

**Montana Hospital Association  
Annual Convention & Trade Show**

**How to Evaluate & Make Decisions on Affiliations: The  
Perspective of a Rural Hospital**

8:30 – 10:00 am  
Friday, September 23, 2011

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Overview of Today's Presentation

- Current Healthcare Environment
- Understanding Hospital Affiliations/Partnerships
- Case Study Examples
- Important Considerations for Affiliations/Relationships

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**Today's Healthcare Environment**

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Top Concerns of Board Members and CEOs

- Hospital-physician alignment
- Physician satisfaction and engagement
- Physician retention, succession planning, and recruitment
- Transparency: pricing, quality, patient safety
- Culture: employee satisfaction and morale

**HEALTH CARE REFORM**

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Source: The Governance Institute's E-Briefings. Vol 5, No 1. January 2008.

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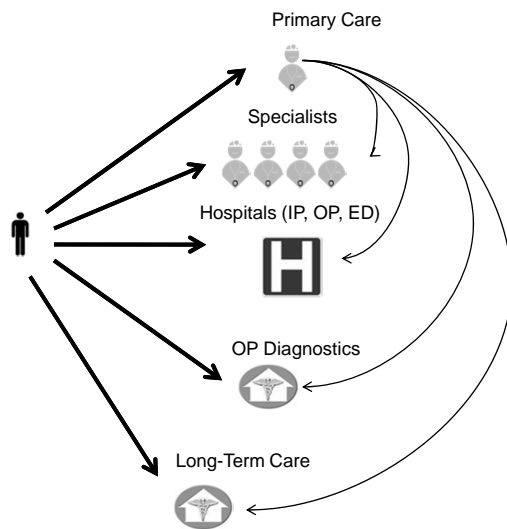
Top Concerns of Board Members and CEOs

- Accelerating technology change, escalating costs
- Financial performance
- Volume and delivery system changes
- Charity and indigent care levels
- Cost of construction & equipment
- Access to capital

**HEALTH CARE REFORM**

Source: The Governance Institute's E-Briefings, Vol 5, No 1, January 2008.

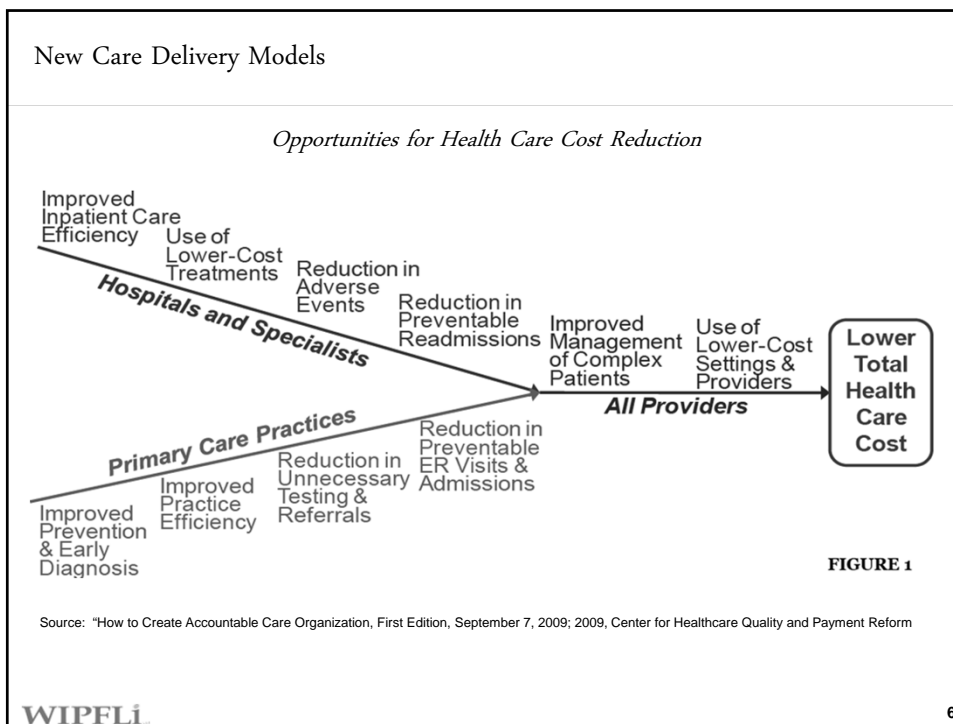
Current Delivery Care Delivery Model



Each unit of service is paid without constraint:

- Coordination may not exist
- Poor quality can be rewarded
- Incentives do not exist to reduce utilization or find optimal care location
- Prevention not emphasized

Providers are incented on volume!



