



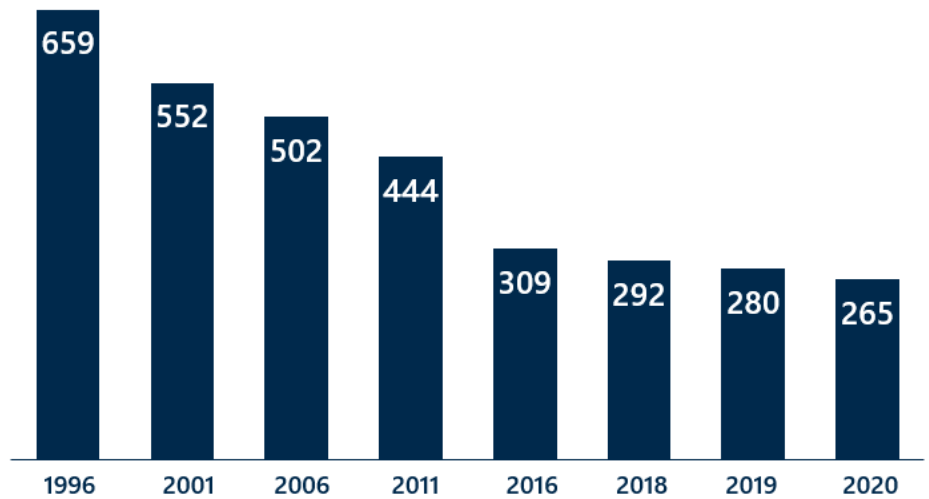
Examining Circumstances That Continue to Allow Independent Hospitals to Thrive

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In 2018, before the COVID-19 pandemic challenged us so thoroughly, Chartis published an article on the unique circumstances that have allowed certain hospitals to continue to thrive as independent institutions. Various impacts of the pandemic—including volume declines, workforce shortages, and financial pressures—have made remaining independent more challenging than ever before. With merger and acquisition activity picking up again in 2023, an increasing number of independent institutions are evaluating anew their ability to remain successful as standalone organizations.

Margins for small- to medium-sized hospitals and health systems have narrowed significantly in recent years, driving many to reevaluate their current situation. The Moody’s data in **Exhibit 2** highlight the fact that hospitals with less than \$3 billion in net revenue (and particularly in the less than \$1 billion category) have on average experienced lower operating margins than larger health systems with \$3 billion or more in net revenue.

Exhibit 1: Number of Independent Hospitals with Greater Than 200 Beds



Notes: Independent hospitals are defined as freestanding hospitals, single-state and multistate healthcare systems.
Source: AHA Hospital Statistics 1998–2022 Report and Fast-Facts (2022 survey data reports on 2020 actuals).

That having been said, many of the characteristics we highlighted in 2018 still allow certain independent hospitals to thrive. Updated Chartis research in 2023 has highlighted nine characteristics that continue to enable certain hospitals to remain successful as independent institutions in today’s more challenging operating environment.

Exhibit 2: Average Operating Margin by Size of Organization (%)

System Size / Time	\$51M–\$500M	\$500M–\$1B	\$1B–\$3B	\$3B+
2022	-0.3	-1.5	-0.1	0.9
Last 5 Years	0.8	1.2	2.2	2.3
Last 10 Years	1.1	1.7	2.8	2.7
Since 2004	1.6	2.2	2.9	2.9

Source: Moody’s MFRA database.

1. **Leading community provider:** Many successful independent hospitals have benefited by serving a large proportion of the patients in their market(s). Not expending significant resources to vie for patients with a substantial local market competitor saves time, energy, and resources. A strong market position is often the result of historical market dynamics. Other times, a strong share results from successful strategies, geographic barriers (such as mountains and rivers), location within a rural region, or regulatory barriers to entry, such as certificate-of-need (CON) laws.
2. **Strong balance sheet, including >200 days cash and consistently positive operating margins:** The ability to fully fund depreciation and invest in growth opportunities is critical to independent hospitals’ ability to thrive. Many hospitals have struggled through the pandemic as they experienced margin declines, reductions in their days cash on hand, and shrinking cash flows that threaten the debt service coverage ration requirements of their lenders. Some hospitals face bond rating downgrades as financial performance has weakened, making it more expensive to access capital markets. Positive operating performance has become as important as having a strong balance sheet for many organizations.

3. **Location in an attractive, stable-to-growing market with a favorable payer mix:** Markets that feature an expanding economy, a growing population base, and a high percentage of commercial patients help enable success of their local hospitals via clinical service expansion and fresh business development opportunities.

Exhibit 3: Common Characteristics of Independent Hospitals



4. **An integrated, closely aligned, loyal physician network and easy ambulatory access:** A strategically deployed network of highly aligned providers is among the greatest assets a hospital or community-based health system can possess. Developing a strategically sized, integrated physician network of highly qualified providers 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 alignment across primary care physicians and specialists gives hospitals the ability to better execute against system goals related to quality management, clinical variation reduction, and enhanced access to care. More so today than five years ago, having a distributed network (including both convenient ambulatory services and digital health capabilities) is a consumer expectation. For hospitals, this also means

having to rethink the role of inpatient services within the care network and anticipating that a growing percentage of revenue will be driven by outpatient services, including ambulatory surgery centers (ASCs).

