

Assessing Independence

A Toolkit for Healthcare Boards and Executives



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Introduction

The majority of non-profit hospital boards are assessing their independence and trying to determine whether to affiliate or combine with another organization or to remain independent. The amount of disruption and transformation in the industry is forcing hospitals to think carefully about whether they can sustain independence, and, if not, what model might be optimal. As boards wrestle with this very difficult decision, the fundamental question they should be considering is this: How do we, sustainably, fulfill our mission in a rapidly changing and highly stressful environment? Deciding what is best for your hospital rests heavily on this answer.

There are several reasons for assessing independence, including market dynamics, the need for economies and efficiencies associated with scale, and to improve quality and safety and lower costs. This toolkit looks closely at these motivations, provides a tool for assessing independence, and highlights board considerations for remaining independent or joining a system.

Step 1: Conduct an Independence Self-Assessment

Some of the most common reasons independent hospitals seek system membership are:

- The desire to tap into more sophisticated infrastructure (IT, shared services, HR, legal, etc.)
- Cost reduction via accretive savings
- Access to corporate expertise and sophistication
- Access to capital
- Access to improved contract rates for service
- Brand enhancement
- Ease of recruiting and retaining talent
- The opportunity to build new or more robust clinical programs (either specialty or population medicine)
- Protection from competitors in the near or neighboring marketplace
- Access to provider-owned insurance vehicles (that exist within a potential acquirer)
- Ability to expand outpatient care delivery within the hospital brand/ownership

When considering independence, the first step is to conduct an organization assessment. To some independent hospitals a merger or acquisition may seem attractive, but it also may be that a particular independent hospital can find ways of accruing the advantages that come with system membership without sacrificing independence, whether that is through maximizing their current strengths, developing partnerships, or changing their business model to meet modern demands. As you review the assessment below, go carefully down the list, exploring:

1. What it will take for the hospital to be sustainable as an independent organization
2. How—short of combining with another organization—it can achieve some of the advantages of system membership

This review will serve to construct a vivid profile of a hospital likely to succeed as a stand-alone entity.

Common Reasons for Seeking System Membership	<i>Do we need this?</i> <i>(Points for consideration)</i>	<i>Can we get it without losing our independence?</i> <i>(Points for consideration)</i>
The desire to tap into more sophisticated infrastructure (bricks and mortar, IT, shared services, HR, legal, etc.)	<i>Are we able to stay current in terms of infrastructure by reinvesting capital from operations or philanthropy, wise choices in vendors and systems over time, etc.? Do we have a strategic plan for keeping up with the inevitable costs of reinvesting in IT?</i>	<i>Do we have an exceptionally strong balance sheet, robust philanthropic support, or corporate partnerships that will allow us to invest in necessary infrastructure?</i>
Cost reduction via accretive savings	<i>Do we have sustainable advantageous payer relationships, strong operating margins, and low cost structures?</i>	<i>Could we take another path to accretive savings such as shared service agreements or group purchasing arrangements?</i>
Access to corporate expertise and sophistication	<i>Have we been able to attract and retain sophisticated leadership teams? If so, do we have ongoing leadership development and succession plans to sustain these strengths?</i>	<i>Do we have well-networked executives who can call upon a range of peer and trade association resources, or could we access the expertise we need through hiring a consultant?</i>
Access to capital	<i>Do we have relatively new physical plants, up-to-date IT, and/or little debt?</i>	<i>Do we have strong local philanthropic support that provides us the necessary access to capital?</i>
Access to improved contract rates for service	<i>Are we likely to benefit from “contract power,” and is system membership the best way to achieve this?</i>	<i>Can we utilize innovative programing, risk arrangements, and direct-to-employer contracting to make up for disappointing contract rates?</i>
Brand enhancement	<i>Do we have a strong local brand, a history of community leadership, and high patient satisfaction and loyalty?</i>	<i>Could we consider a clinical affiliation with a nationally renowned brand?</i>
Ease of recruiting and retaining talent	<i>What qualities stand out for our organization when recruiting or retaining talent (e.g., an attractive location, a culture marked by high engagement and satisfaction, a respected brand)? Do we have residency training programs (both clinical and administrative) or affiliations with strong residencies to bolster recruitment efforts?</i>	<i>Should we consider creating programs to help bolster recruitment (e.g., a program that identifies talented and interested youngsters in middle school and high school, offering jobs and opportunities for mentoring, scholarships, etc.)?</i>
The opportunity to build new or more robust clinical programs, including outpatient	<i>Are we able to offer a full complement of clinical programs without system membership? What is our outpatient strategy? Longer term, as care moves away from the hospital setting, will be able to remain relevant?</i>	<i>Can we utilize regional collaboratives, telemedicine, and clinical affiliations by program or service line to offer services that we otherwise would not be able to present to our community?</i>
Protection from competitors in the near or neighboring marketplace	<i>Do we (or will we) need protection from our competitors? How much local competition is there, and do we benefit from any specific characteristics (e.g., being geographically isolated, having high brand loyalty, or offering differentiated services)?</i>	<i>Could we affiliate with a high-profile brand or develop marquis services? Would we consider a genuine local merger of equals?</i>
Access to provider-owned insurance vehicles	<i>Do we need tighter integration with insurance products, and if so, will joining a system help achieve this?</i>	<i>Could clinical integration or direct-to-employer contracting bring some of the same advantages of having a “captive” insurance company?</i>

