New Partnership Models Respond to the Impacts of COVID-19 Pandemic

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The COVID-19 pandemic has put significant operational and financial constraints on many hospitals and health systems. New partnership models can help ensure that organizations have the capabilities they need to sustain and grow their core businesses *and* expand the services they offer to the community.

Impacts of the Pandemic

Few industries have felt the impact of COVID-19 more than healthcare. In the early months of the pandemic, hospitals and health systems faced precipitous declines in volume. Kaufman Hall's *National Hospital Flash Report* data showed that in April 2020, discharges fell 30 percent compared to the prior year, while emergency department visits were down 43 percent. Physicians' offices similarly saw volume declines of 30 to 79 percent across a range of practice areas, according to estimates from the Commonwealth Fund. The situation has improved, but Kaufman Hall's data for September 2021 show that discharges are still 9.5 percent below pre-pandemic levels and ED visits are down 11 percent.[1] The average per physician subsidy (or investment) for employed physicians as of Q2 2021 had gone down to $232,583 from a pandemic high of $294,073 in Q2 2020, but it remained 16.5 percent above the last pre-pandemic quarter (Q4 2019).[2]

Despite some improvements, healthcare organizations and their workers have paid a heavy cost. Infection surges have continued to strain the resources of hospitals across the country. One hundred percent of the respondents to Kaufman Hall's *2021 State of Healthcare Performance Improvement* survey reported that they faced issues with clinical staff, including burnout, difficulty filling vacancies, wage inflation, and high turnover rates.[3] These issues are adding significantly to health systems' costs. An analysis by Premier found that hospitals and health systems are spending $24 billion more per year on qualified clinical labor than they did prior to the pandemic.[4]

Workforce problems extend beyond clinical staff. Ninety-two percent of respondents in the Kaufman Hall performance improvement survey are having difficulties recruiting and retaining support staff in critical areas, including dietary and environmental services; many are increasing base salaries, offering signing bonuses, or paying for more overtime hours. These challenges are accelerating the need for legacy systems to rethink "access" and "care" in entirely new dimensions.

One significant growth area during the pandemic was digital health. For many hospitals and health systems, however, the rate of growth created by the pandemic was unanticipated and much work will be needed to improve the customer experience and integrate digital health services more fully within the organization's overall operations. Before the pandemic, it seemed there might be a few decades until population segments that expect mobile and digital health solutions would be high users of services, but the pandemic catalyzed technological adoption by older age cohorts as well.

Although the growth in digital health helped maintain contact with patients, it was unable to overcome one of the most prevalent side effects of the pandemic: social isolation. Behavioral health needs—which were a significant issue before the pandemic began—have been magnified. Polling by the Kaiser Family Foundation, for example, found that during the pandemic, four in 10 adults in the U.S. reported symptoms of anxiety or depressive disorder, up from one in 10 before the pandemic.[5] More than half of older adults reported feeling isolated from others in June 2020, compared with 27 percent who reported feelings of isolation in 2018, with potential long-term impacts on memory, mental and physical health, and longevity.[6] Growing isolation among the elderly is both calling attention to the need for home health services and increasing the demand.[7]

Key Board Takeaways

- Because of the impacts of the pandemic, boards and senior leaders are naturally focused on sustaining the organization's core business. But the pandemic resulted in a growing population of patients that need help in high-touch specialty services including behavioral and home health.
- With constrained resources and workforce shortages, expanding services might seem to come at the expense of the core business. But it does not have to be an either/or decision that is difficult to resolve.
- Hospitals and health systems can move from "or" to "and" by pursuing strategic partnerships that enable them to focus on their core business strengths while also expanding services to the community by:
  - » Defining the core business
  - » Identifying areas for expansion
  - » Determining the necessary degree of control
  - » Determining the optimal structure for the strategic partnership through key considerations including ownership, financial commitment, governance, clinical decision making, and branding

Moving from *or* to *and* With Strategic Partnerships

In sum, the pandemic's impacts thus far include:

- A tightening financial vise for hospitals and health systems, which are caught between decreased revenues and rising expenses.
- Staff shortages that threaten to hamper both recovery and growth of core services.

