Rural Focus

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Collaborating to Realize the Value of Your Rural Hospital

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Many large health systems have long understood the financial benefits of including critical access hospitals, small rural hospitals, and rural health clinics within their portfolio of facilities. Health systems are able to use their scale to achieve operational efficiencies beyond the reach of most independent rural facilities and frequently benefit from profitable referrals into their system from these rural communities. Additionally, organizations that coordinate well with their rural facilities and/or partners benefit from enhanced care coordination and rationalization across their facilities, resulting in more robust and profitable clinical service lines.

Meanwhile, many independent rural hospitals are unable to retain patients they could otherwise treat when those patients have the resources to bypass them in favor of larger facilities, particularly for more advanced clinical care. Because these patients directly seek care outside of their community, independent rural hospitals not only lose potential procedural volume, but are also unable to offer pre- and post-procedural care for these patients closer to home.

But it doesn't have to be this way. What would the financial impact be to your rural hospital if you shared in the profit generated from cases originating in your service area but treated at a partner hospital? What value would your rural hospital bring to a larger facility and, in turn, how could a collaborative partnership with a larger facility enhance the level of care being provided by your medical team?

Joint clinical service lines, also referred to as service line revenue mergers, provide opportunities for a rural hospital to partner with a larger facility to provide defined clinical services under a mutually beneficial arrangement. Although the specifics of these arrangements typically vary to meet the parties' shared objectives, the typical result is two or more organizations benefiting financially while enhancing access to care and coordination of services.

→ Key Board Takeaways

Boards of rural hospitals should take time to consider how a service line revenue merger could benefit their organization including:

- Integration with independence: Closer alignment with larger hospitals can enhance services locally without sacrificing independence.
- Network enhancement: Large hospitals are eager to partner with rural providers to expand their reach and defend against the threat of other large competitors.
- Service optimization: Service line revenue mergers can enhance patient access, advance care coordination, improve quality, reduce costs, and reduce unnecessary duplication of services.

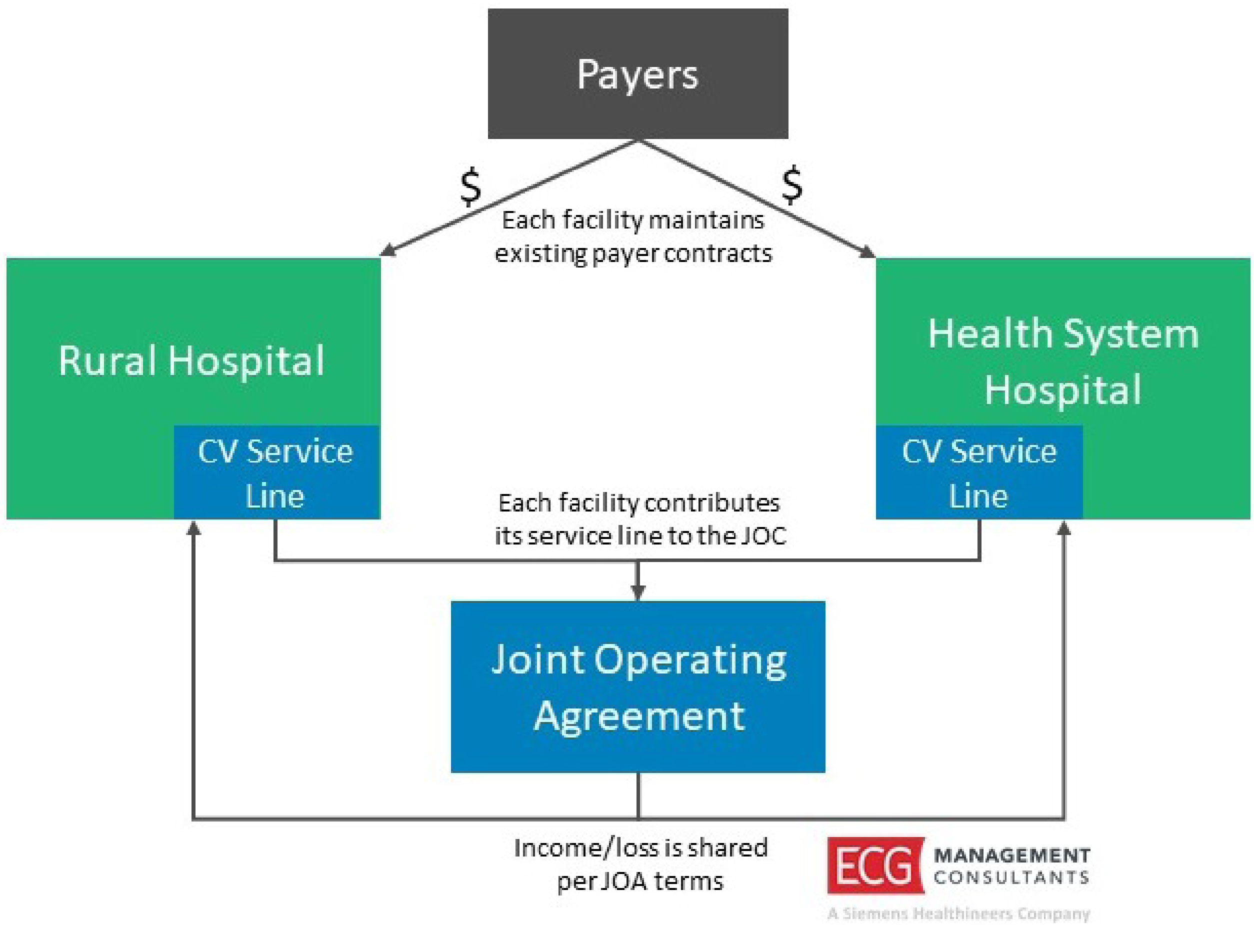
What Is a Service Line Revenue Merger?

