

A Call to Action: Hospital Strategic Options for Success

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Since the outbreak of COVID-19 in March 2020, our entire nation has witnessed fundamental shifts in the construct of society, as well as across the entirety of our healthcare delivery system. Perhaps no other sector of the domestic economy has felt the impact of the pandemic more intensely than our nation’s hospitals and health systems. While prognosticators abound across every news and media outlet, the lack of conclusive evidence regarding the duration and severity of COVID-19 results in mixed perspectives and heightened uncertainty regarding what will ultimately be the “new normal” for the U.S. healthcare sector. Today, more than ever, hospitals must seek to rapidly deploy a multi-faceted approach towards ensuring the sustainability of clinical and financial operations. This article provides hospital leaders with the tools required to assess organizational durability in both the current and post-COVID-19 environment.

The Importance of Developing a Strategic Evaluation Framework

A crisis of the magnitude of COVID-19 requires careful and comprehensive examination of both current and future organizational risks. Most importantly, understanding the spectrum of organizational risk within the context of both risk identification, as well as certainty of risk, provides a baseline framework from which to optimally navigate COVID-19’s impact on hospitals. **Exhibit 1** provides a

representative overview of how this strategic evaluation framework enables hospital leadership to develop a foundation for current and long-term sustainability.

Plotting the Course to Long-Term Sustainability

The considerations developed and articulated within the strategic evaluation framework noted above will impact hospital strategy in various ways. This impact will in part be dependent upon a given organization’s size, scale, geography,

Exhibit 1: Strategic Evaluation Framework for Independent Hospitals and Health Systems

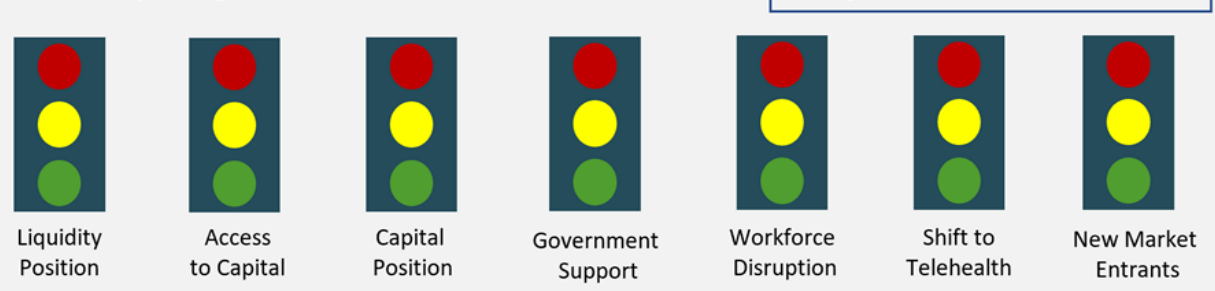
		Certainty	
		High	Low
Identification	Knowns	<p>Known Knowns</p> <ul style="list-style-type: none"> ✓ Increase in patients utilizing telehealth services ✓ Reconfiguration of sites of care ✓ Postponed elective procedures ✓ \$100 billion in federal funding ✓ Volatile financial markets ✓ Disrupted workforce 	<p>Known Unknowns</p> <ul style="list-style-type: none"> ✓ Recapture of patient demand ✓ Shift in service mix and payor mix ✓ Potential shift in state/federal healthcare programs (i.e. DSH, 340B, etc.) ✓ Liquidity and spreads in tax-exempt and taxable bond markets
	Unknowns	<p>Unknown Knowns</p> <ul style="list-style-type: none"> ✓ Future impact of COVID-19 affected population ✓ Timing of testing and vaccines ✓ Repeat COVID outbreaks ✓ Impact of November elections 	<p>Unknown Unknowns</p> <ul style="list-style-type: none"> ✓ Private investors interest in healthcare investment ✓ Change in human behaviors
		Low	Unknowns

and clinical configuration. Accordingly, while there is not a one-size-fits-all approach for assessing the operational, financial, and strategic implications of both the current and post-COVID-19

environments, certain hospitals will likely emphasize (or de-emphasize) select variables impacting and influencing their respective strategic imperatives. **Exhibit 2** outlines the key strategic evaluation variables that hospital boards and senior leaders should consider when plotting the course towards long-term sustainability. Overlaying these variables against the backdrop of their strategic evaluation framework will enable and empower leadership teams and boards to respond and assimilate their organizational strategy and focus towards the most relevant areas of risk exposure.

