

The Various Pathways to Health System Transformation

Anu Singh

Managing Director and Practice Lead
Kaufman Hall

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What Does Transformation Mean?



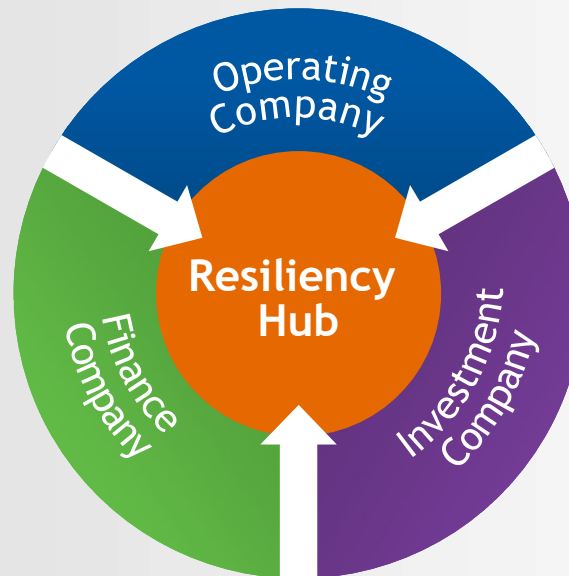
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So...Where Exactly Are We?

We Remain at an *Unprecedented* Time in Our Industry

1. Exceptionally poor hospital operating performance, mainly due to external drivers
2. Significant negative impact of capital market activity (income and balance sheets)
3. Increasing cost and more difficult access to debt and other forms of capital



OPERATING COMPANY

- Lower volumes
- Ongoing operational disruptions
- Longer length of stay
- Higher cost structure

INVESTMENT COMPANY

- Investment losses
- Weakened balance sheet (the “resiliency anchor”)

FINANCE COMPANY

- Higher borrowing costs
- Declining cash reserves
- Potential breach of debt covenants

Where (Were We) Are We Headed?

Industry Forces Are Reshaping the Basis of Competition



Innovation

Transactions are a given: new forms of alignment with unexpected participants and with novel structures will become the norm



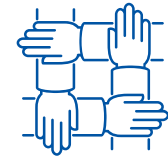
Specialization

Healthcare service delivery will further disintegrate into more distinct and specialized segments of care – beyond just ‘inpatient’ and ‘outpatient’ care



