# Partnerships Go Bold as Organizations Face New Challenges

*By Courtney Midanek, Kaufman, Hall & Associates, LLC*

The past three years have created a new reality for not-for-profit hospitals and health systems. The pressures of responding to the COVID-19 pandemic put enormous stress on the clinical workforce, resulting in a wave of early retirements that compounded a nursing staff shortage that had been predicted before the pandemic began.[1] Staffing shortages have contributed to wage inflation and have required hospitals to rely on more expensive contract labor; in some cases, shortages have meant that hospitals must run at less than full capacity, hindering efforts to generate revenue. Inflationary pressures have increased the costs of supplies and purchased services. In key areas—including emergency department visits—volumes continue to lag pre-pandemic levels. And the migration of care to outpatient settings continues, posing new competitive challenges for legacy hospitals and health systems.

As the nation moves further from the heights of the pandemic, it seems increasingly clear that these changes represent a permanent reset of revenue and cost structures for not-for-profit healthcare. For more than a year, a majority of hospitals have seen negative operating margins.[2] This appears to be a transformational moment for not-for-profit healthcare, and recent trends in partnerships, mergers, and acquisitions indicate that hospitals and health systems are exploring increasingly bold strategies to meet these new challenges.

This article considers three key trends:

- Rapid escalation in the size of partnership transactions
- Growth in the number of cross-regional partnerships
- Emerging discussions of new affiliate models that support the continued independence of small and mid-sized health systems

## Escalating Transaction Size

While the number of M&A transactions between hospitals and health systems has been lower since the pandemic began in March 2020, the size of those transactions has increased markedly. Last year, the average size in annual revenue of the smaller party to a transaction reached a historic high of $852 million, up from just under $400 million in 2020 (see **Exhibit 1**). For the past two years, 15 percent or more of the transactions have had a smaller party with annual revenues exceeding $1 billion.

This data suggests that health systems—even those with revenues in excess of $500 million—are finding it increasingly difficult to generate sufficient revenue to cover the high costs of running a not-for-profit health system. They are seeking efficiencies, new capabilities, or access to capital that will enable them to reduce operating costs, provide new revenue-generating services, and improve their competitive position.

## Cross-Regional Partnerships

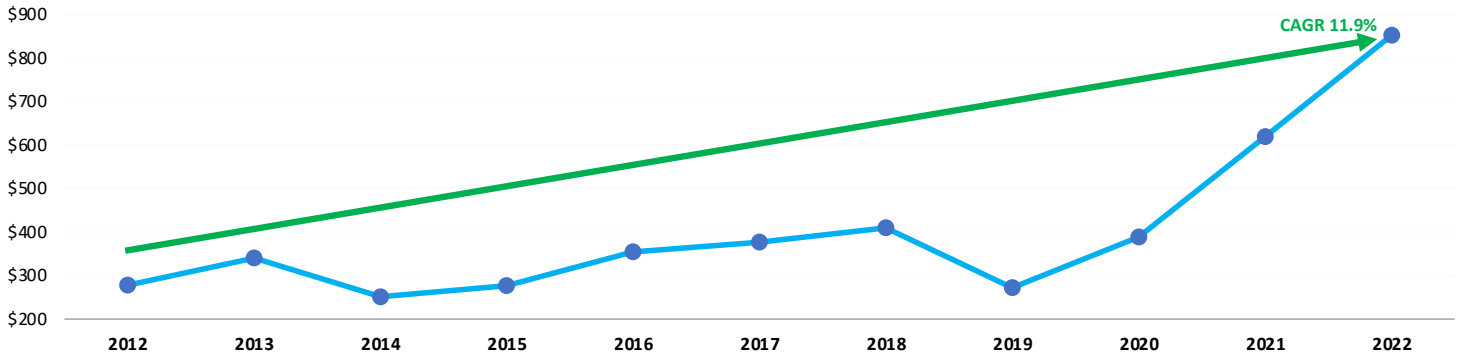
On an even larger scale, the number of partnerships between large, regional health systems is growing, creating new health systems that span multiple geographies. These mergers may combine health systems in adjacent or near-adjacent geographies (e.g., western Michigan-based Spectrum Health's 2022 merger with Beaumont Health in eastern Michigan to create Corewell Health) or involve partnerships

### Key Board Takeaways

As boards discuss potential partnership opportunities with leadership, key questions include:

- Is our health system generating a sustainable operating margin? Do we need to seek new efficiencies, capabilities, or enhanced access to capital to remain on a sustainable path forward?
- Are there service line or capability gaps that could benefit from a best-in-class, specialty provider who might bring capital, operational expertise, or other resources?
- What attributes of our health system would make us attractive to a potential partner? Could we attract the interest of a partner outside of our home region?
- Do we have unique or particularly strong administrative or clinical capabilities that we could offer to other health systems?
- Do we want to maintain governance control over local healthcare delivery decisions?