Beyond COVID-19, over the past several years, independent hospitals have also experienced a wide array of disruptive challenges. From a financial perspective, their operating profiles have been stable to negative, driven by a fundamental divergence of expense growth outpacing revenue growth. Additionally, hospitals have witnessed a shift in the

Exhibit 2: Key Strategic Evaluation Variables



setting of care away from inpatient towards outpatient, primarily driven by a change in patient preferences and a push from payers to move episodes of care into the lower-cost outpatient care setting. Further, market dynamics have shifted as independent hospitals have seen increased competition from the emergence of vertically integrated market entrants (e.g., CVS and Aetna) driving consumer-centric strategies, private equity-backed physician groups impacting physician compensation models, and super-regional and national health systems expanding through M&A activity (see **Exhibit 3**).

As a result of these converging forces, many hospitals have faced increasingly difficult strategic decisions even prior to the outbreak of COVID-19. With razor-thin operating margins and an ever-increasing array of capital-intensive needs (i.e., ASCs, telehealth, EMRs, etc.), many of these organizations are now faced with a lack of balance sheet capacity to adequately endure the economic pressures from

COVID-19. Hospitals across the U.S. have been temporarily dealing with these challenges by furloughing non-essential staff, reducing compensation, and significantly delaying (or in some instances outright canceling) essential capital projects in an effort to bolster near-term balance sheet and liquidity strength. **Exhibit 4** on the following page utilizes the key strategic evaluation variables on both a pre-COVID-19 and post-COVID-19 basis to illustrate the overall impact of the “new normal” operating environment facing hospitals across the U.S.

A Call to Action: A New Environment Requires New Strategies and Tactics

Deploying the strategies and tactics of the pre-COVID-19 era to the current and future challenges facing hospitals will undoubtedly result in an unsustainable and increasingly weakened organizational end state. Within the construct of the new era, both leadership teams and boards alike should strongly consider the

following strategic options as key elements to the attainment of both near-term sustainability and long-term success:

Exhibit 3: Hospital/Healthcare System M&A Targets by Total Revenue

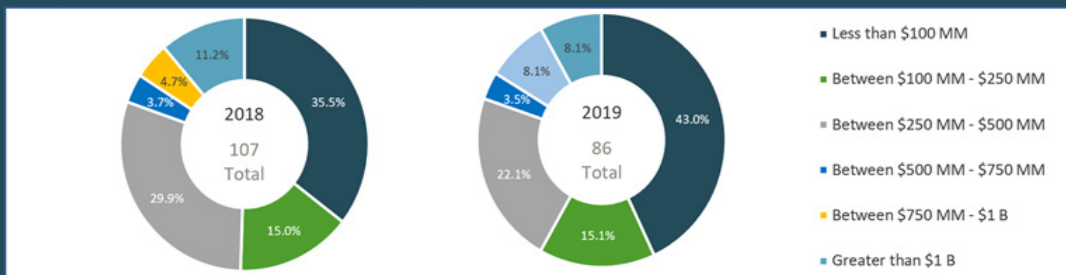
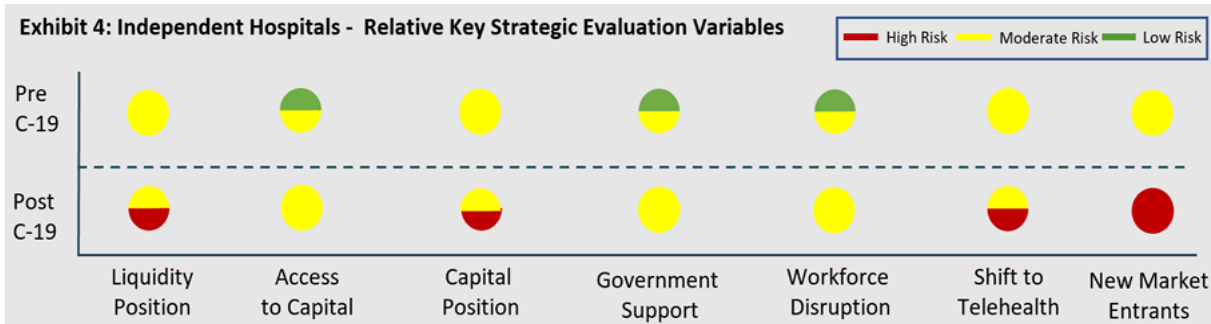


