E-Briefings

Volume 16, No. 2 • March 2019

New research and expert opinions in the area of hospital and health system governance.

Government-Affiliated Hospital Business Combinations: The Governance Dynamic

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Indian River Medical Center (IRMC) and Indian River County Hospital District (IRCHD) in Vero Beach, Florida, joined the Cleveland Clinic on January 1, 2019. This business combination represents an extraordinarily positive outcome for the community of Vero Beach. It also stands in sharp contrast to the sluggish level of change in ownership and control being experienced by governmental hospitals nationally.

This article explores how IRMC and IRCHD were able to avoid hurdles that other governmental hospitals have encountered in attempting to join larger organizations. In particular, it focuses on the role that governance and social factors play in depressing openness to change and the ability to complete business combinations. An understanding of how IRMC and IRCHD managed certain governance and social dynamics in Vero Beach might be useful to other public hospitals considering change.

Key Board Takeaways

Leaders of governmental hospitals that wish to consider ownership change should focus heavily on governance issues, rather than any organizational and legal complexities that they face. Most resistance-to-change and transaction difficulties have resulted from leadership of the governmental entity and the hospital failing to act in a unified manner. Vero Beach's combination with the Cleveland Clinic offers several suggestions for governmental hospitals considering ownership change:

- The initial focus should be to encourage both governmental and hospital leaders to reach early agreement regarding the topic.
- It is helpful to gain consensus among the two groups on several fundamental objectives for the health system.
- Proceed in a collaborative manner with consistent governmental and hospital representation.
- Work with legal and financial professionals to overcome legal and structural complexities.
- Follow state sunshine laws assiduously and provide the public with regular updates on the process.
- Utilize communications professionals.
- Understand and confront the challenges of group decision-making; foster frequent interaction between leadership groups.

Governmental Hospital Structures

The range of state, city, county, district, hospital authority, and public trust governmental hospitals is wide. A common structure consists of community 501(c)(3) organizations that lease their facilities from governmental units. Government entities exert their ownership control in differing ways, ranging from tight control by appointing the hospital board and approving all decisions, to loose control with the governmental entity fairly removed from the 501(c)(3). Other governmental hospitals are made up of single government entities that own land, buildings, equipment, and the hospital business; these take many organizational forms.

Challenges Associated with Governmental Ownership

Many governmental hospitals might benefit from ownership change; in certain instances it is acutely needed. They face the same pressures to improve quality and lower costs that challenge most hospitals and health systems. In addition, they are confronted with complicated governance structures and disclosure requirements along with restrictions on capital. Many governmental hospitals were formed in the early- and mid-20th century when far different transportation and hospital industry structures were prevalent, accounting for their sometimes anomalous locations and structures.

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Resistance to Change

Despite the exigency of these factors, change within governmental hospitals has been occurring at a slower pace than experienced by other non-profit ownership groups. Change is often the most difficult challenge for community hospital boards to address. Governmental hospitals have even greater difficulty than other non-profit ownership forms. The unique legal and political features found in governmental hospitals are often blamed for this.

In circumstances where the 501(c)(3) hospital leases assets from the governmental entity, two distinct groups of decision-makers are present. Difficulty in addressing change often results from the divergent perspectives of these two groups. Community hospitals typically have self-perpetuating boards whereas governmental units have identified owners and elected board members. Publicly elected officials have obligations to their constituents as well as to the community's healthcare needs, potentially creating conflict with hospital leaders. In addition, differing understandings of authority can cause challenges between these two groups. When the governmental entity owns assets and controls operations, political considerations can arise because the governmental entity's mandate includes constituencies beyond healthcare.

Difficulty in Executing Transactions

Given these complexities, it is not surprising that government hospitals have made fewer attempts to consider ownership change. Those that have done so have experienced a higher incidence of protracted, cancelled, or failed transactions. Along the way, much organizational disruption and delay resulted.