- New Care Delivery Models
- Operational Implications – What will be required?*
- Coordination of care, aligned incentives, lower cost model
    - Value-based purchasing
    - Comprehensive payment for all inclusive service
  - Interdisciplinary teams of care providers
  - Defined and proven care practices; primary care driven
  - Access to patient information at various stages of care delivery
  - Quality and outcome metrics tracking at various stages of care
  - Levels of service and management integration
  - Structures and defined relationships allowing transfer of payment
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Operational Realities

*According to the National Association of Rural Health...*



**Changes in Medicare and Medicaid payment and delivery systems will have the most direct impact on providers**

- There will be increased pressure on operating margins due to payment reductions
- Will make the generation of and access to capital more difficult
- Quality will drive reimbursement levels and will become a differentiator in the market
  - Quality reporting will require the development of a more sophisticated infrastructure
- Physician alignment will become increasingly important
  - Physician integration will be necessary to support accountable care organizations or medical home models

Change is Coming

**Now**

- Fee-for-service
- Provider silos
- Fragmented care
- Data as an afterthought
- Defensive medicine

**Future**

- Outcome-based reimbursement
- Integrated provider networks
- Coordinated care
- Data is essential
- Evidence-based “quality” medicine

*A Common Reaction...*

“We need to join a system.”



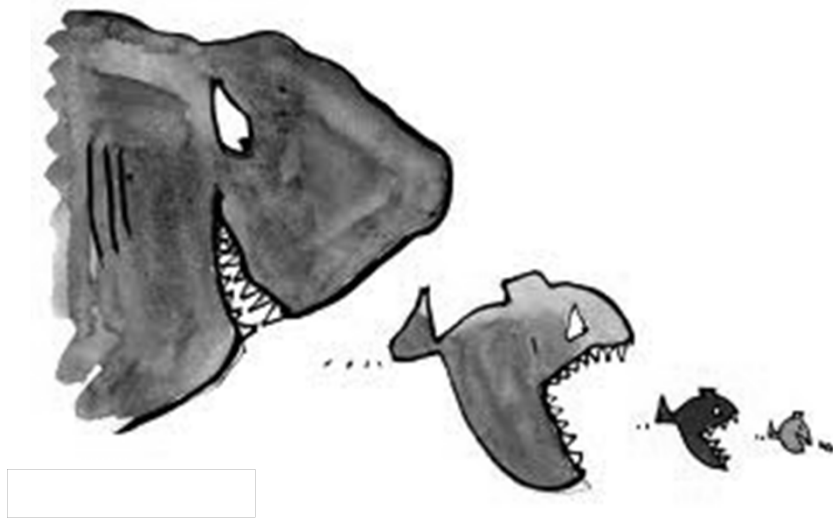
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## Understanding Hospital Affiliations/Partnerships

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Market Forces: Bigger is Better?



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Key Drivers of Increased Alignment /Affiliation

- Health reform (real or threat) and impact on market
- Laws and regulations are beginning to soften to encourage aggregation
- Shared desire to expand “market” presence
- Belief that size matters to effectively respond to market changes (i.e., health reform, ACOs. etc.)
- Provider-based reimbursement creates financial incentive for clinic-based specialties to integrate
  - e.g., cardiology, internal medicine, etc.

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So What Do We Mean When We Say...

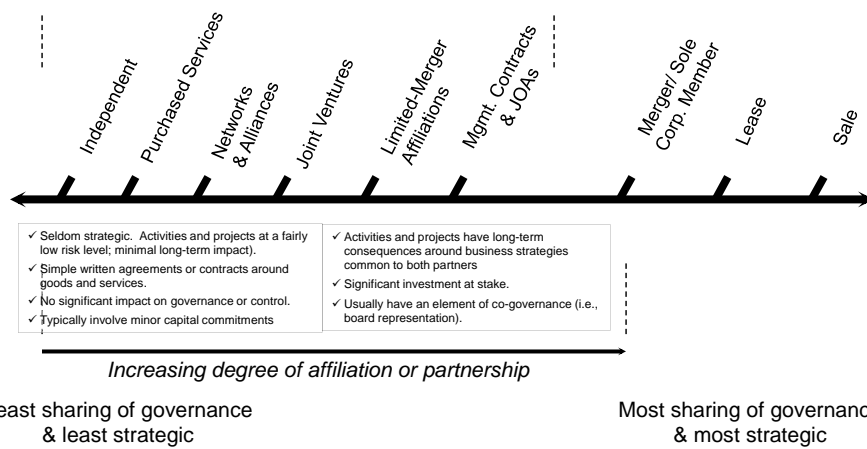
...Strategic affiliations, partnerships, and joint ventures?