Exhibit 4: Independent Hospitals - Relative Key Strategic Evaluation Variables



The importance and results of this reassessment exercise will shape how organizations invest in strategies such as telehealth, ASCs, and M&A, all of which are critical to maintaining

- Conduct a core and non-core asset review:** As healthcare providers have grown and service offerings have increased, many independent hospitals have allocated resources in areas that may be incompatible with core operational capabilities. A comprehensive clinical service line/asset review is required to assess areas that may be outside an organization’s strategic priorities. Possible areas to investigate are labs, home health, hospice, long-term care, and behavioral health, amongst others. Based on this assessment, organizations can consider alternative strategies for these services areas, such as divesting or seeking a joint-venture partner that can alleviate financial stress and provide resources to reinvest in services areas more central to the entity’s strategic plan.
- Consider physician practice partnerships:** Employed physician groups can often be a significant burden on profitability for hospitals. As financial positions see further stress due to COVID-19, coupled with increased competition from non-traditional players such as private equity-backed and payer-backed physician practice management companies, hospitals should consider partnerships with these non-traditional entities to both mitigate financial stress and strengthen their relationship with in-market physicians
- through novel and innovative economic alignment models offered by these new market entrants.
- Analyze digital health capabilities:** Prior to the outbreak of COVID-19, the adoption of new digital health technologies had already begun to impact the day-to-day operations of many hospitals. However, the sudden and drastic impact of COVID-19 has vastly accelerated patients’ willingness to utilize digital and telemedicine technologies to manage their health. As a result, hospitals must rapidly adapt to changes in patient consumer demand for healthcare services and explore investments in telehealth and other patient-centric technologies. These are no longer “nice to haves,” but instead are becoming increasingly critical assets and capabilities that will bolster overall competitive positions.
- Reassess capital position and strategic capital plan:** One of the critical factors of any hospital’s self-evaluation is the relative strength of the entity’s overall capital position. The outbreak of COVID-19 has impacted the core drivers of otherwise strong capital positions (i.e., operating cash flow, unrestricted debt/equity investment portfolios, and overall access to the debt capital markets), thus necessitating many hospitals to reconsider their strategic plan as it relates to capital deployment.
- competitive positions in today’s dynamic marketplace.
- Restructure clinical footprint:** The current financial strain placed on organizations serves as the impetus to review clinical service line asset portfolios that may have “bulked up” over the past decade. Strategic imperatives that may have previously been critical may no longer be areas of growth. As a result, hospitals should objectively evaluate the restructuring of sites of care to right-size clinical portfolios and properly address new strategic imperatives. For example, a hospital that is witnessing increased competitive dynamics may no longer need its current physical and/or service-line configuration. Based on this objective evaluation, organizations can either divest physical plant assets, reconfigure service lines, or invest in new sites of care (i.e., ASCs or stand-alone EDs) to optimally provide services based on patient demands.
- Consider M&A and strategic partnerships:** In circumstances where hospitals experience unsustainable challenges, a possible solution is a merger, acquisition, affiliation, or partnership with another healthcare organization. Assessing your organization’s goals and objectives for a partnership will ultimately help narrow down the range of available structural affiliation

options. In general terms, there is a trade-off between the resources and support a partner entity will be willing and able to provide, and the controlling stake your organization will retain from a governance perspective. Hospital leaderships teams should also consider that a weakened financial position may limit the range of partnership or affiliation options available. Ultimately, boards and leaderships teams must carefully evaluate and consider any potential partnership or affiliation structure that allows for the long-term preservation of healthcare services to both their communities and patients.

