Pediatric Focus

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Preparing to Thrive in an Uncertain Era for Children's Hospitals and Pediatric Providers

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Key Board Takeaways

- Understand the nuances of your organization's business, and the external threats to those key business drivers.
- Seek deeper awareness and insight into your organization's operational and financial performance relative to other children's hospitals and larger comprehensive health systems.
- Create a compelling performance management agenda that is reflective of the strategic aspirations of the organization and the operational imperatives to attain them.
- Develop a more sophisticated system to monitor and manage performance relative to the external environment, and greater ability to rapidly respond to changes.

Children's hospitals have performed exceptionally well clinically and financially over the past decade. While generally effective at managing operations, children's hospitals can attribute much of their favorable performance to strong revenue growth. However, mounting pressures on both revenue and costs will eventually outpace their ability to excel using traditional approaches to performance management. To retain their position as leaders in child health, children's hospitals and their boards must proactively address impending threats in order to secure a financially sustainable business model.

Past Performance and Future Risks

Children's hospitals have continued to generate healthy margins and balance sheets—often far superior to their adult hospital counterparts.[1] This performance is typically driven by a strong market position, favorable contract rates with commercial insurers, sizable philanthropic support, and substantial revenues in the form of supplemental government payments. However, larger macro-environmental trends portend a much more challenging road ahead for children's hospitals, as outlined below:

- **Demographic challenges:** A declining birth rate will lead to a flat-to-shrinking market demand for many children's hospitals, putting direct pressure on the ability to continue revenue growth trends.
- **Competitive challenges:** Increasing competition from both traditional and new consumer-oriented competitors focused on regional expansion will lead to greater pressure to capture and maintain additional volumes. The emergence of consumer-oriented offerings, such as One Medical and national telehealth providers, also will increase competition for ambulatory services, an area in which many children's hospitals invested heavily over the past decade.
- **Reimbursement challenges:** Affordability is an increasing focus of all stakeholders, from consumers and employers to state and federal financers:
  - Out-of-pocket expenditures and premiums are rising faster than wages and surprise medical bills are impacting a greater proportion of families. Consumers will increasingly look to manage their share of spending by seeking out lower-cost options or foregoing care altogether.

1 "Hospitals & Health Service Providers—U.S.: Medians—Strong Demand Will Drive Financial Strength at Children's Hospitals," Moody's Investors Service, October 16, 2018.

    - Commercial health plans and employers are pushing care from high-cost environments to lower-cost ones; children's hospitals have largely been spared but should expect to see greater pressure to lower costs.
    - Government payers facing budgetary pressures are seeking to limit the growth in healthcare spending through a variety of policy initiatives, with likely impacts in reduced coverage, reduced reimbursements, and/or reduced supplemental payments (e.g., provider fee and disproportionate share payments).
- **Structural cost pressures:** The underlying drivers of cost inflation for children's hospitals are unlikely to dissipate in the coming years—increasing wages and benefits, high-cost specialty pharmaceuticals, and growing capital costs as facilities seek to expand in highly competitive markets.

Preparing for an Uncertain Future: The Board's Role

Over the next several years, children's hospitals will need to balance the immediate needs of the enterprise, while actively pursuing more transformative strategies to preserve and protect the financial performance required for next-generation pediatric programs. Board members can support their management teams by focusing across several fronts, including:

1. **Understand your organization's nuanced sources of revenue and margin, and the potential threats to them.** This must include understanding specifics of revenue sources, such as differences in patient cohorts/payers, revenues from core operations vs. supplemental funding, and clinical services that drive margin vs. mission-driven and enabling services. For each major line of business and source of revenue, the board and management team must have a firm grasp on the potential threats that could impact the organization. The board should ask leadership to:
    - Identify and categorize threats to key sources of revenue and margin.
    - Quantify both magnitude of impact and likelihood of occurrence.
    - Prepare contingency plans based on threat assessments, to keep "pivot scenarios" top of mind for management and the board.
2. **Craft a compelling performance management agenda that reflects and supports strategic scenarios and links future strategic positioning to the operational imperatives required to succeed.** Management will need to clarify its strategic and operational agenda in the face of future challenges. Boards can push leadership to establish or shift strategic priorities based on the relevant market opportunities or threats, organizational strengths or gaps, and growth-oriented acquisition or defensive partnership strategies. Boards also can position leadership for success by providing and aligning operational resources (human, capital, and technology) to support strategic scenarios and to encourage and promote a culture of performance improvement to sustain the long-term vision and culture of the organization.
3. **Develop a deeper understanding of your organization's operational and financial performance, relative to other children's hospitals and larger health systems.** Children's hospitals will need to take a much more rigorous approach to performance management, from more robust benchmarking across both the inpatient and ambulatory pediatric enterprise, to a more ingrained and committed culture of ongoing performance improvement. This should start with an assessment to test if operations across the system are consistently organized and aligned to efficiently achieve strategic aims, and how the organization is performing relative to its peers and high-performing leaders in the industry, recognizing that there may be room for improvement even among top performers.
4. **Establish a monitoring system that connects the threats facing the organization to key performance indicators associated with a robust performance management agenda.** The board and management should routinely monitor strategic and operational key performance indicators and evolving external dynamics to rapidly identify problems and develop performance management solutions to mitigate them. Development or adoption of tools and resources to monitor,

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drive, and differentiate performance will be imperative, such as clinical and operational dashboards, workforce management tools, and specialty-specific service access and patient satisfaction indicators. Also critical is having the skills and training in place to address any identified performance issues. These will allow the organization to quickly adapt to subtle shifts in industry and competitive factors, as well as internal business conditions.

Given their history as leaders in advancing child heath, children's hospitals must now also become leaders in transforming the clinical and business operations critical to addressing future challenges. This will require dedicated commitment from the board and management team to embrace an ambitious performance management agenda and secure their position for the long-term.

The Governance Institute thanks Rob Gamble and Pamela Damsky, Directors with the Chartis Group and leaders of the firm's Financial Performance Improvement Practice, and Brian Thygesen, Principal with the Chartis Group and leader of the firm's Pediatric Practice, for contributing this article. They can be reached at rgamble@chartis.com, pdamsky@chartis.com, and bthygesen@chartis.com.