Consumerism

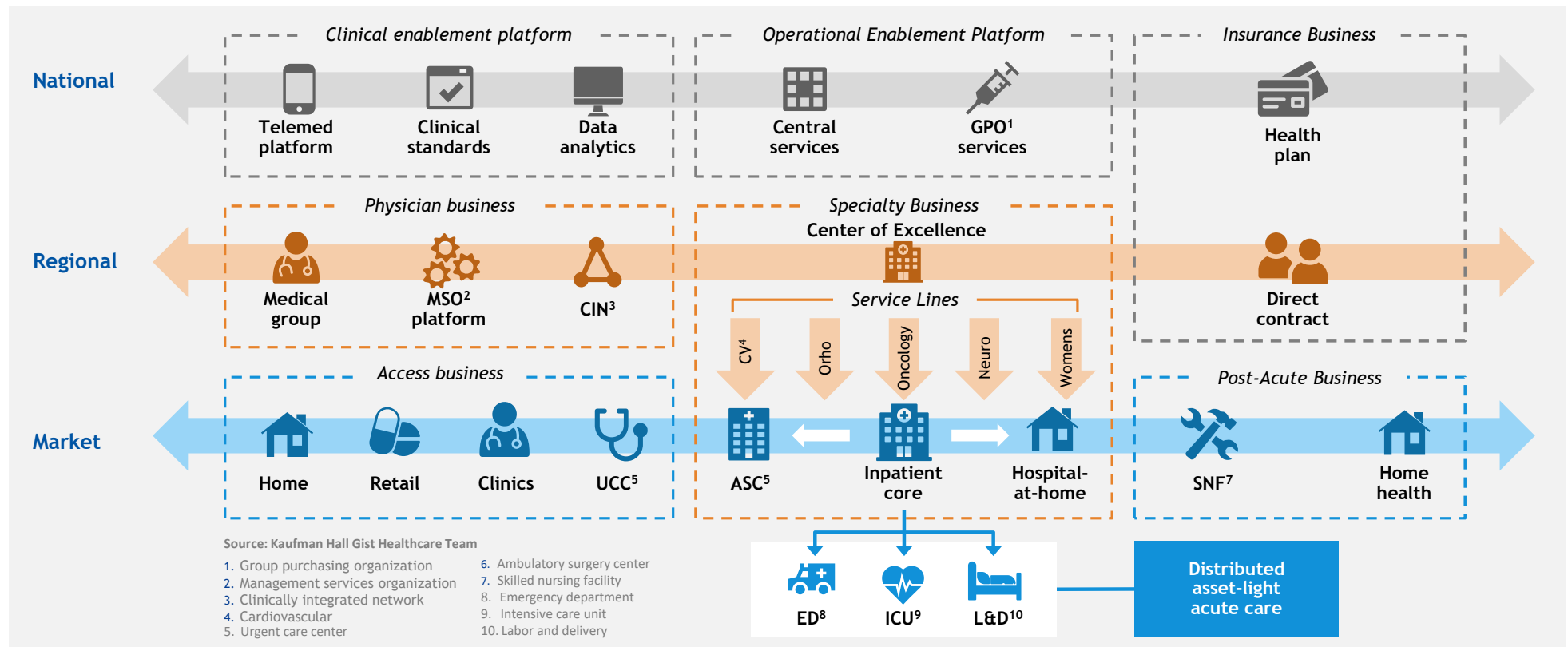
New entrants likely will focus on either higher margin services or more consumer-driven elements, ceding the rest to legacy providers



Collaboration

True population health management likely will be beyond the reach of most organizations that opt to ignore all forms of alignment and partnerships

Leading Health Systems Are Faced With a Proliferation of Demands



Axioms of Competitive Strategy Will Be the New Success Measures



Consumer Perception & Preferences



Better



Cheaper



Faster



Considerations of Legacy Healthcare Providers

Differentiation

- Front Door
- Service Experience
- Push/Pull Source
- Coordination
- Clarity/Specificity

Cost Efficiency

- Timing Premium
- Distance/Effort
- Alternative Site(s)
- Prevention Focus
- New Pricing Models

Segmentation

- Core Business Focus
- Virtual and Tele- Access
- Network Tiering
- Parity Strategies
- Collaborations/Ventures