- Spectrum of relationships
- Both short and long-term strategic consequences
- Can involve varying degrees of joint governance
- Various degrees of risk and reward involved

NOTE: *Typically, the greater the \$ invested, the greater control required and the greater the difficulty in the formation*

Partnership Continuum: Hospital-to-Hospitals

Range of options that do not require a full merger



What Health Systems Want From Affiliation

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<u>Old Approach</u>	<u>New Approach</u>
<ul style="list-style-type: none"> <li>• Broaden and secure their referral base and build market share</li> <li>• Build/solidify their upstream revenue</li> <li>• Compete with other tertiary systems and extend system market reach, influence, and access</li> <li>• Create a platform for managed care products</li> <li>• Obtain operating economies – shift fixed costs</li> </ul>	<ul style="list-style-type: none"> <li>• Create partnerships with efficient, cost-effective and high quality providers</li> <li>• Concentrate expertise</li> <li>• Increase ability to control providing the right care in the right setting</li> <li>• Build a sizable number of Medicare lives</li> <li>• Reduce costs and eliminate redundancies</li> </ul>

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What Small Hospitals Want From Affiliation

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<u>Old Approach</u>	<u>New Approach</u>
<ul style="list-style-type: none"> <li>• Clinical Expertise</li> <li>• Cash infusion</li> <li>• Increased access to specialists</li> <li>• Broader scope of services</li> </ul>	<ul style="list-style-type: none"> <li>• Expertise, both clinical and operational, IT</li> <li>• IT Systems and on-going support</li> <li>• Access to Capital</li> <li>• Protection from irrelevance/guarantee of acute care presence in the community</li> </ul>

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## How to Consider Alignment or a “Partnership”?

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Do I Need a Partner? First Agree on a Decision Process

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SAMPLE PROCESS

- Develop a decision-making framework
- Revisit priorities for the community
- Build and document the “business case”
  - Understand the reasons why to develop a partnership
  - Current situation and future challenges for your situation/organization
- Understand the types of partnership options available
- Identify potential partners
- Develop criteria for evaluating potential partners
- Agree on the process for evaluating partners

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### Key Questions Prospective Alignment Must Answer

- Under what conditions will we (hospital or physicians) consider closer alignment?
- How can we minimize the legal risk?
- How can we determine the most suitable partners?
  - High performers? Biggest threats? Strong governance/ management? Clear strategic vision?
- What terms can we build into the contract to avoid strategic and operational pitfalls?
- What is the alignment's potential impact on our respective financial performance?
- How does that impact compare to declining the deal?

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### Key Elements for Successful Partnerships

- |   |                                 |
|---|---------------------------------|
| • An objective fact and data base                   | • Equitable relationship        |
| • Clear objectives and business purpose             | • Balanced risks and rewards    |
| • Physician concerns and objectives are factored in | • Sufficient capitalization     |
| • Physician participation                           | • Strong and trusted leadership |
|   | • Flexible structure            |
|   | • No competing strategies       |

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SAMPLE “Best Partner” Characteristics

- ✓ Ability to meet objectives and needs
- ✓ Market presence/clout
- ✓ Corporate and regional vision
- ✓ Capable senior leadership
- ✓ Chemistry, philosophy, and compatibility
- ✓ Experience and success with similar relationships
- ✓ Human and capital resources

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Developing the Business Case: Sample Outline

- I. Current Situation
  - I. Financial
  - II. Capital
  - III. Resources (Physicians, Staff, Market Characteristics, etc.)
- II. Current and Future Challenges
- III. Objectives of Alignment
- IV. Must Haves and Deal Breakers
- V. Partners
  - I. Options
  - II. Key Characteristics
  - III. Evaluation

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Case Study #1

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Case Study #1 - Overview

Michigan Critical Access Hospital

<p style="text-align: center;"><u>Current Situation</u></p> <ul style="list-style-type: none"><li>✓ Existing relationships with larger hospitals/health organizations</li><li>✓ Long term board members and leadership</li><li>✓ Financial position was not good, minimal cash</li><li>✓ Additional capital needs, but no debt capacity</li><li>✓ No plan for IT and meaningful use</li><li>✓ Located in a challenging market with boom &amp; bust cycle</li><li>✓ Small leadership team with minimal management resources</li></ul>	<p style="text-align: center;"><u>Assets</u></p> <ul style="list-style-type: none"><li>+ Brand new facility</li><li>+ Sizable service area, pivotal location</li><li>+ Physicians stable, easy recruitment</li><li>+ No ties to any one Health System through purchasing or other service arrangements</li></ul>
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**Result:**  
Sole Corporate  
Member Structure

