



Independence or Merger? A Board's Most Difficult Decision

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For most hospital governing boards, the decision whether to remain independent or merge with another healthcare system will be one of their most significant and difficult legacy decisions. The decision can be divisive, threatening, and seen as a failure to maintain a viable community resource. Or the decision potentially can be positive and opportunistic, enabling the hospital to survive into the future. Many boards fear the loss of control, yet this can result in eroding financial sustainability and even insolvency and closure. The Center for Healthcare Quality and Payment Reform (CHQPR) recently estimated that more than 800 rural hospitals are at immediate or high risk of closure in the near future.

By early 2020, Washington Health System (WHS) in southwest Pennsylvania had been approached with merger and affiliation proposals by multiple healthcare systems. The Washington Hospital is the primary hospital within WHS and is positioned in an attractive market situated at the crossroads between three major academic medical centers and five large community hospitals and health systems in surrounding areas. The board embarked on an objective analysis of scenarios to assess if WHS could be financially and operationally capable of achieving its stated vision “to remain a locally governed healthcare system that is a leader in healthcare quality, safety, and value” as an independent healthcare system for the next five to 10 years.

Scenario Analysis: Modeling Impacts for Governance, Finance, Operations, and Clinical Services

The scenario analysis focused on addressing the following questions:

- What alignment options will allow WHS to achieve its vision to remain an independent health system?

- Which strategic partner(s) could significantly advance WHS’s mission and vision, capabilities, and overall market position?
- What are the opportunities and risks associated with the future strategic path for WHS?

The analysis projected how WHS would perform relative to the core competencies that are required for successful performance in a value-based care environment, including leadership and governance, finance, physician alignment, clinical program alignment, quality and safety, care management, operations, and information technology. It also projected:

- WHS’s long-term financial runway
- Strategies required to be relevant and sustainable in a value-based care environment
- High-level evaluation of potential strategic partners

The process allowed WHS to discover what needs and gaps they had that could be fulfilled by a potential partner and identified what capabilities WHS could provide in the relationship to enhance the value of an affiliation agreement.

→ Context and Background: Essential Community Providers

Washington Health System comprises two rural hospitals—The Washington Hospital (260 beds) and WHS Greene Hospital (50 beds)—that serve two counties and their surrounding communities southwest of Pittsburgh, Pennsylvania. The system generates \$587 million total patient revenue and has more than 2,300 employees and over 40 outpatient sites including a rural health clinic and an employed multi-disciplinary provider practice group, Washington Physician Group (a 70+ provider physician group), with more than 350 hospital medical staff members.

In addition, Washington Health System has diagnostic centers, outpatient care facilities, the Wilfred R. Cameron Wellness Center, Greenbriar Treatment Center (a chemical dependency rehab organization), residency and fellowship programs, the school of nursing, numerous joint ventures in the areas of hospice, senior living, home health, and others to provide patient/family-centered care. It owns a regional ACO/CIN with three similarly sized community health systems as a value-based healthcare organization and is a participant in the Pennsylvania Rural Health Model CMMI pilot program.

The Analytic Process

Step 1: Assess WHS's Value-Based Care Readiness

The board steering committee defined core competencies for success in value-based care, and WHS was evaluated using a matrix showing its performance in each of the following eight areas relative to market leaders' current and future capabilities:

- Finance
- Physician alignment
- Information technology
- Clinical program alignment
- Care management
- Leadership and governance
- Quality and safety
- Operations

The central questions being addressed were:

- Will WHS be able to enhance and accelerate its development of these eight competencies over time to remain competitive with other provider networks and hospitals?
- As an independent organization, will WHS be able to keep up with the pace of change and market evolution occurring across the region?

Step 2: Test Strategic Options Against Organizational Objectives

Three strategic alternatives were identified and evaluated against the partnership goals noted above:

- Maintain independence
- Create a new regional system with other independent organizations
- Join an existing regional system/academic medical center

Five test criteria were used to evaluate WHS's options:

- **Test A:** Does the potential option provide WHS with access to capital and the ability to enhance the organization's regional market essentiality with payers and purchasers of healthcare?
- **Test B:** Does the potential option provide access to a physician infrastructure that will support WHS's care management and clinical objectives and incentivizes cost reduction, quality improvement, and financial sustainability?

- **Test C:** Will the option provide WHS with an advanced business intelligence platform with robust clinical, strategic, operational, and financial analytics?
- **Test D:** Will the option position WHS as a preferred acute provider as part of a broader integrated healthcare delivery network with real-time access to high-performing provider organizations across the continuum of care?
- **Test E:** Does the option provide WHS with a clinically integrated provider workforce with care coordination and care management tools to ensure seamless transitions of care?