Industry Transformation Has Shifted the Nature of Partnership Objectives

Transactional

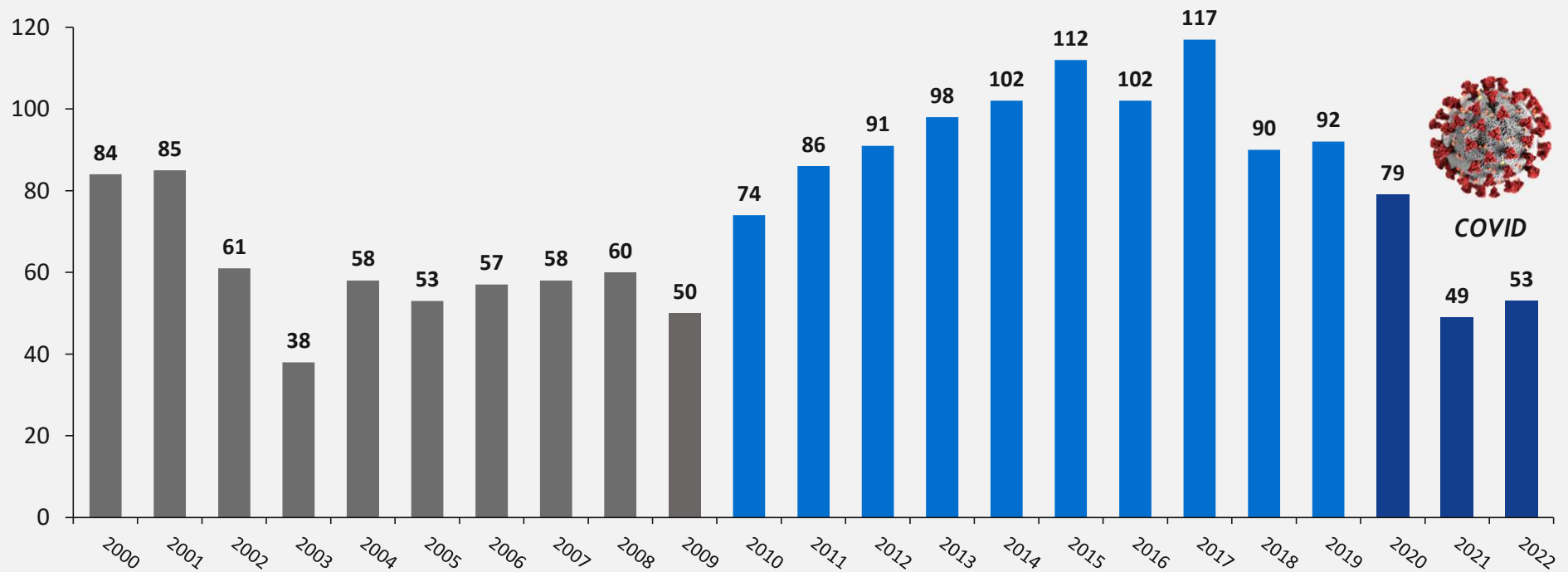
- Driven by distress or need
- Transactions most often traditional “Acquisitions”
- Key Criterion often driven by Scale or even Leverage
- Trade-offs balanced Governance and Consideration
- Many deals were more “defensive” in nature; aimed to reduce or share of risk

Transformational

- Driven by access to and future need of differentiation
 - Intellectual Capital
 - Care Access, Management Delivery
 - Revenue Quality and Cost Efficiency
 - Market Essentiality
 - Technology, Business Intelligence, and even AI
- Network-based platforms for care delivery
- Cross-Vertical pursuits that tear down borders between providers, health plans, and care givers
- Addressing broader underpinnings of healthcare needs, with the focus of policy influencing
- Advancing innovation, disruption, and reinvention of service delivery and payment