1 Kaufman Hall, *National Hospital Flash Report*, September 2021.
2 Kaufman Hall, *Physician Flash Report*, August 2021.
3 Kaufman Hall, *2021 State of Healthcare Performance Improvement: COVID Creates a Challenging Environment*, October 2021.
4 Mari Devereaux, "Hospitals Spending $24B More per Year on Clinical Labor," *Modern Healthcare*, October 6, 2021.
5 Nirmita Panchal, et al., "The Implications of COVID-19 for Mental Health and Substance Use," Kaiser Family Foundation, February 10, 2021.
6 University of Michigan National Poll on Health Aging, "Loneliness Among Older Adults Before and During the COVID-19 Pandemic," September 2020.
7 Seth Joseph, "Home Health Care Is a Bright Light During COVID-19 With an Even Brighter Future," *Forbes*, August 5, 2020.

- A growing population of patients that need help in high-touch specialty services, including behavioral health and home health.

In this environment, boards and senior leaders are naturally focused on sustaining the organization's core businesses. They may be concerned that, given the constraints on resources, expanding the services they offer to their communities would come at the expense of their core businesses. At the same time, these hospitals and health systems may be struggling to provide certain core services or face growing needs for specialty services in their communities, and risk losing patients to competitors. Healthcare leaders may feel they must make an either/or decision that is difficult to resolve.

Hospitals and health systems can move from *or* to *and*, however, by pursuing strategic partnerships that enable them to focus on their core business strengths *and* expand the services they offer to the community, while differentiating their value for consumers, employers, and other key stakeholders. The key questions in determining strategic partnership goals include:

- What do we define as our core services? Where are we facing capabilities gaps in providing these services?
- Where do we want or need to expand our services? Do we have the resources to expand these services on our own?
- What degree of control do we need to maintain as we expand services?

Some hospitals and health systems have already begun asking these questions, and the answers are appearing in new partnership models across a range of services and partner organizations.

Defining the Core

Boards and senior leaders can take several approaches to defining core businesses. Health systems with a presence in multiple markets might begin by considering their relative strength in these markets. In which markets is the health system maintaining or growing market share? Are there any markets in which market share is declining or where growth prospects seem limited?

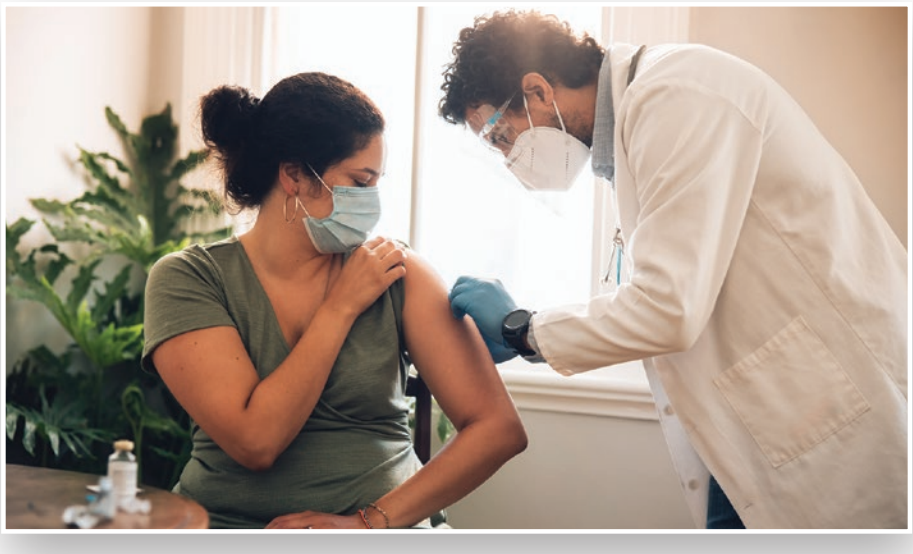
Answers to these initial questions are appearing in a trend we described as the "benefits of regionalization" in Kaufman Hall's *M&A Quarterly Activity Report* for the second quarter of 2021.[8] On the one hand, we see health systems building depth in their local markets and breadth by partnering with health systems that have a strong presence and complementary capabilities in adjacent geographies. On the other hand, we see health systems divesting facilities in markets where they do not have a strong presence and using the resources from these divestitures to strengthen their presence and capabilities in core markets. This is perhaps the dominant trend in traditional mergers and acquisitions between hospitals and health systems since the pandemic began.

Another approach identifies core businesses through an analysis of service lines. Here, key questions include:

- What do we do well and what do we not do well?
- Are there services where we underperform but that are nonetheless critical to our mission?
- Are any of the services we offer becoming commoditized, limiting our ability to distinguish ourselves from our competitors?
- Are there any services that expose us to ongoing performance risk, capital claims, or other drags on organizational resources?