Key Questions to Ask When Assessing Independence

- What are the factors motivating the board to consider a potential transaction?
- What are the pros, cons, and alternatives to a potential transaction?
- Will a potential transaction help further the mission of the organization?
- Will mission be best served partnering with a for-profit or religiously affiliated partner?
- Should the hospital use a “controlled competitive process” to solicit proposals from potential partners and maximize value or broaden the search for interested parties?
- What is the fair market value of the hospital assets being sold (and can the competitive process help establish that)?
- What non-monetary criteria should be considered (e.g., physician recruitment or retention, EHR, access to resources to improve quality and manage population health)?
- How will the proceeds of the transaction be utilized? Will a community foundation be formed and maintained?
- Are there key community stakeholders or other parties that need to be informed? Should they be allowed to provide input into the process?
- What experts and other resources are needed to assist the board in exploring a potential merger/acquisition/affiliation?

Step 2: Make a Strategic Decision About the Hospital's Future

After reviewing your hospital's current state and carefully thinking through the best way to move forward and fulfill the organization's mission, you will arrive at your decision: remain independent or join forces with another organization. Below we provide considerations for the board related to both of these options.

Remain Independent, For Now

Your conclusion might be that you are well positioned to remain independent. Some healthcare organizations are still able to be successful on their own or by developing unique partnerships. Some common characteristics that allow independent hospitals to thrive include whether the organization:

- Is the sole or predominant community provider in the market(s) it serves.
- Is located within an attractive, stable, or growing market with a favorable payer mix.
- Is large enough to achieve efficiencies in care delivery and cost management.
- Provides a wide array of profitable specialty care services and has a high case mix index, enabling it to earn favorable margins per case.
- Has a strong balance sheet, including over 200 days cash on hand and a favorable debt-to-capitalization ratio.
- Has built an integrated, closely aligned physician network that is growing and well distributed across the service area.
- Benefits from strong community support, including philanthropy.
- Is able to create a level of “network essentiality” that positions it to negotiate favorable commercial and other payer contracts.

Exhibit 1: Common Characteristics of Successful Independent Hospitals



(As Informed by The Chartis Group Experience)

If you find that independence works, but partnerships are a must for current and future success and sustainability, it will be helpful to think about the partnership strategies short of a full-asset merger that are available to the organization. This could include:

- Clinical affiliation of selected programs (including residency programs) to include telemedicine
- Contracting for or collaboratively developing infrastructure services (purchasing, back-office, facilities, etc.)
- Creating regional consortia to offer and disperse more comprehensive clinical or infrastructure services and increase outpatient care
- Participation in a clinically integrated network (involves data sharing and the pursuit of best practices, but allows joint contracting and risk contracting)
- Joint ventures

Organizations that have successfully remained independent have availed themselves of one or more of these affiliation strategies. Such options can enable a future growth plan that does not involve a tight affiliation with a larger health system. Options such as these may even serve as a catalyst to bring together other like-minded hospitals in the region.

Periodically Review Your Options

If your organization decides to stay independent, it is still essential to conduct a rigorous, yearly review of your current positioning and future prospects. This can include revisiting the assessment above. The board and management will also want to assess how the market is evolving and consider a range of options that will ensure the organization is meeting its mission objectives and the needs of the community it serves.

During this time, consider the following questions:

- **Does our organization currently fit the profile of a strong, independent hospital?** Begin by examining the hospital's current situation and prospects from an objective viewpoint. It may be beneficial to seek support from an outside advisor to assess the organization's strengths and weaknesses without bias. Very few hospitals have all the characteristics highlighted above (and in **Exhibit 1**); therefore, it is important to focus on those elements of success that are most pertinent to the specific market and internal context. A valuable output of this exercise is the identification of potential gaps in performance and other areas that may require attention.

