by-case basis. However, there are many options from which to choose. An increase in creative and complex partnerships has been observed in recent years. Starting with the letter “A,” affiliations, alliances, associations and ACOs are just some of the options considered.

This level of choice and flexibility allows organizations to select the best fit for their community. However, the proliferation of available options makes the selection of the proper path forward more confusing. Most healthcare providers indicated that they were primarily involved in affiliations, collaborations or alliances likely due to the simpler, more flexible nature of these types of agreements.

Recent Activity of Contractual Relationships in Healthcare

When determining the optimal vehicle to enable an organization’s future success, form must follow function. A closer relationship with another organization may be needed to achieve the organization’s long term goals. However, the mission, vision and values should drive the structure, rather than the allowing the constraints of a particular structure to dictate what can be achieved.

Options for a closer relationship with another organization vary greatly. A degree of affiliation may be the best strategy to achieve sustainability, while still allowing the organization to maintain the desired level of independence. While there is no way to accurately comprehensively depict the large number of strategic alternatives available, the following visual provides an overview of the continuum of potential structures.
Clinical Affiliation

Clinical affiliations are an agreement for organizations to collaborate on a particular initiative or to provide a specific service line together, that may involve local, regional or national partners.

Cost:

- Depends on the clinical area of focus and often requires investment in staff and/or IT infrastructure

Pros:

- Offers quick implementation
- Allows co-branding of clinical services
- Enables shared investment in costly resources, including staff and equipment
- Leads to sustainable volumes via less patient outmigration

Cons:

- Creates significant competition risk for volumes if forged with a local competitor
- Limits partnership to the specific focus of the agreement

Clinical affiliations are becoming more popular with the growth of retail health clinics. The number of U.S. retail health clinics jumped from 200 in 2006 to 1,500 in 2012 and is forecasted to add an additional 1,200 locations in 2016.

In 2015, CVS Health entered into clinical affiliations with Sutter Health in California, Millennium Physician Group in Florida, Bryan Health Connect in Nebraska and Mount Kisco Medical Group, PC in New York. Through these clinical affiliations, CVS Health provides prescription and visit information to the participating healthcare organizations by enabling communication between secured electronic health record systems.
Regional Collaborative, Joint Venture and Joint Operating Agreement

A Regional Collaborative offers flexible umbrella structure for partnering on specific initiatives and building the foundation for potential future integration, and often encompasses many independent organizations in a common geographic area. Joint ventures contain some form of profit/risk sharing. Joint Operating Agreements, which are similar to a joint venture, are larger and extend past a specific service or activity and can drive a regional collaboration. This virtual integration often has separate assets with coordinated services.

Cost:

- Depends on the goals of the partnership and can vary from time to capital investment for shared IT or operational functions

Pros:

- Offers quick implementation
- Provides low-risk, low-investment model
- Opens communication with other providers, enabling additional partnership opportunities if desired
- Supports large number of partners to expand best practices sharing, economies of intellect
- Creates new or enhanced services that might be overwhelming to do solo due to capital limitations or management expertise
- Can position organizations to address outmigration

Cons:

- Typically does not achieve significant economic integration
- Limits the ability to hold partners accountable
- Long-term sustainability challenged due to the “loose” nature of the affiliation
Accountable Care Organization

An Accountable Care Organization (ACO) is an independent entity formed for entering into advanced payment models/contracts. ACOs are owned by constituent organizations and create shared accountability among participating providers.

Cost:

- Significant start-up investment and ongoing operating costs

Pros:

- Enables joint contracting with private payers by sharing risk
- Supports participation in public payer ACO programs
- Facilitates development of shared quality incentives
- Allows for shared investment in population health structure

Cons:

- Requires costly and time-consuming integration of IT, staff and clinical processes
- Lacks guaranteed success as a risk-based contract

Growth of ACOs Over Time

As of December 2015, there were 782 ACOs in the U.S. serving an estimated 23.2 million covered lives.

Incentives and penalties imposed by federal and/or state government will also shape the growth of the movement by shifting the financial risks and opportunities. Additionally, the move toward accountable care will continue to differ by region according to market variations in ACO success, government policies and other factors.
In 2015, ACOs participating in shared savings covered 7.2 million beneficiaries, roughly 14% of the Medicare population.