These questions will help health system leaders identify services that they could exit or monetize to enhance the resources available to other core services.[9] But they will also help identify core services that the health system might need to bolster. Service areas where the health system underperforms but that are critical to its mission are likely to be core business areas where the organization needs to build capabilities. Capability gaps may be especially prevalent in areas that require specialized skills or employ different staffing models, such as behavioral health, home health, and post-acute care.

Once capability gaps in core business services have been identified, boards and senior leaders can consider whether they are best strengthened internally, through an acquisition, or through a strategic partnership.



Identifying Areas for Expansion

Innovation, technological change, and demographic change have not been stopped by the pandemic—in some areas, they have been accelerated. Boards and senior leaders must remain attentive to areas where services could or should be expanded. These decisions affect both the ability of patients to easily access

8 Kaufman Hall, *M&A Quarterly Activity Report: Q2 2021*, July 8, 2021.
9 As discussed in Courtney Midanek, "Portfolio Optimization Strategies to Build Resiliency," *System Focus,* The Governance Institute, April 2020.

needed services and the hospital or health system's competitive strength and position.

The pandemic has accelerated several care delivery models, including digital and hospital-at-home models. Many hospitals and health systems had experimented with digital health but had to quickly ramp up their capabilities when demand for digital access soared early in the pandemic. Hospitals and health systems must now determine whether demand for digital services will remain high or grow, and how they can improve access to digital services that may have been quickly put into place during the pandemic. Again, a key question will be whether to develop and enhance digital health capabilities independently or seek a strategic partner.

Hospital-at-home received a significant boost as well, as hospitals and health systems sought ways to keep inpatient beds free for the most acute patients when COVID infection levels surged, while still ensuring that other patients with less acute needs received the care they required. This is a model where hospitals and health systems may seem well-positioned to push out their own capabilities into a new service area; the question will be whether they have the resources available to do so.

The pandemic also saw significant demographic shifts as remote work arrangements—some of which are likely to remain permanent—enabled individuals to move to suburban areas, smaller cities, or fast-growing population hubs in states such as Florida, Texas, and Arizona. Population growth may make new service lines financially sustainable or necessary to meet community needs. Adding these service lines will require investments, including in new clinical expertise; a strategic partnership with an independent physician group is a possibility here.

Determining the Necessary Degree of Control

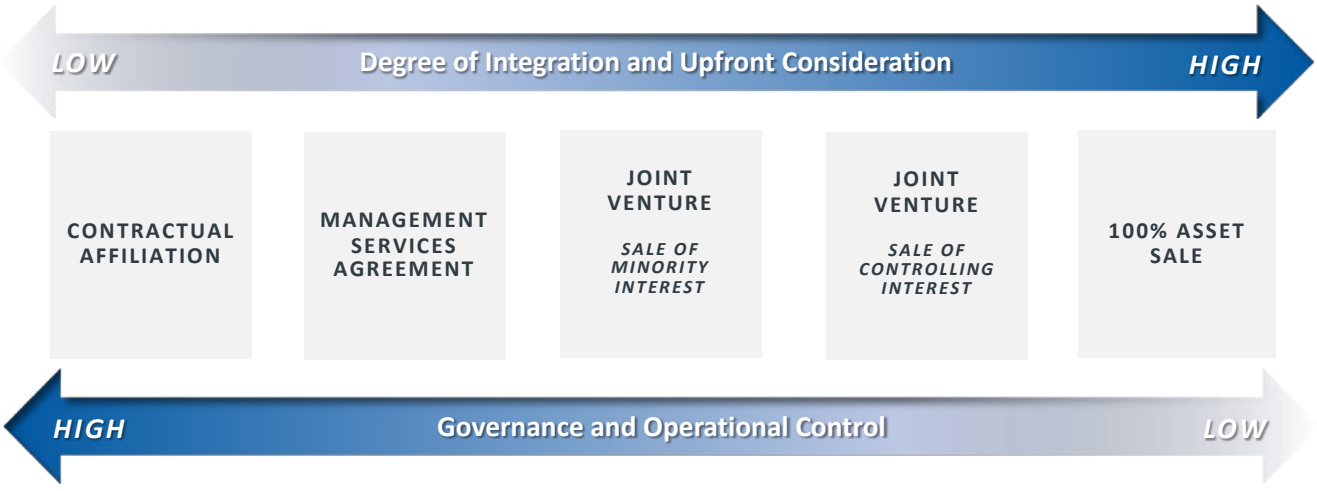
Health systems have traditionally sought to maintain a high level of control across all facets of their operations: framing a decision to expand in terms of "build or buy" was representative of this desire to maintain control. But a wide range of partnership options lie between "build" and "buy," and these may very well be more attractive to potential strategic partners that have desired capabilities but also wish to maintain their autonomy. From the health system perspective, allowing partners to maintain more autonomy may mean less integration, but also a lower upfront investment in the partnership. **Exhibit 1** illustrates this dynamic across a range of partnership structures; more tightly integrated structures typically require a higher