- **Is it realistic to think we can independently close gaps in our positioning and operational performance?** Some areas of deficiency are more mission-critical than others. Evaluate each opportunity for improvement, gauge its relative importance to the future success of the organization, and identify options to address each opportunity, including the potential role of partners. For example, if a gap in the provision of specialty care services is identified, possible solutions may include viable organic growth strategies or a targeted partnership with a nationally known system or a nearby academic health center.

Evaluating whether your organization should remain independent is among the most strategic fiduciary topics the board can address. Active board involvement and leadership in the review process is critical. The evaluation process should review the internal state of the organization and the external context, including market evolution, new competitive threats, and other external challenges.

Critical Success Factors for Consideration

- Can you continue to make necessary investments in your physical plant to improve the patient's experience?
- Can you continue to make necessary investments in medical technology to support a high-quality standard of care?
- Can you continue to make necessary investments in EMR, decision support information systems, and population health database management?
- How competitive is your environment? What are current and projected trends in market share?
- What are the trends in payer mix and market demographics (birthrates, aging population, etc.)?
- Is the hospital aligned with its medical staff? Are you developing medical staff leadership?
- Is the hospital positioned to achieve physician growth and succession planning via recruitment and a sustainable employment model?
- Can you recruit and/or train the needed skilled staff and retain them?
- What is the hospital's current status and ability to improve clinical quality including the use of physician performance tools in credentialing, etc.?
- What is the historical performance and future projections in the hospital's operating margin?
- Is the hospital prepared/capable to respond to reimbursement reforms?
- Can you generate sufficient cash flow and debt capacity to fund all the necessary investments?
- Are there opportunities to provide and/or expand outpatient services through joint ventures or other collaborative relationships?
- Do you have a wide variety of content experts on staff or do you rely on the work of consultants for key strategic initiatives?

Join Forces with a System

It may become clear that it is only a matter of time until the organization will need to join a system. If this is the case, the board should consider what options would be the most ideal for achieving its mission, and when to get serious about finding an acquirer. Initiating the search sooner rather than later is generally best so that you can enter negotiations from a position of maximal strength (rather than waiting until a partner is critical).

If you decide to merge into a much larger organization, there are several issues where critical questions need to be asked.

- **Alignment of mission, vision, and culture:** Independent hospitals need to look carefully to ensure the system is the right fit for their organization. This includes looking at the values that have been demonstrated in the activities and decisions of system leadership. Important dimensions of culture include the rigor of accountability systems; the commitment to service, quality, and safety; attention to developing people; sensitivity with which hard decisions are made; inclusiveness or the lack thereof; and the ability to engage providers in an orientation to the future.

- **A track record of successful system expansion:** Much can be learned by studying how earlier system acquisitions have gone. How do entities new to the system feel about their assimilation into the larger entity? Have promises been kept? Has value been added? How disruptive was the process? Has the system learned along the way? Are central or “flagship hospital” programs made relevant and available to affiliate hospitals? If so, is this done in a collaborative or imperialistic manner?
- **A clear and future-oriented strategic plan:** Does the entity with which you are considering affiliation have a clear plan for the future? Does this plan include accommodation to the inevitable shift from inpatient to ambulatory care? Does it include attention to population health and the ability to accept risk? Does the system demonstrate the ability to adapt overarching plans to local realities across its geography?
- **Resources adequate to realize that plan:** A strategy without resources is doomed to remain aspirational, rather than actual. Ask hard questions about resources, and the ways in which resources are deployed. Does the system have reserves or access to capital that it can invest in turning its strategy into reality? Does it make an operating profit? What is its track record with respect to philanthropy? What is its bond rating? Its cash position? What promises can it make regarding a local capital infusion, if your entity should agree to enter the system? How will your particular ongoing capital needs figure into the system’s five-year capital plan?
- **Respect for local traditions and unique market factors:** While system-wide strategic clarity is essential, so is enough flexibility to take advantage of opportunities across the system, and mitigate risks that are unique to each geography. Has the system that you are thinking about joining shown the ability to strike a balance between staying consistent to core strategic initiatives on the one hand and flexing to meet local realities on the other hand? Is there receptivity at the system governance level to input from local boards, and is there a spirit of inclusiveness when system strategies are being formulated?