**Exhibit 1: Average Smaller Party Size by Annual Revenue, 2012–2022 ($s in Millions)**




Source: Kaufman, Hall & Associates, LLC

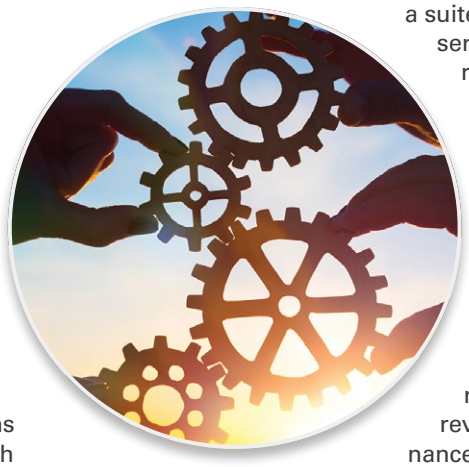
1 Stephen P. Juraschek, et al., "United States Registered Nurse Workforce Report Card and Shortage Forecast," *American Journal of Medical Quality*, September/October 2019.

2 Kaufman Hall, *National Hospital Flash Report*, March 28, 2023.

across non-contiguous geographies (e.g., Illinois and Wisconsin-based Advocate Aurora Health's 2022 merger with North Carolina-based Atrium Health to create Advocate Health).

The potential efficiencies created by these mergers—especially in administrative and back-office functions as the systems centralize in a single headquarters—are significant, and parties are establishing bold goals to leverage the resources these efficiencies could generate. Advocate Health, for example, plans to "do more, be better, and go faster" with emphases on accelerating innovations to patients, addressing root causes of health inequities, and advancing population health.[3] In other instances, the combination facilitates the expansion of a partner's capabilities into a new geography. For example, in both the Corewell partnership and the recently announced plan to combine New Mexico-based Presbyterian Healthcare Services with UnityPoint Health in Iowa, one of the partners has long-standing expertise with a provider-based health plan.

Cross-regional partnerships also provide an opportunity to build scale when opportunities for inorganic growth in a health system's local market grow scarce. In an environment of heightened regulatory scrutiny, partnerships within a system's existing geography have become more difficult. Combinations of health systems with little or no geographic overlap do not affect the concentration of providers in the combined markets. In some cases—for example, when one partner can introduce new health plan offerings into the other partner's market—competition for healthcare services can be enhanced.



## A New Model for Affiliation?

Several drivers are creating the need for a new affiliation model for certain smaller or mid-sized systems. First, heightened regulatory scrutiny may leave these systems "trapped" in their market, unable to merge with a local partner because of potential regulatory challenges. Second, some may have difficulties attracting interest from potential partners because of their size, strategic positioning, financial health, or other reasons. Third, some systems are reluctant to give up governance control over local healthcare delivery decisions. We believe there are opportunities for a new affiliation model that can deliver true value to all partners, offering revenue enhancement opportunities for health systems that have developed sophisticated administrative or clinical service offerings and opportunities for smaller systems that need to reduce expenses to improve operating margin or expand service offerings to remain competitive in their market.

This model would resemble a management services organization (MSO) model, with health systems that have developed strong capabilities offering a suite of administrative services (e.g., human resources, revenue cycle, finance, IT), clinical services (e.g., service line support, care delivery redesign consulting), or both. The model may be fee-based, with no ownership investments or combinations that would require regulatory review or affect governance structures. The model could be structured in numerous ways, with considerations including whether services would be offered as a package or a menu of options, and whether the affiliation would be branded (potentially valuable for clinical service enhancements) or non-branded.

UnitedHealth Group's Optum division has piloted a model that provides

support in such areas as IT, revenue cycle management, analytics, claims processing, and utilization management.[4] The challenge for large health systems is to create a differentiated model that leverages their unique expertise and provides the support needed for health systems in smaller markets or rural areas to remain independent. As margins tighten at health systems both large and small, this model could offer new ways for health systems that have successfully pursued efficiencies of scale to monetize their expertise.

## Conclusion: A Time for Bold Thinking

Facing challenges on multiple fronts, hospitals and health systems are rethinking how partnerships can help them achieve long-term sustainability. New efficiencies, capabilities, and growth opportunities are required, and a willingness to think big—and think beyond traditional boundaries—will be a driver of success.

*The Governance Institute thanks Courtney Midanek, a Managing Director at Kaufman, Hall & Associates, LLC, for contributing this article. She can be reached at cmidanek@kaufmanhall.com.*

3 Advocate Health Care, "Advocate Aurora Health and Atrium Health Complete Combination" (press release), December 2, 2022.
4 John Muir Health, "John Muir Health and Optum Launch New, Comprehensive Relationship to Advance Quality Care and Experiences for Patients in Bay Area" (press release), July 7, 2019.