Key Questions for Decisions on Control

Health system leaders should approach potential partnerships with an understanding of the degree of control they believe they will need in the partnership. Key questions in reaching this understanding include:

- How important is this partnership to achieving our strategic goals? If this partnership does not materialize, are there other options available to us?
- Does this partner have capabilities that we do not, which could uniquely be obtained through this partnership?
- Will this partnership have any disruptive impacts on our current operations (e.g., staffing models, community relations, etc.)? What will be the potential costs of addressing these impacts?
- Are there core decisions we must be able to control or drive, but others we would be willing to cede to a partner? If that is the case, could a minority interest partnership with key supermajority or reserved rights still meet our needs?
- What is the desired length of the partnership? What is our backup plan if the partnership does not succeed?

Exhibit 1. The Dynamic Between Integration and Control



Source: Kaufman, Hall & Associates, LLC

investment by one partner and a loss of control by the other.

The question of control has become more significant as potential strategic partners offer an increasing number of options to consider. Independent physician practices, for example, might choose to partner with a health system, a health plan, or any number of start-up companies that are experimenting with new physician practice models that offer more attractive practice arrangements and shared equity opportunities. Digital health vendors might align with a health system, a retail pharmacy's clinics, or a health plan or large employer. Skilled specialty service operators can directly compete with health systems or partner with them.

Health systems should approach all potential strategic partnerships with an understanding that control is not an assumption, but a point of negotiation. The goal is to find the balance between integration, investment, and control that enables both partners to achieve their goals and optimize the chance of a successful partnership.

Additional Considerations for Structuring Strategic Partnerships

As illustrated in Exhibit 1, strategic partnerships can take many forms, from a fairly loose contractual affiliation to a more tightly integrated joint venture. The optimal structure will depend on several key considerations, including:

- **Ownership**: This consideration is always important, but particularly so if the partnership will require acquisition or construction of new facilities or assets. If there will be co-ownership of assets, what are the provisions for unwinding ownership interests if the partnership dissolves? If assets are owned primarily by one partner, what will be the other partner's commitments to the partnership?
- **Financial commitment**: Financial commitments might be structured in different ways, depending on such factors as which partner's core capability is the focus of the partnership or the relative financial strength of the partners. The partner whose core capability is the service line that the partnership is structured around may put up most of the capital, or two relatively equal partners might share the upfront financial commitment to a new partnership. In other cases, the larger partner might provide most of the upfront financial commitment but structure the partnership so the smaller partner can gradually contribute and build equity in the partnership and its assets. Members of an independent physician group, for example, may not want an upfront draw on their salaries or assets in an ambulatory strategic partnership with a larger health system, but may be very interested in an arrangement that allows them to build equity over time in the partnership's assets.
- **Governance**: If the partnership involves formation of a new entity, as is the case in many joint ventures, the partners will want to determine the number and roles of each partner's representatives on the governing body that oversees the new entity. The number of representatives will often reflect the ownership interests of the two partners, while the respective responsibilities of the partners will help determine roles. Supermajority or reserved rights for the minority interest partner may partially or fully mitigate concerns around decision making, particularly regarding clinical decision making.
- **Clinical decision making**: In partnerships between healthcare providers, the question of who will have final decision-making authority over patients' care pathways, referrals, discharges, etc. should be determined in advance. This is an area where questions of control, discussed above, may be particularly sensitive; clarity will be essential to the long-term health of the partnership.
- **Branding**: Several options are possible here. The partners might keep their separate brand identities, combine them, or create a new brand entity for a new venture. In certain areas, such as digital health, a vendor might offer a "white label" solution that brands services under the health system's name. In this case, the partners will need to consider what structural protections should be in place for the "name brand."

Conclusion

Strategic partnerships offer opportunities for hospitals and health systems to sustain and grow their business in an environment where many resources are under pressure. As partnership options grow, rethinking questions of control can help organizational leaders structure new partnership models that are attractive to potential partners and further both partners' strategic goals.

The Governance Institute thanks Anu Singh, Managing Director, Kaufman, Hall & Associates, LLC, for contributing this article. He can be reached at asingh@kaufmanhall.com.