The Trajectory and Expectations of Partnerships Are Clear

Hospital and Health System M&A Transactions, 2000-2021



Source: Public information, Kaufman Hall proprietary database

PATH 1

Partner for Organizational Complements



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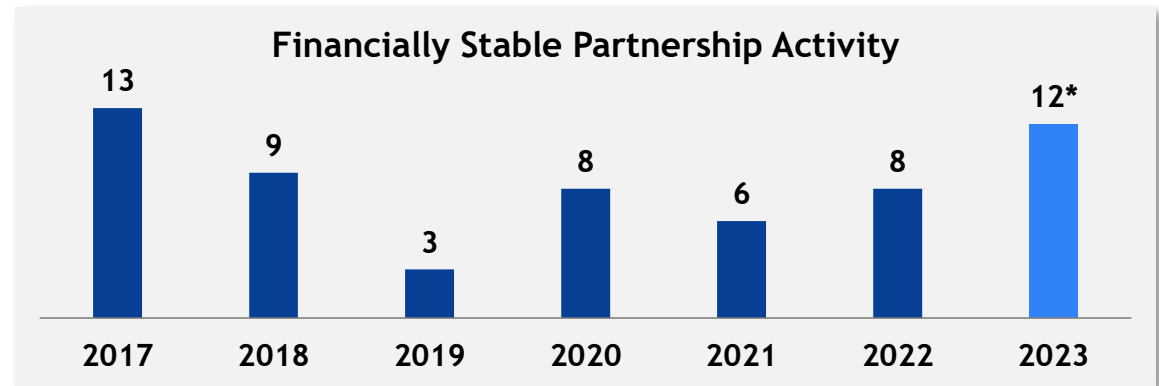
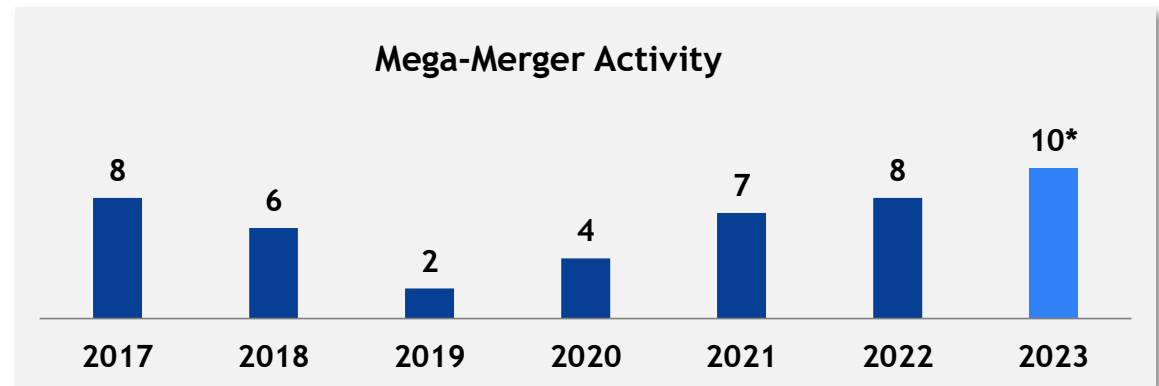
The Nature of Participants Demonstrates the Prevailing Intent

Through the pandemic, **mega-merger** (\$1B+ revenue of smaller partnering entity) **activity remains elevated** as annualized 2023 would imply the most in decades

The increase in mega-mergers activity is concentrated in mergers focused on **non-contiguous or complementary geographies**

Hospitals and health systems with credit ratings of “A-” or better continue to seek proactive partnerships to ensure long-term sustainability in their communities

Note: Asterisk (*) reflects annualized data as of June 30, 2023.
Source: Public announcements and disclosures, Kaufman Hall proprietary database



The Evolving Nature of New System Formation Transactions



Note: Includes New System Formation Transactions among Regional/Super-Regional Systems with the Smaller Organization Revenue Base > \$1B

The Initial Wave – *Summary of Key Drivers*

Provena Health and Resurrection Health Care Corp. have spent a combined \$18.4 million on their merger, a transaction that **formed the second largest hospital network in the Chicago area** (a sprawling health care system with 12 hospitals), **but leaves a challenge to achieve savings that were key to the deal**. The transaction saddled the pair with special merger costs, ranging from higher consulting fees to severance payments to employees whose positions were eliminated to cut costs.

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Beaumont, Botsford, Oakwood to combine into \$3.8 billion nonprofit health system. “We will finalize the corporate, (governance) and management structure between now and closing,” said Michalski, adding the **three systems have targeted a general geographic area for the new corporate headquarters equidistant from each of the system’s current offices**.

CRAIN'S DETROIT BUSINESS

The Current Wave – *Summary of Key Drivers*

Advocate Health is committed to being a **force for meaningful social impact**. The organization aims to bring medical innovations to patients more quickly, **address the root causes of health inequities**, advance population health, enable career advancement and achieve carbon neutrality by 2030. The Advocate Health Care, Atrium Health and Aurora Health Care **brands will continue to be used in their respective local communities**



Goals for exploring the creation of a new healthcare organization...include making **greater investments in clinical excellence, digital innovation, workforce development and value-based care** while lowering overall administrative costs. The **different strengths of the two systems is a key element of the merger**, said Mr. Holderman...Presbyterian, for example, has a robust health insurance arm, UnityPoint has a more comprehensive hospital ecosystem.