5. **Sufficient size to achieve efficient care delivery and cost management:** Typically, this might mean having 20,000 or more admissions and a large, well-distributed outpatient network. Greater scale allows institutions to manage revenue and costs effectively. Such institutions can sustain profitable subspecialty care and surgical services, and better manage their cost structure by negotiating volume-driven discounts with suppliers, among other things. Independent hospitals that have the scale to invest in clinical service and network expansion across key geographies are well-positioned to reap the benefits of these investments. Being of significant scale is particularly important today to the extent that it allows the hospital to diversify across different lines of business. Offering a wide range of services across the continuum of care can help position local hospitals as attractive partners for new players entering the market (such as those offering technology-enabled care and disease management solutions).
6. **Strong community support, including philanthropy:** Successful independent hospitals translate their strong community support into productive philanthropic initiatives. The donations of grateful patients and community donors aid in the formation of strategic capital, positioning the hospital to grow and support critical services. Safety-net providers that qualify for supplemental support can also garner added revenue from their home cities, states, and other governmental agencies.
7. **A wide array of profitable specialty care services and a high case mix index:** Specialty care, particularly complex procedural care (e.g., cardiac services, neurosciences, orthopedics, and cancer care), typically generates higher margins, bolstering 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, known for the quality of care provided. The migration of many surgical procedures to the outpatient and ambulatory environments was accelerated by the pandemic, particularly in areas such as orthopedic surgery. Independent hospitals need to anticipate the associated shifts in revenue and profitability by making appropriate investments in ASCs and by working with payers to ensure adequate reimbursement.

8. **Recognition as a critical community health access point:** Being a critical community health access point means making available needed services with reasonable drive times and with reasonable availability of providers. Broad access ensures independent hospitals' status and their aligned medical groups' positions as core components of local and regional payer networks. With supportive payer relationships and a reputation for quality of care, the hospital and its aligned providers have the opportunity to explore value-based and other innovative payment arrangements that better manage care in combination with proper incentives and data-driven analytics.

9. **Ability to recruit, retain, and develop a highly talented workforce:** All hospitals have encountered workforce challenges over the past three years, including clinician burnout¹ and challenges meeting intensive care unit, operating room, emergency department, and patient care unit staffing needs. Workforce shortages have resulted in the escalating use of highly expensive interim staffing solutions across the nation. Consistent focus on employee well-being and workforce development has emerged as a core competency for all hospitals and certainly for independent institutions that don't have the regional and national resources to lean on. The ability to recruit, retain, and develop top talent at all levels is—and will be—a distinguishing feature for leading independent hospitals now and in the future. This critical competency includes fostering a culture that values diversity, respect, equity, and inclusion.

[Check out our interactive Web page for more information and recommended resources.](#)

The Need for Periodic Review of the Benefits and Risks of Remaining Independent

While standalone hospitals will continue to join local, regional, and national health systems, a subset of well-positioned institutions will remain independent and demonstrate their ability to thrive as standalone institutions. At the same time, the markets and circumstances surrounding individual institutions will continue to evolve.

1 [“The Systematic Approach to Banishing Burnout and Reclaiming Your Healthcare Workforce: An Interview with Dan Shapiro, PhD,”](#) Chartis, February 22, 2023.

Standalone hospitals should regularly evaluate their prospects in the changing market. They can do this by conducting an objective, rigorous evaluation of their current positioning and future prospects.

This assessment should include reviewing a range of options, including potential partnerships (loose or tight) that might preserve the mission and meet the needs of the communities these hospitals serve. The assessment should involve a thorough board and executive team review 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. As very few hospitals will have all the characteristics highlighted above, it is important to focus on those elements that are most pertinent to your specific institution and where you see needs and opportunities to strengthen the hospital's market position and performance. The goal is to identify gaps in positioning and performance and to develop a plan to close those gaps to the extent possible.
- **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. This should include the role of potential partner organizations. For example, if a gap in the provision of specialty care services is identified, possible solutions may include organic growth strategies or a targeted partnership with a nationally known health system or a nearby academic medical center. Addressing issues such as long-term access to capital or the ability to create a differentiated position in the market may require a proactive evaluation of how affiliation partners can help address current or future shortfalls. Exploring affiliation options before a crisis develops should position the institution to attract a partner that is well-suited to meet the needs of the communities served. To achieve a successful outcome, it is vital to evaluate these questions through a deliberate, thoughtful process that engages stakeholders and forges leadership consensus.
- **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 matters a board can address. Active board involvement and leadership is critical. A periodic evaluation process should

review the internal state of the organization and the external context, including market evolution, 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 or critical access hospitals, considering options for vertical integration to expand the continuum of care, and continuously strengthening the physician enterprise. Opportunities may also involve the consideration of a variety of looser affiliation models (e.g., service line partnerships, cost-sharing collaboratives, and academic affiliations) that may bring significant benefit while preserving a high degree of independence. Such options frequently support a plan for growth that does not involve a tight affiliation with a larger health system.

The Governance Institute thanks Sue Anderson, Principal, and R. Christopher Regan, Founding Partner and Managing Director, at The Chartis Group for contributing this article. They can be reached at sanderson@chartis.com and cregan@chartis.com.