Plan Now to Attain Near-Term Sustainability and Achieve Long-Term Success

Independent hospitals should strive to remain cognizant of the increasing stress on sector participants across nearly every functional area of the clinical care delivery enterprise. Given the spectrum of both known and unknown risks, effective implementation of the constructs described above will ensure our nation's hospitals maintain their essential roles as providers of essential healthcare services in a sustainable and highly successful manner in both the near- and long-term.

The Governance Institute thanks Hector Torres, J.D., M.B.A., Managing Director and Co-leader of the Healthcare Investment Banking practice, and Aaron Newman, Vice President in the Healthcare Investment Banking practice, of FocalPoint Partners, LLC, for contributing this article. They can be reached at htorres@focalpointllc.com and anewman@focalpointllc.com.

Key Board Takeaways

The following action items can help boards of independent hospitals attain near-term sustainability and achieve long-term success:

- **Develop and/or “stress test” your hospital’s five-year strategic financial plan.** If your hospital has not already developed an integrated five-year strategic financial plan, aim to do so as expeditiously as possible, as this tool will serve as the roadmap to understanding and optimally managing your overall financial, capital, and liquidity position, and enable a comprehensive assessment of the overall strength of your organization both today and in the immediate future. Ensure that this five-year financial plan can incorporate scenario sensitivity analysis that can account for the impact of variables such as loss of overall market share, decreases in managed care reimbursement, market-specific competitive dynamics, and other relevant considerations. If your hospital has already developed this invaluable tool, aim to develop and empower a cross-disciplinary committee comprised of both board members and administrative leadership that are tasked with fine-tuning and “stress testing” your five-year strategic financial plan, so as to ensure it fully articulates a diverse array of viewpoints and perspectives.
- **Plan and prepare for the “black swan” events.** The thought that the entirety of the U.S. would be dealing with a crisis of the magnitude of the COVID-19 pandemic 12–18 months ago would have been unfathomable, yet these are the exact type of “black swan” events that your hospital will need to think through and prepare for to ensure near-term sustainability and long-term success. Balance the overall mix of events by stratifying them into categories such as “probability of occurrence” and “magnitude of impact” in order for your hospital to be fully prepared to respond to the most probable and/or most negatively impactful events. The strategic evaluation framework included in Exhibit 1 can serve as the baseline construct for this contingency stratification analysis.
- **Avoid the “this is how we have always done things” mentality.** The current and future healthcare industry landscape is dynamic and rapidly changing. As a result, your organizational strategies must not only adapt to these ever-changing market conditions but also be able to accurately predict systematic shifts in the overall operating environment. Both your board and leadership teams should always steer away from the myopic organizational mentality of “this is the way we have always done things” at almost all costs. In today’s environment, the only constant is change, and even more so today, the velocity of change demands that your organization deploy new and innovative strategies in order to remain relevant in both the near and long term.
- **Embrace a fluid and adaptable organizational strategy.** Strive to avoid an organizational strategy that is rigid in its construct, and aim to develop one that is both fluid and adaptable. This approach ensures your organizational strategy can optimally mitigate both internal and external challenges as they present themselves, while simultaneously making the most of opportunities that arise by virtue of the ever-changing competitive landscape and/or overall operating environment. Seeking to balance a disciplined approach to the pursuit of your organization’s strategic priorities, combined with the flexibility to be nimble and opportunistic when worthy pursuits that are outside the core pillars of your strategic plan present themselves, provides for the optimal construct to ensuring your hospital’s sustainability and long-term success.