BECKER'S
HOSPITAL REVIEW

Partnerships Are Not a Panacea; False Starts Are Occurring



Source: Kaufman Hall Internal Database. Note: Transactions with target revenue of >\$1B

X = canceled

PATH 2

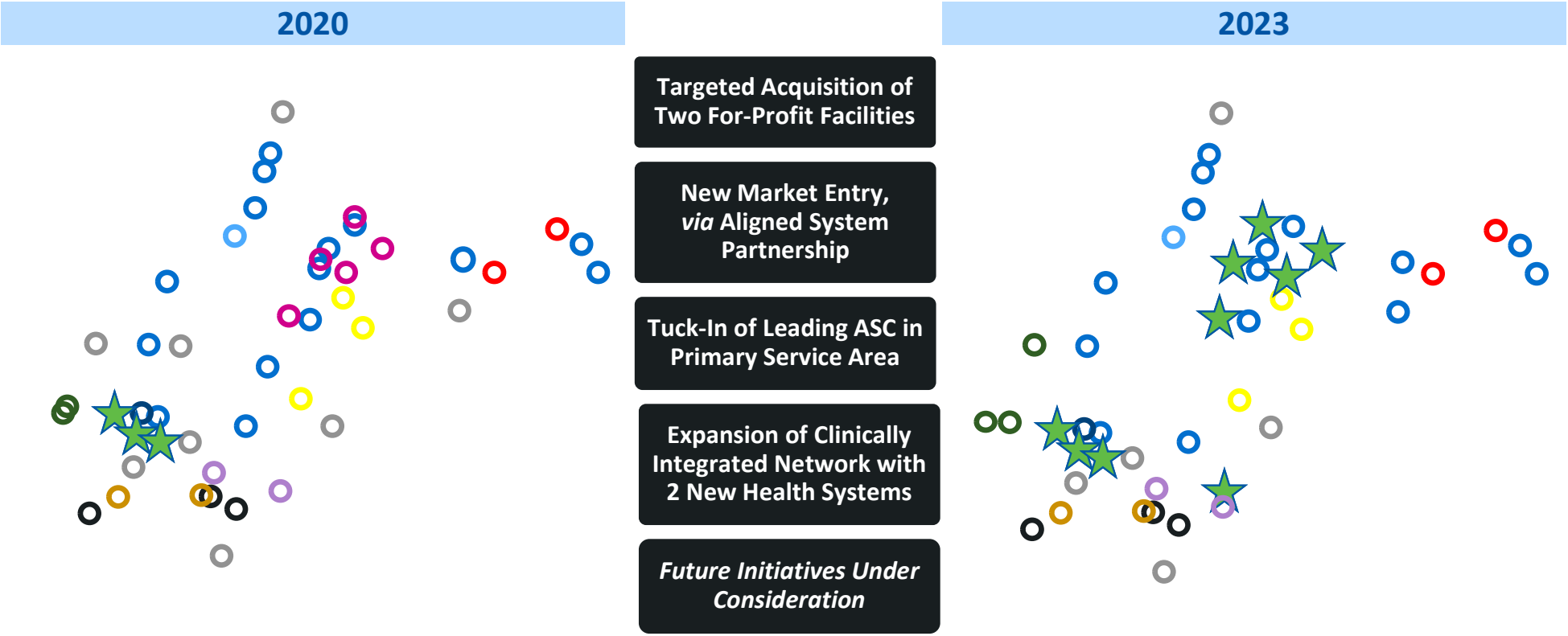
Execute Market Convener Strategies



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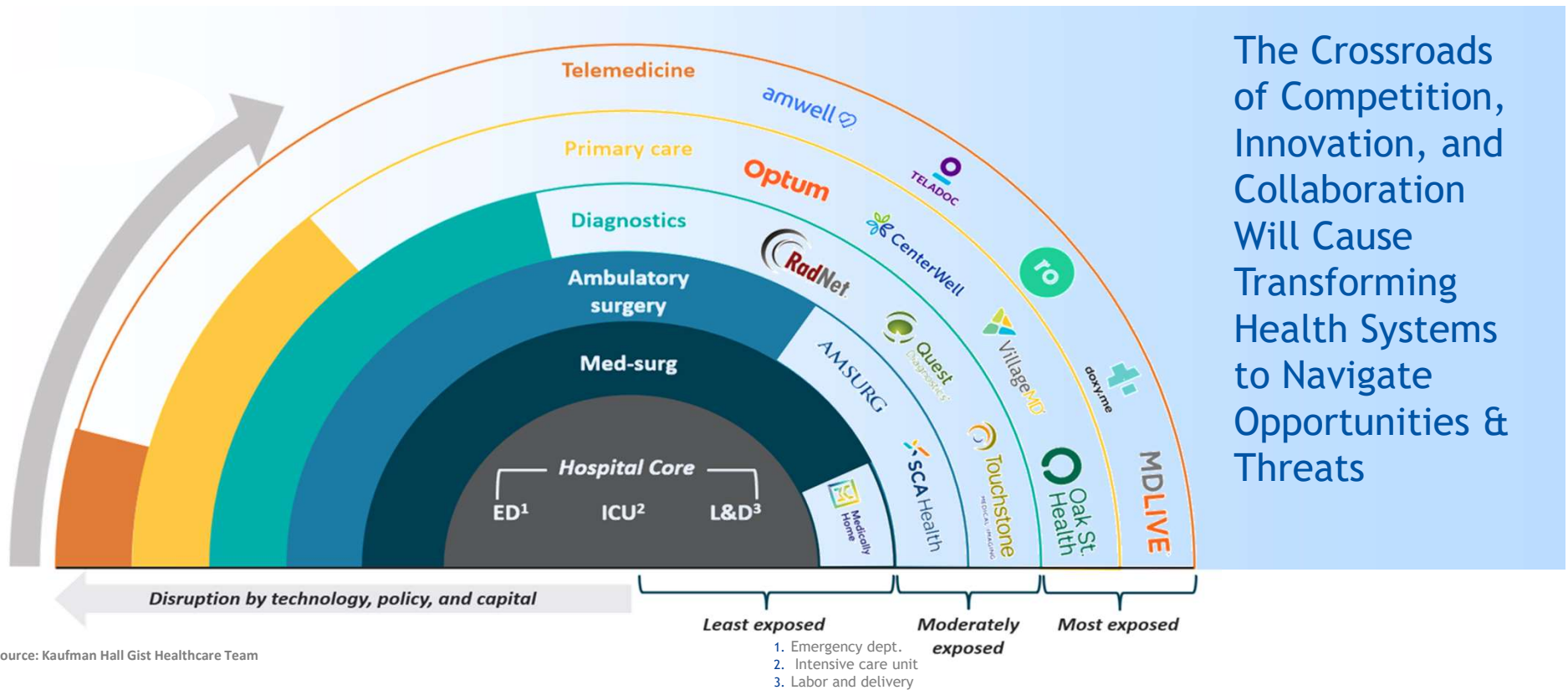
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Regional System Development – In Empirics



Source: Definitive Healthcare; Kaufman Hall proprietary transaction database

Innovation & Disruption Driven to Where Systems Aren't Focused



The Crossroads of Competition, Innovation, and Collaboration Will Cause Transforming Health Systems to Navigate Opportunities & Threats

Source: Kaufman Hall Gist Healthcare Team

Note: logos are not comprehensive and do not represent an endorsement from Kaufman Hall

Prevailing Segment Outlooks May Favor System-Based Initiatives



DELIVERY SYSTEMS

- The revenue and expense model – especially in non-profit healthcare – has broken down significantly
 - Lower recovery of volumes & Reimbursement limits
 - Increase in nearly all forms of expenses
 - Higher costs or risks of treasury/debt options
- Problems related to this breakdown seem to be structural and systematic

NATIONAL HEALTHCARE ORGS



- The largest companies in healthcare continue to pursue aggressive growth, diversification, and vertical integration
- UnitedHealthcare, as others (e.g., regional BCBS licensees) seek to emulate Optum's success
- Other companies (e.g., CVS/Aetna) target their point of care solutions toward retail health and will continue to disrupt legacy healthcare