Several potential alignment models were considered, including limited-purpose affiliation relationships with other providers to fill specific strategic needs, affiliation with regional hospital(s) and/or systems, integration opportunities with local physician groups, and alternatives identified during the assessment. An evaluation tool was used to judge the merits, benefits, and drawbacks of individual opportunities. Potential partnership objectives for consideration included:

- Mission and vision congruence
- Culture and fit
- Scale
- Market position
- Service distribution
- Geographic expansion
- Physician alignment
- Risk diversification
- Financial capability

Building upon the regional market characteristics and the identified partnership goals and needs, potential partners were profiled on key market, strategic, and financial facts about these organizations. An evaluation matrix was used to summarize the key qualitative and quantitative factors of the strategic alternatives under consideration including an objective assessment of the principal advantages and potential risks associated with each.

Key Finding: All of the options considered had the potential to address a certain component of WHS’s core objectives, but no single option would immediately and fully address all the objectives.

→ Key Board Takeaways

Conducting a proactive rigorous and objective scenario analysis of potential sustainability will:

- Show that the board is open to objective, quantifiable, evidence-based analysis of potential options available and associated timelines tied to a financial forecast.
- Demonstrate that an objective assessment of partnership options fulfills the board's fiduciary duty to the organization regardless of the emotional impact of considering these scenarios.
- Allow all board members to understand the process, variables, and data modeling essential to provide sufficient information to make an informed and defensible decision about independence and alignment options and strategies.
- Provide the information necessary for the board to assess if the hospital is capable of remaining independent financially and operationally into the future in a sustainable way.

Step 3: Conduct a Financial Analysis

A financial model was used to analyze several scenarios with varied assumptions around projections of future volume, revenues, expenses, and other relevant factors. While WHS enjoys a strong balance sheet, the EBITDA and operating margins were projected to decrease over time as WHS deals with expense inflation and flat to declining revenue, similar to most health systems in the country.

The Results: Many Options, Varied Conclusions

The analysis process was prolonged due to the pandemic and resulted in the WHS board steering committee holding several additional meetings than was originally planned. This allowed for an extraordinarily detailed level of analysis and discussion about independence, affiliation, and merger alternatives that would not have otherwise happened. The following conclusions were reached regarding each of the options assessed:

Option 1: Remain Independent

- While WHS outperforms the market in terms of inpatient market share, operating margins continue to be razor-thin with limited cost-reduction opportunities.
- The COVID-19 pandemic and encroachment from regional competitors have challenged the organization's ability to sustain the current level of volumes and operating margins.
- WHS will need to be assertive about generating the capital capacity necessary to support long-term strategic investments for key priorities (e.g., physician alignment, IT, clinical program alignment, and care management).

Option 2: Create a New Regional System

- The difficulty of partnership execution increases exponentially with each additional party; while multi-party partnerships are not impossible, the execution risk is high.
- Competing cultures, community politics, and physician alignment dynamics compound the difficulty for WHS.
- Agreement will need to be reached on critical issues such as governance, asset integration, physician alignment, and service rationalization.

Option 3: Partner with a Non-Profit Health System

- This option meets several of WHS's organizational objectives and strategic requirements and would help respond to the competitive and market dynamics facing southwestern Pennsylvania hospital providers.
- At this time, WHS will be operating from a position of strength—a position that will allow it to have significant influence in determining its future role in the community and the region.

Hybrid Strategy: Independence and Non-Merger Alternatives

The recommended strategy is to remain independent while pursuing partnerships and alliances across the region with selected organizations that can provide specific resources and relationships that will lower per-unit costs in selected service lines and reduce total costs of care. Partnerships will also be pursued in specific service lines where gaps exist in provider and technology capabilities. The goal is to increase patient volume in inpatient and outpatient services, improve patient access to higher levels of care, and at the same time improve quality, safety, and patient experience.

The WHS board has determined to remain vigilant in tracking key financial, operations, and quality performance indicators, setting thresholds that can trigger a reassessment of strategic alternatives. For the time being, independence remains the vision, with integration and selective alignment being the strategy.

Final Words Regarding an Independence/Merger Decision

Boards that govern independent hospitals and health systems at some point will or already have wrestled with the questions, “*Can we remain independent?*” and “*Should we remain independent?*” Regardless of the emotion attached to the discussion, objective unbiased analysis should be done to ensure that the board is considering what will be best for the community it serves and for the hospital to fulfill its fiduciary duty. Assess the facts with arduous rigor, deliberate openly, then choose the best course of action to ensure local sustainable healthcare regardless of whose name is on the door in the future. The community’s health, healthcare offerings, and economic impact is depending on it.

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