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# System Focus

## Leveraging a Flexible Partnership to Combat Macro Challenges

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**The macro challenges facing health systems are significant, and arguably unlike anything that we have experienced over the last few decades.**

Expense inflation has resulted in significantly higher labor and supply costs. The bar has been “reset,” and payers and employers are reluctant to fund the increases. These expense pressures will continue to strain cash flows. In addition, reimbursement pressure will also continue to strain cash flow as we cope with Medicare trust fund insolvency, federal deficits, single-site reimbursement, and 340B issues.

When you add in the complexity of the current political and labor environments, it makes realizing cost structure improvements more difficult. Yet achieving structural cost efficiencies must be considered.

As daunting as cash flow strain is from expense and reimbursement issues, perhaps an even more important issue is the changing competitive landscape. Currently, eight secular multi-state health systems control nearly 25 percent of the national health system market share (measured by revenue). If you add to that number the largest multi-state religiously affiliated systems, then 15 systems control about one-third of the national market. These 15 systems are in 33 states. In addition, there are seven to 10 large multi-billion dollar single-state health systems that are seeking to expand beyond their current state footprint. It is entirely plausible that fewer than 25 health systems will control over 50 percent of the U.S. health system market in the next few years.

**In a nutshell, the old playbook won't work anymore for community health systems. On the bright side, this moment in time creates the opportunity for a new innovative model.**

On top of the significant health system consolidation, health systems must also deal with major insurers and retailers moving aggressively into the ambulatory care space. OptumCare, a subsidiary of the nation's largest health insurer UnitedHealthcare, is the country's largest ambulatory care network with over \$60 billion in revenue and a presence in 45 states. And Humana's CenterWell, Walgreens/VillageMD, and Walmart are also quickly moving more deeply into the ambulatory care space. In some respects, they are becoming health systems without the burden of owning and operating acute care brick-and-mortar.

It begs the question, why are not-for-profit health systems ceding ambulatory care to public equity-funded retailers and insurance companies?

In a nutshell, the old playbook won't work anymore for community health systems. On the bright side, this moment in time creates the opportunity for a new innovative model.

## MSOs: An Alternative Strategic Partnership Model

Universities compete fiercely with each other in the athletic arena. Yet they work together in conference broadcast networks in a way that benefits all the universities. And they do this in conjunction with outside operating and capital partners, too. These broadcast networks are a basis of collaboration between the universities, rather than the basis of competition.

Community health systems within a region can construct a similar collaboration as a way to address the threat of emerging national and super-regional health systems and ambulatory care providers, as well as to deal with expense pressures. This collaboration would be in the form of a management services organization (MSO).

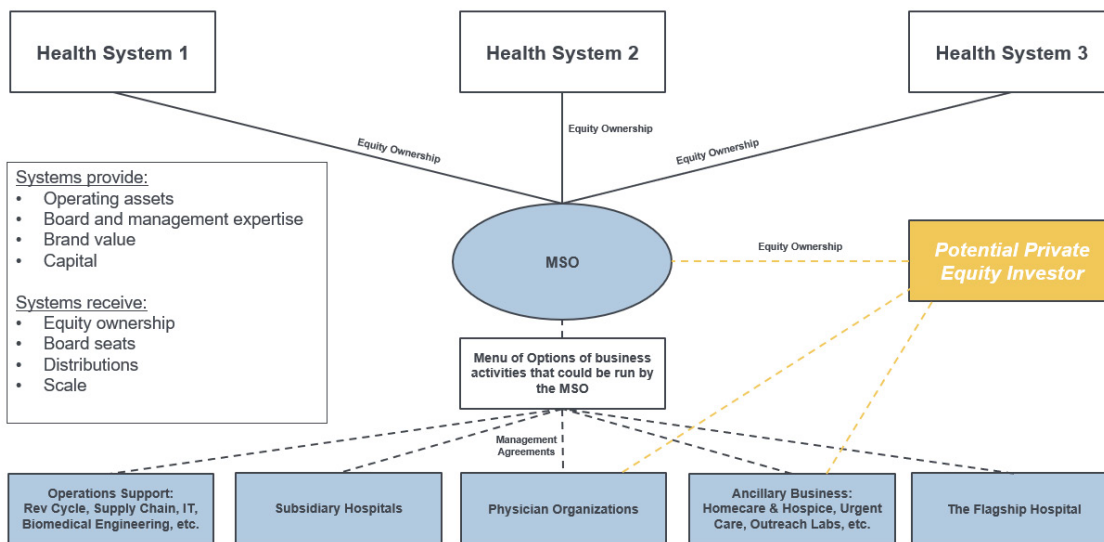
An MSO can be a dynamic alternative to historical strategic partnership models. The creation of an MSO puts in place a flexible organization that can oversee a menu of business activities spanning from back-office functions to the entire health system (see

**Exhibit 1**). The MSO can oversee:

- Ancillary business, such as:
  - » Home health and hospice
  - » Outreach labs
  - » Ambulatory surgery centers (ASCs)
  - » Freestanding imaging centers
  - » Retail physical therapy clinics
  - » Urgent care

- Employed community physician group practices
- Back-office functions, such as:
  - » Information technology
  - » Revenue cycle
  - » Supply chain
  - » Biomedical engineering
- The hospitals

### Exhibit 1: Illustrative MSO Partnership Model



This model combines some key attributes of a variety of partnership models in a structure that can flex to meet the health system partners’ evolving interests. Those attributes include:

- Partner systems retain their individual identities and brands
- Economies of scale
- Centralized decision making for certain business activities
- Investment vehicle for outside capital
- Shared operational and financial risk and upside
- Delineated reserve powers
- Individual health systems preserve their community missions

Health system executives frequently raise a variety of questions when discussing this MSO concept, including:

**Q: Does this MSO model entail selling our hospital?**

A: No, there is no sale involved in the formation of the MSO.

**Q: Are there material impacts to employees?**

A: There is no requirement to rebadge employees or eliminate labor union relationships.

**Q: Is patient care impacted?**

A: No, the MSO sits separately from the health system entities (where the provision of patient care is held).

**Q: What initial and ongoing costs are involved?**

A: Legal and financial advisor expenses are included in the formation of the MSO. And ongoing costs will flex based on the services provided by the MSO.

There are a variety of benefits that health systems can experience from the MSO model:

- Flexibility to address a variety of situations
- Increased scale
- Cost savings
- Access to outside capital and expertise
- Support and scale for ancillary businesses and non-acute care

## Key Board Takeaways

- Scale and flexibility will be necessary as the healthcare business model continues to evolve.
- Health systems can take a cue from college athletics to respond to the evolving environment.
- An MSO can provide a flexible path to grow and scale your community health system without giving up control.

An MSO model is a flexible, dynamic, and creative way for health systems to address some of the most difficult conundrums that they are facing today. A deeper dive into the concepts, along with discussion and debate on the merits, are well worth your efforts.

*The Governance Institute thanks Dave Morlock, Managing Director, Head of Health Systems Group, Cain Brothers, for contributing this article. He can be reached at [dmorlock@cainbrothers.com](mailto:dmorlock@cainbrothers.com).*

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