The answers to these questions should, in turn, begin to build a profile of more and less desirable partners, and will highlight issues for discussion during the negotiation process.¹

¹ For more detailed resources around partnerships, mergers, and affiliations (e.g., partnership options, transaction considerations, and the post-merger transition) visit our Partnerships/M&As Web page: www.governanceinstitute.com//KT_PMA.

Case Example: Methodist Fremont Health

Fremont Health was a small, independent health system based in Fremont, Nebraska with a quasi-rural primary service area of 45,000 people. The board wanted Fremont Health to remain independent, but the organization was facing serious threats such as a change in demographics (payer mix moving away from private commercial insurance and towards Medicare/Medicaid), declining inpatient utilization, falling market share, cost pressures, and declining Medicare/Medicaid reimbursement.

The board and management spent time researching similar hospitals and the current environment/marketplace and created 10-year financial models to evaluate how an independent Fremont Health might look under best-case, average-case, and worst-case scenarios. "The best-case scenario would be wonderful, but the worst case was that in 10 years we wouldn't be viable, and because our role was to preserve our mission of healthcare for the community, we couldn't take that risk," said Monty Sellon, M.D., Board Chair. "We all concluded that it would be a good idea to look into the possibility of partnering."

After thoroughly assessing its options, the board put in place a task force to research merger options, signed on an M&A transaction firm, and conducted research to determine objectives for selecting a partner, and potential partnership structures. Ultimately, they partnered with Nebraska Methodist Health System and became a subsidiary of the system. The primary reasons behind selecting Nebraska Methodist as Fremont's partner were:

- It made sense regionally/geographically (Fremont was only 20 miles away from the system's nearest hospital, and there was overlap on medical staffs; potential overlap in where patients could go for care).
- There was a strong cultural alignment.
- Nebraska Methodist was the only prospective partner to make a realistic offer to take over and preserve the county pension plan for Fremont Health employees.

Methodist Fremont Health will enjoy the following benefits of the merger:

- Bringing the trusted and respected Methodist name to the Fremont community
- Integrating into the system-wide EHR
- Integrating administrative operations and other IT systems such as cybersecurity
- Identifying and executing on cost-structure opportunities, including growing certain specialty service lines such as OB and orthopedics, and cost-savings in purchasing and elimination of duplicate systems/functions
- Integrating service lines where appropriate
- Having access to new insurance networks and products

Conclusion

Independent hospitals of all shapes and sizes should be planning for a future health-care landscape that looks very different from today. Whether a hospital should remain independent or seek a partner is one of the most difficult decisions a board will have to make. It requires taking a serious look at the current state of your organization and considering the best way to fulfill the needs of the community(s) served.

Whether the end decision is to remain independent or join a system, the outcome will be significant change. The status quo will most likely not be an option. Independent organizations will need to have a clear plan for sustainability. This may include transforming their business model and forging new partnerships to ensure that they are able to successfully improve the health of their communities well into the future.

To-Dos

- Conduct a thorough independent assessment that considers what the organization needs to effectively carry out its mission.
- Consider if the needs can be met through unique partnerships or if this will require joining forces with another organization.
- If you decide to remain independent (for now):
 - » Think through how to maximize on the organization's strengths and build creative partnership strategies to address potential gaps in performance and remain financially viable.
 - » At least annually, conduct a review of your current positioning and consider the risks and benefits of remaining independent.
- If you decide to join forces with another organization:
 - » Decide when it is best to search for an acquirer (sooner is ideal, rather than waiting until a partnership is critical).
 - » Initiate a search and thoroughly vet possible partners to find the right fit (for example, consider culture alignment, the system's history with previous acquisitions, the strategic plan and resources to achieve that plan, and if there is respect for unique market factors when making decisions).
 - » Use this information to build a profile of more and less desirable partners and identify issues to discuss during the negotiation process.

References and Resources

["Considering Independence: What Does It Take?"](#) (*BoardRoom Press* Special Section, February 2016)

["Examining Circumstances That Allow Independent Hospitals to Thrive"](#) (Hospital Focus Article, June 2019)

[Considering Independence: Are Standalone Hospital Boards Best Serving Their Communities?](#) (Webinar, November 6, 2013)

[Methodist Fremont Health: A New Partnership from a Position of Strength](#) (Case Study, May 2019)

["Assessing Independence"](#) (E-Briefings Article, January 2015)

["Standalone Hospitals: Making the Most of Alliances"](#) (*BoardRoom Press* Article, December 2015)