Difficulties have occurred during both of the principal phases of transactions involving change in ownership (i.e., selecting a partner and structure of choice, and negotiating transaction agreements). Group decision-making can be very difficult with one board; the need for two groups to reach the same choice of a partner and approve the same agreements exacerbates the challenge. Many infrastructure privatizations have not worked well. As a result, there is considerable resistance to outright sales of assets by governmental entities, and they frequently enter into long-term leases of real assets.

To a certain extent, these challenges relate to specific governance, political, legal, business, and regulatory considerations associated with government hospitals. It is tempting to attribute the many transaction missteps that have occurred to these complexities. However, in Juniper's observation of this market, transaction difficulties most often result from disagreement between government and hospital leaders on goals, objectives, and processes early in any consideration of change or a transaction. Often, this includes a lack of any agreement on these issues at all. This is the central difficulty across all forms of governmental hospitals.

How Vero Beach Overcame Challenges

For many years, IRCHD and IRMC experienced a very typical relationship found in governmental hospitals. There were frequent disagreements concerning strategic and operating decisions and, fundamentally, which group was in control. They also experienced many of the legal and organizational complexities that one could find in governmental hospitals (e.g., regulatory and statuary approval processes and public disclosure requirements). This constrained IRMC's ability to develop service lines and other medical offerings that Vero Beach's residents sought. Further, Sunshine rules that required board and committee meetings to be conducted in public had an inhibiting impact on change and innovation. As a result, there was little consideration given to potential changes to ownership structure.

Collaborating and Considering Change

Despite their history and challenging structure, the opportunity for change came when the chairs of both boards met and shared their concerns regarding the future. They saw a way to begin to work together. This rapport between the leaders of the boards led to an ability to reconsider the past. Both were aspirational and understood the limitations of the current structure.

At the outset, these leaders agreed to a collaborative approach to considering change that included hospital, district, and foundation representatives. Once they had this breakthrough, a collaborative group quickly exhibited a willingness to listen to external observers of the hospital industry (who were critical of governmental control) and consider change. This allowed the leaders of these three groups to actively consider the potential benefit of ownership change. Finally, they instituted a formal assessment of their situation with the help of a consultant over a several month period, and then retained Juniper to assist in a partner search. Most importantly, the difficult job of

reaching agreement on approach and objectives regarding the potential for change in ownership was accomplished before moving forward.

Overcoming Transaction Challenges

Once equipped with a better understanding of their circumstance, the decision to consider change was aided by the recognition that both boards had the same essential objectives. Simplifying these into quality healthcare, financial wherewithal, and the ability to thrive under any future healthcare environment helped both boards to recognize that their goals for the future were essentially the same.

After deciding to approach the market of potential partners, it was important to determine how best to adhere to Florida's Sunshine Law. A set of carefully considered logistical and communication tactics was designed to ensure careful compliance. This was challenging from a process point-of-view because many of the elements of for-sale processes are commercially sensitive. All proposals were made available to the public throughout the process. In addition, Vero Beach instituted a communications strategy aided by an external communications advisor. Selecting a partner involved two boards arriving at the same conclusion twice. First, regarding the selection of four finalists and, ultimately, deciding on the partner of choice.

The transaction between IRMC and the Cleveland Clinic was structured as a membership substitution. Simultaneously, IRCHD entered into a new, modified and extended lease agreement with the Cleveland Clinic. Input and approval on both agreements was needed from both boards. This elongated the transaction process but was successful because of early agreement amongst the groups regarding the need for, and intent of, this change.

Conclusion

Others considering a change of this sort should expect a transaction involving a governmental hospital to take longer than one involving a community hospital. This is especially true at the front and back ends of any similar process. At the front end, considerable effort and time is required to establish a collaborative process, and at the back end, extra steps are required for multiple approvals. Importantly, the market-clear process need not, and should not, be elongated relative to a similar transaction involving only a community hospital.

The Governance Institute thanks James Burgdorfer, Principal with Juniper Advisory, for contributing this article. He can be reached at jburgdorfer@juniperadvisory.com.