PROVIDER ORGANIZATIONS

- The undersupply of providers – particularly for primary care – is expected to increase as physicians retire due to retirement and/or burnout
- Independent practice continues to decline, as national companies with scale (e.g., Amazon, Optum) with limited obstacles to aggregation
- Constraints on for profit amalgamation of specialty lines is facing headwinds of scarcity, scale and borrowing costs

NEW INDUSTRY ENTRANTS



- Aggressive investment and valuations in new industry entrants have waned considerably in CY2022, driven by:
 - Underperformance from new industry entrants aggressively pursuing scale (e.g., Bright, Oscar, etc.)
 - Downturn in capital markets that create barriers to access investment dollars
- As a result, new companies are scaling back business to core offerings and more willing to seek partnerships with market incumbents with scale, including delivery systems

Health Systems Are More Deliberately Collaborating with ASCs

Recently Announced System Partnerships

June 2022



June 2022

BON SECOURS MERCY HEALTH



February 2023



April 2023








May 2023



- Many systems have existing ambulatory surgical units, with recent focus centered on service line optimization/specialization
- Large ASC managers continue to assist their legacy health system partners grow and add higher acuity service lines to their existing footprint
- Small/mid-sized operators have gained traction by offering a similar level of domain expertise coupled with flexible partnership terms

Source(s): 1) Health System Websites and Press Releases 2) Becker's Healthcare

Systems and Digital Disruptors Are Also Finding Common Ground

Strategic	Example	Description
Primary Care	 	<ul style="list-style-type: none"> • Brings clinically and digitally integrated delivery model to key markets • Enables Providence to expand its primary care footprint and improve primary and specialty care coordination • One Medical receives PMPM development fees
Home Care	 	<ul style="list-style-type: none"> • Medically Home enables Kaiser doctors to reach patients via remote monitoring and emergency response systems • Partnership enhances Kaiser's vertically integrated model to better manage the total cost of care
Virtual Health & Telehealth	 UW Medicine	<ul style="list-style-type: none"> • UW Medicine offers on-demand virtual care for its patients in collaboration with 98point6 • Subscription product gives patients unlimited access to 98point6 physicians to address routine care needs, including Rx and labs

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PATH 3

































Pursue Cross-Vertical Alignment



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Health Plan Pursuits Are Migrating Toward Providers

Insurer	 14%	 7%	 4%	 11%	 N/A	 19%	59% Insurer Combined Market Share
Pharmacy Benefit Manager	 16%	 14%	 8% 	 11%	 N/A	 11%	60% PBM Combined Market Share
Specialty Pharmacy	 14%	 25%	 21%	 25%	 2%	 13%  2	75% Specialty Pharmacy Combined Market Share
Provider Services	  3	   4	 1	  	  		

1. Cigna partners with providers via its Cigna Collaborative Care program. However, Cigna does not directly own healthcare providers.

2. AllianceRx Walgreens Prime is jointly owned by Prime Therapeutics and Walgreens Boots Alliance.

3. United recently announced a 10-year partnership with Walmart to bring value-based care to Walmart care delivery and jointly launch a Medicare Advantage plan

4. CVS Health has also announced its intention to acquire a primary care footprint by the end of 2022; Walgreens has recently acquired home healthcare company CareCentrix, adding to its capabilities in primary care through VillageMD

Source: Drug Channels Institute research. An earlier version of this chart appears as Exhibit 89 in The Economic Report on U.S. Pharmacies and Pharmacy Benefit Managers, Drug Channels Institute. (drugch.nl/pharmacy) October 2020

Note: Callouts denote national market share. Source: AIS Health, Q3 2021. Drug Channels, 2018.