A service line revenue merger is typically established when two or more organizations enter a joint operating agreement (JOA) to manage and share in the performance of a clinical service line. An example of a service line revenue merger for a cardiovascular (CV) service line is illustrated in **Exhibit 1** on the following page. In this example, a rural hospital and a larger health system hospital create a financially integrated partnership for their combined CV service lines. Features of this arrangement include the following:

- **Ownership**: The value of the contributions of each hospital to the JOA determines each party's ownership of the JOA. For example, if the larger health system's service line is valued at $9 million and the rural hospital's service line is valued at $1 million, the JOA's ownership would be shared 90 percent for the health system and 10 percent for the rural hospital.
- **Governance and management**: The JOA board has authority over the CV service line, including strategic planning, development of operating and capital budgets, determination of new service offerings, locations, etc.
- **Scope of services**: The definition of CV services may vary depending on the service offerings of each organization, but the parties agree on which services should be included in a partnership and how those services should be defined.
- **Operations**: Each hospital typically maintains its own operations.

- **Clinical integration**: While JOAs benefit from increased clinical coordination (e.g., care pathways and transfer protocols), organizations often continue to bill for services under their own licenses, payer contracts, and provider numbers.
- **Funds flow**: The income or loss from each hospital's service line is combined and allocated based on the parties' respective ownership percentages.

Exhibit 1: Example JOA Structure



How Do Rural Communities Benefit?

Service line revenue mergers are designed to enhance services closer to patients' homes and provide greater care coordination for advanced procedural care that requires patient travel. Benefits include the following:

- **Enhanced access**: Rural hospitals are able to offer coordinated pre- and post-procedural care to patients seeking services outside of their community, resulting in improved service line profitability and patient access closer to home.
- **Expanded services**: On-site clinics and virtual consultations for patients potentially needing advanced care can expand the level of services offered locally (e.g., heart failure clinics and remote monitoring).
- **Coordinated care**: Increased collaboration with a larger hospital partner may provide shared clinical protocols, care pathways, provider education/training, and a more seamless patient care experience.
- **Avoiding redundancies**: Clinical and financial integration mitigates the need for organizations to unnecessarily offer duplicative services and ensures that patient care is provided appropriately among the partnering facilities.
- **Financial performance**: Rural hospitals frequently benefit from the resources of their larger hospital partners, mitigating the need for duplicative infrastructure and achieving some economies of scale (e.g., group purchasing).

How Are Service Line Revenue Mergers Developed?

The process involved in developing a service line merger involves defining the partnership opportunity, confirming the scope of services to be included, preparing a business plan for the proposed partnership, and defining the specific terms of an

→ Questions for the Board

- Do the parties have a shared vision for the partnership? Are their goals aligned and attainable (e.g., agreed upon performance goals and quality measures)?
- Will this partnership enhance local delivery of care to keep patients closer to home when possible? Will it increase patient access to specialized care?
- Are there opportunities to better formalize a coordinated system of care, referral pathways, transfer processes, etc.?
- Do both organizations have the needed resources and infrastructure to manage this type of arrangement?
- Are there opportunities to improve operational performance and reduce costs through the use of shared resources?

arrangement. Experienced legal counsel should be engaged early to help guide the process.

- **Defining the opportunity**: An assessment to define the benefits of an arrangment between the parties includes an evaluation of market data to understand the competitive forces and growth opportunities. In addition, operational and financial information related to the service lines at each organization should be assessed to determine areas of strength and weakness and to evaluate opportunities to improve overall patient care delivery.
- **Confirming scope of services**: While the parties may agree conceptually on the scope of services to be included, it is important to understand what can be easily monitored by both parties and to ensure a common understanding of what each organization is contributing to the arrangement.
- **Planning the business**: A business plan for the JOA should be collaboratively developed to appropriately plan for changes to the joint care delivery model and to understand its projected financial performance. The business plan outlines key elements, including:
  - Partnership vision and goals
  - Business development opportunities
  - Financial projections and capital requirements
- **Defining the terms of the arrangement**: Concurrent with business plan development, the parties should engage in discussions regarding terms for the JOA. Ideally, a facilitator and legal counsel would meet with key stakeholders, including executives and physician representatives from each organization, to evaluate possible JOA contractual provisions, including terms related to:
  - Corporate structure
  - Buy-in/asset contribution and equity ownership
  - Management and governance
  - Performance monitoring
  - Funds flow and distribution formula
  - Term, termination, and dissolution
  - Noncompetition and nonsolicitation clauses

While there are numerous benefits to a service line merger, its success ultimately requires close collaboration between the parties and a clearly defined scope of services. Hospital boards should consider the relative value of a JOA in light of their community need for access to local and advanced specialty care. Careful consideration of the terms of an arrangement and its ongoing management will ensure that the collective goals of the parties are achieved and that the resulting partnership is not only financially viable but profitable.

The Governance Institute thanks John Fink, Principal, and Katy Reed, Associate Principal, ECG Management Consultants, for contributing this article. They can be reached at jfink@ecgmc.com and kreed@ecgmc.com.