Many of Quorum’s managed hospitals have chosen to enter into the risky ACO market through the National Rural Accountable Care Organization (NRACO). While still in early stages of implementation, this program provides a mechanism for hospitals to manage their high-risk, complex patients. It encourages the use of ancillary staff and automation to decrease the burden of quality reporting and positions them for enhanced performance and improved physician Medicare payments under the new physician Merit Based Incentive Payment System (MIPS).

It is important to note that this collaborative can be used in conjunction with other options presented here.
Clinically Integrated Network

Clinically integrated networks are collaborative strategies among hospitals and other providers that contract jointly in order to support improved care coordination and clinical outcomes.

Cost:
- Significant administrative and capital costs to meet baseline thresholds for IT and physician integration
- Varies based upon degree of clinical integration desired

Pros:
- Enables joint contracting with private payers
- Facilitates some degree of clinical integration
- Establishes performance-based incentives

Cons:
- Requires experienced legal guidance and clinical systems advisory involvement
- Increases significant regulatory scrutiny

Merger or Acquisition

A merger or acquisition is a formal purchase of one organization’s assets by another, or combination of two organization’s assets into a single entity.

Cost:
- Significant legal costs to bring the deal to fruition
- Significant administrative costs to effectively integrate organizations after the deal closes

Pros:
- Enables joint contracting with private payers
- Facilitates balance sheet consolidation and debt refinancing
- Centralizes authority to make difficult strategic and operational decisions
- Potential to enhance access to capital

Cons:
- High risk of lost time and resources if the deal does not close
- Requires difficult and time consuming integration of processes and culture
- Loss of local control

The trend in the market has been one of consolidation for the last several years, with the number of hospital merger and acquisition transactions more than doubling from 2009 to 2012.
Strategic Positioning – Making a 50-Year Decision for Your Hospital and Community

Strategic Positioning Imperatives

Making a legacy decision for your organization requires a deliberate and disciplined process. The question Quorum is most often asked by our clients is “How should we be strategically positioned for success?” To answer this question, we assess the following:

- How can they sustain healthcare in their community?
- How can they identify core clinical services that they can sustain over time?
- How can they invest their limited resources into these core services?
- How can they rebalance their overall cost structure to achieve required margins in these services?
- How can they establish a culture of collaboration and integration with their medical staff?
- How can they reduce practice variation to improve outcomes and control operating costs?

In many instances, some sort of collaboration strategy with another provider is needed to complement and advance the hospital’s core clinical priorities, financial viability and market competitiveness to achieve sustainability.

Those organizations that successfully collaborate are ones that develop:

- a data driven rationale;
- precise objectives for the community;
- criteria by which the collaboration meets those objectives;
- financial, operational, strategic, clinical and cultural impacts of various collaborative models; and
- the long-term impacts that the collaboration will have on the community and the organization.

About the Author

As President of Quorum Health Resources’ Strategic Integrated Resources Group (SIRG), John Maher focuses on helping organizations prepare to respond to market consolidation and advanced payment models. Maher has more than 20 years of experience in healthcare management, consulting, and leadership. His experience comprises strategic planning, client engagement management, business plan development and execution, market research and analysis, revenue and market expansion, and financial management and improvement. Prior to joining Quorum, Maher held a variety of roles in The Advisory Board Company and Premier, Inc.

About Quorum Health Resources

The Quorum Difference is the extraordinary combination of consulting guidance and operations experience that enables client healthcare organizations to achieve a sustainable future. As an integrated professional services company, Quorum Health Resources is the nation’s leading provider of hospital management services (700+ hospital clients over nearly four decades) and consistently ranks among the nation’s top healthcare consulting firms. In addition, the Quorum Learning Institute educates more than 10,000 healthcare leaders and professionals each year. For more information on Quorum’s Consulting Services for Strategic Positioning, please contact John Maher at (615) 371-7979 or John_Maher@QHR.com.

About Hospital 100

Hospital 100 is the most insightful and visionary conference for hospital and health systems executives. By invitation only and limited to 100 provider organizations, Hospital 100 is where top leaders go to garner fresh ideas and discover solutions to drive their strategic initiatives forward.

The 2016 Hospital 100 Conference takes place October 16-18 at the Hyatt Regency Lost Pines in Cedar Creek, Texas (near Austin). For more information, please visit www.hospital100.com.