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Multi-Hospital System Sole Corporate Member

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    graph TD
      RS[Regional System] --- H1[Hospital]
      RS --- H2[Hospital]
      RS --- H3[Hospital]
      RS --- RE[Real Estate]
    
```

- Each hospital is a separate legal entity and has its own governing board
- Has substantial responsibility for operations
- Regional System is the “sole corporate member” of each entity
- Regional System has certain reserved powers\* that allows for substantial corporate governance control of each hospital entity
- Borrow capital as an “Obligated Group”

\* Reserved powers usually include approval of CEO, capital and operating budgets, changes to bylaws and articles of incorporation, sale or lease of hospital or significant assets, change of corporate purpose, strategic plan

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Case Study #1 - Result

Michigan Critical Access Hospital

Key Characteristics

- ✓ Local board representation, 4 to 3 from system
- ✓ Timing of reporting dictated by corporate
- ✓ Respond to strategic plan developed by system and make recommendations
- ✓ Regional liaison to communicate with corporate board
- ✓ Capital requests approved by corporate, competitive with other hospitals in the system
- ✓ Adopt system mission/vision statement
- ✓ Ceded authority to develop/discontinue services, choose professionals (legal/audit)

What They Got?

- + Physician specialists providing clinics at hospital
- + \$5MM in cash for working capital
- + Implementation of EMR
- + Improved billing/reporting systems

**Result:**

Still responsible for local operations &  
Ensured acute care presence in  
community

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Case Study #2

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Case Study #2- Overview

Illinois Critical Access Hospital

Current Situation	Assets
<ul style="list-style-type: none"><li>✓ Multiple relationships for various services including multiple tertiary care providers</li><li>✓ Newer Board members, change in physician staff</li><li>✓ Recent changes in service offering</li><li>✓ Located in a challenging market from payor mix perspective</li><li>✓ Inconsistent support from community/medical staff</li><li>✓ Flat to declining volumes</li><li>✓ Difficulty recruiting and retaining physicians</li><li>✓ Employ small number of primary care providers, no specialists</li></ul>	<ul style="list-style-type: none"><li>+ Brand new facility</li><li>+ Sizable service area</li><li>+ Implemented EMR, already have plan for clinic IT</li><li>+ Savvy management team more than usual resources</li><li>+ Financially stable, for now...</li></ul>

**Result:**  
Built Business Case for  
Affiliation

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## Guiding Principals & Characteristics

*The following criteria were identified as important considerations in any potential partnerships and "affiliation".*

- **Guiding Principals**
  - ✓ Mutually beneficial and interdependent relationship
  - ✓ Preserves local autonomy and control
  - ✓ Enables hospital to better serve their community
  - ✓ Cultural consistency & synergy between organizations
  - ✓ Allows for participation in developing a corporate and regional vision
- **Partner Characteristics**
  - ✓ Must be a quality provider
  - ✓ Human and capital resources
  - ✓ Financial health
  - ✓ Market presence/clout

## Case Study #2- Result

### Illinois Critical Access Hospital

- Key Characteristics
- ✓ Ability to run operations as needed
  - ✓ Responsible for obtaining own capital
  - ✓ Develop local strategy for enhancement of services, physician recruitment
  - ✓ Allows for relationships with other systems if service not available from parent
  - ✓ Services agreement for expertise

- What They Got?
- + Access to expertise unable to provide
  - + "Buy in" option over time to be considered when key success factors were met
  - + Selected services at a discount
  - + Clout of the larger organization to dictate payor contract
  - + Information sharing across multiple providers in the region

**Result:**  
Purchased Services Ad Hoc / Monitor Partners

## Important Considerations

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### What Matters the Most?

The “deal” should follow from established priorities. The deal itself is more about “legalese” or the paperwork.

#### **Key issues for discussion in a relationship**

- How can you achieve alignment of the Hospital with physicians/providers?
- How will local accessibility to healthcare be ensured?
- What should be the primary focus of the local organization?
- How will we be tracking quality and patient satisfaction in the future?
- Will we be able to secure resources?
- *Will special consideration be given to our status as a CAH?*

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Expectations Post-Alignment

*Rules for a Happy (Mostly) Relationship*

1. Make sure that there is fundamental agreement on what matters most
2. Consistent attention to the needs of both the local system and corporate are essential
3. The relationship is not a silver bullet
4. Some will be unhappy at times
5. Change will not occur overnight
6. It is impossible to predict the future, but be sure that this is a relationship that allows for change

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Contact Information

**For further questions and comments:**

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