Collaborative Models Have Focused on Clinical/Network Development



CIN extension with provider relationships

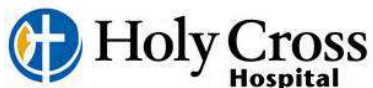


CIN development with BCBS-Georgia



A Physician-led Clinical Integration Network

CIN/ ACO repositioning











Atlantic Coast Health Network "Super CIN"

Florida, Two-Hospital Joint CIN



Medicaid network collaboration

Alignment with Health Plans Are Advancing

Payer	Provider	Approach	Strategic Rationale
		<p>Full Merger/Acquisition</p>	<p>Maneuvered to address head-to-head IDN system-level competition (vs. UPMC) through a fully integrated payer/provider entity</p>
		<p>Direct Investment <i>Legacy purchased 50% interest in PacificSource</i></p>	<p>Legacy acquired interest in Pacific Source to increase the community's access to care, create new health plan offerings, and bring stability to the marketplace</p>
		<p>Joint Venture</p>	<p>Partnered to develop value-based capabilities and develop a more collaborative model between the payer and delivery system</p>
		<p>"Synthetic" joint venture (health product)</p>	<p>Market opportunity to align common interests of broader regional participants in a market that is drawing new entrants (e.g., KFHP, Optum) and value-based disrupters</p>

Retail Players Are Emerging as a “Fourth” Vertical in the Industry

- Consumer healthcare spending outside of hospitals & physicians is significant with OTC/Rx drugs and wellness driving both revenue and margin growth.
- Per CMS, between 2014 and 2020, US personal healthcare spending grew on average 4.8% per year¹

			
			
			<p><i>Note: While Walmart’s physician play is behind other retailers, they are trying to close this gap with a new 10-year partnership with the largest provider group (Optum)²</i></p>
			

Source: (1) <https://www.cms.gov/research-statistics-data-and-systems/statistics-trends-and-reports/nationalhealthexpenddata/nhe-fact-sheet>
 (2) <https://corporate.walmart.com/newsroom/2022/09/07/walmart-and-unitedhealth-group-collaborate-to-deliver-access-to-high-quality-affordable-health-care>

Implications to Delivery of the Community Promise



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Implications to Strategic Partnership Pursuits

Source of Industrial Change	Path 1 – Complement	Path 2 – Convener	Path 3 – X Vertical
Reducing or Diversifying away from the high cost of the legacy business model	Capital Investment Avoidance or Duplication of Efforts	Increased Regional Scale and Revenue Source Diversification	Capital Investment Avoidance or Duplication of Efforts
Technological change and Consumer Engagement to engage in healthcare choices	New Capability, with potential transfer of Intellectual Capital	Advancing the Sphere of Influence to New Segments and Markets	Catalyzes Unique Aspect of Market Differentiation
Innovation and Disruption focused on the nature, form and friction of care delivery	Tactical and Focused Element of Care Access or Delivery	Advancing the Sphere of Influence to New Segments and Markets	Tactical and Focused Element of Care Access or Delivery
Execution of Transformational Change or Mitigation against Black Swan events	Addresses Specific Sources of Exposure, Capability or Risk	Premised on High Degree of Platform Optimization	Provides Hedge Against Prevailing System Risk

Epitomizing the Role of Fiduciaries and the Community Promise

**“Nonprofit is a tax status,
not a business model.”**

DORRI MCWHORTER



CRAIN'S CHICAGO BUSINESS

Think Differently. Lead Differently.

Not-for-profit hospitals' historical adherence to three principles may no longer be relevant

1 "We Do It Best."

- Where is the volume going?
- Can partners aid in delivering the best outcomes to patients?
- What is the 'it' that matters most today?

Focus on what is done well and gauge performance against such parameters, recalibrating where needed

2 "We must do it all."

- Is it time to rethink what a provider must be for their community?
- Where are we expending resources (tangible and intangible) that fulfill or detract from promises to our community?

Reimbursement and scale are not reasons to define our core business

3 "We Can Do It Ourselves."

- Are we the most effective agent of change for our organization?
- Have we defined our competitor and collaborator relationships?

Recognizing where we have the most to fuel transformation is part of the solution; the remainder may be where we align with others

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