



Hospital Focus

Examining Circumstances That Allow Independent Hospitals to Thrive

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Over the past 20 years, the percentage of the nation's hospitals over 200 beds that are part of health systems has risen from 56 to 77 percent.¹ This trend continues as local, regional, and national health systems expand in search of greater scale, financial stability, and market presence. From 2006 to 2016 alone, the number of independent hospitals over 200 beds declined nearly 40 percent, from 502 to 308.² The seemingly inexorable trend toward system expansion has caused industry observers to state frequently that stand-alone community hospitals are "dinosaurs."

While stand-alone hospitals will continue to join local, regional, and national health systems, a subset of well-positioned institutions can continue to stay independent, support their communities, and demonstrate the ability to thrive. This article describes some of the special circumstances under which stand-alone hospitals can continue to thrive, at least for the foreseeable future.

There are also a multitude of new partnership arrangements that make it possible for successful institutions to retain a high degree of independence while securing

1 American Hospital Association Hospital Statistics 2017, 2013, 2012, 2008, 2005, 1998.
2 *Ibid.*

Key Board Takeaways

As boards of stand-alone hospitals look to the future, they should:

- Routinely evaluate their hospital's current positioning, understanding if any changes in internal or market dynamics will impact the hospital's ability to remain independent.
- Test the strength and viability of the organization and its strategy through a structured annual evaluation process.
- Consider periodically whether the community might be better served through a regional partnership.
- Keep current on the range of partnership opportunities that might be available, including both horizontal and vertical integration.

many of the benefits of hospitals that are affiliated with larger health systems. Moreover, executives and boards of independent hospitals can pursue several proactive strategies to maintain their independence and strengthen their market position.

In our experience, successful independent hospitals share many of the same advantages, including that the hospital:

1. **Is the sole or predominant community provider in the market(s) it serves.** Many successful independent hospitals have benefited by serving a large proportion of the patients in their market(s). Not expending significant resources to compete with a substantial local market competitor is an obvious advantage.
2. **Is located within an attractive, stable, or growing market with a favorable payer mix.**

Not surprisingly, markets that feature a growing population base and economy and a high percentage of commercial patients can help support clinical service expansion and produce fresh business development opportunities for the hospital.

3. **Is large enough to achieve efficiencies in care delivery and cost management.** Typically, this might mean having at least 20,000–25,000 admissions and a large, well-distributed outpatient network. Having scale allows an institution to manage revenue and costs effectively. Such institutions can sustain profitable subspecialty care and surgical services, and better manage their costs by, among other things, negotiating volume-driven discounts with suppliers.
4. **Provides a wide array of profitable specialty care**

Exhibit 1: Common Characteristics of Successful Independent Hospitals



(As Informed by The Chartis Group Experience)

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services and has a high case mix index, enabling it to earn favorable margins per case.

Specialty care, particularly complex procedural care (e.g., cardiac services, neurosciences, orthopedics, and cancer care), typically generates relatively high margins, aiding the hospital's financial position. Having a high percentage of surgical cases and a robust base of elective admissions reflects the benefit of having a closely aligned network of specialists and surgeons.

5. **Has a strong balance sheet, including over 200 days cash on hand and a favorable debt-to-capitalization ratio.** Hospitals often seek affiliation partners to bolster weak balance sheets or provide access to capital. Consistently strong margins and a healthy balance sheet are enduring advantages that give successful hospitals the ability to weather internal and external market challenges. These advantages make it

easier for institutions to invest in internal organizational needs and to capitalize on growth opportunities.

6. **Has built an integrated, closely aligned physician network that is growing and well distributed across the service area.** A strategically deployed network of highly aligned providers is among the greatest assets a hospital can possess. Developing a large, integrated physician network is more challenging for independent hospitals; they may encounter greater difficulty recruiting physicians and developing the infrastructure to successfully support them in growing their practices. A high level of physician alignment across primary care physicians and specialists gives hospitals the ability to better execute against system-wide goals related to quality management, clinical variation reduction, and enhanced access to care.

7. **Benefits from strong community support, including philanthropy.** Successful independent hospitals translate their strong community support into productive philanthropic initiatives. Donations from grateful patients and other community supporters aid in the formation of strategic capital, positioning the hospital to grow and support critical services.
8. **Is able to create a level of "network essentiality" that positions it to negotiate favorable commercial and other payer contracts.** While it is more difficult to achieve the same degree of network essentiality as a leading academic medical center or large regional health system, it is possible for a stand-alone hospital to be considered essential at the local or sub-regional level.

These special market and internal characteristics can enable many of the remaining stand-alone hospitals to remain independent, meet their

mission objectives, fund routine and strategic capital needs, and fend off competition from larger systems.

Periodic Review of the Benefits and Risks of Remaining Independent

Regardless of how successful they have been in the past, it is critical for the remaining independent hospitals to conduct a rigorous, periodic review of their current positioning and future prospects. These institutions should assess how their markets are evolving and consider a range of options to preserve their ability to meet their mission objectives and the needs of the communities they serve.

This assessment should involve a thorough board and executive team evaluation process that considers the following types of questions:

- **Does our institution 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; therefore, it is important to focus on those elements 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.
- **How should we involve the board in an objective, periodic evaluation process?** Evaluating whether an institution can and 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. Even if most indicators suggest that the hospital is well-positioned for current and future success, boards and hospital leadership should regularly consider options to further solidify their market position. These opportunities

include forming networks with smaller independent hospitals, considering options for vertical integration, expanding the hospital's continuum of services, and strengthening the physician enterprise. There may also be opportunities to pursue a variety of looser affiliation models (e.g., cost-sharing collaboratives, academic affiliations, etc.) that may bring significant benefit while preserving a high degree of independence. 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.

The purpose of this article is to examine the unique circumstances/organizational characteristics that have enabled certain hospitals to continue to succeed as independent institutions despite the wave of consolidation that is sweeping the nation. Using those circumstances and characteristics as a frame of reference, boards of the nation's remaining independent hospitals are encouraged to evaluate regularly how their market is changing and whether their institution's current strategic positioning is sustainable. Such an evaluation can identify ways to fortify the hospital's current independent positioning; it also can help the board determine whether now is the right time to consider partnering to achieve strategic advantage and operational benefits the institution cannot achieve on its own.

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