The Value Journey
How Affiliations Can Strengthen Organizations for the New Era

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Presentation Overview

• The value gap
• Highlights of previous Value Project research
• New research findings: acquisition and affiliation strategies
  • Drivers of acquisition and affiliation today
  • Acquisition and affiliation options
The Value Gap

Disconnect Between Cost and Outcomes

<table>
<thead>
<tr>
<th>COUNTRY RANKINGS</th>
<th>AUS</th>
<th>CAN</th>
<th>FRA</th>
<th>GER</th>
<th>NED</th>
<th>NZ</th>
<th>NOR</th>
<th>SWE</th>
<th>SWI</th>
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<tbody>
<tr>
<td>Quality Care</td>
<td>2</td>
<td>9</td>
<td>8</td>
<td>7</td>
<td>6</td>
<td>5</td>
<td>4</td>
<td>11</td>
<td>10</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Access</td>
<td>3</td>
<td>10</td>
<td>2</td>
<td>6</td>
<td>7</td>
<td>9</td>
<td>11</td>
<td>5</td>
<td>4</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Efficiency</td>
<td>5</td>
<td>8</td>
<td>10</td>
<td>7</td>
<td>6</td>
<td>3</td>
<td>11</td>
<td>9</td>
<td>2</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health Expenditure/Capita, 2012**</td>
<td>$3,800</td>
<td>$4,522</td>
<td>$4,218</td>
<td>$4,495</td>
<td>$5,099</td>
<td>$3,182</td>
<td>$5,669</td>
<td>$3,925</td>
<td>$5,643</td>
<td>$3,405</td>
<td>$8,508</td>
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</tbody>
</table>

Notes: * Includes tax. ** Exchange rates shown in USD. PPP purchasing power parity. Australian $ data are from 2010.
Source: Calculated by The Commonwealth Fund based on 2011 International Health Policy Survey of Adults; 2012 International Health Policy Survey of Primary Care Physicians; 2013 International Health Policy Survey (Commonwealth Fund National Bowlward 2013); World Health Organization; and Organisation for Economic Co-operation and Development; OCE Health Data, 2013 (Paris OECD, Nov. 2013).
Employees Are Paying More for Health Insurance

Percentage of covered workers enrolled in a plan with a general annual deductible of $1,000 or more for single coverage, by firm size, 2006-2013

ACA Enrollees Are Opting for High-Deductible Plans

Avg. Silver Plan Deductibles:
$2,907 Individual; $6,078 Family
% Covered: 70%

Late ACA Enrollment Dominated by Bronze and Silver Plans.
Today’s Healthcare Challenge:
One Foot on the Dock, One in the Boat

• Propelled forward by
  – Unsustainable trajectory of rising healthcare costs
  – Continued fragmentation of care delivery
  – Purchasers’ demand for greater value

• Driven back by
  – Realities of the current payment environment
  – Resistance to change

Highlights of Previous Value Project Research
The Value Equation

\[ \text{VALUE} = \frac{\text{Quality}^{(1)}}{\text{Payment}^{(2)}} \]

(1) Composite of patient outcomes, safety, and experiences  
(2) Cost to all purchasers of purchasing care

Key Recommendations

- View value through the purchaser’s lens
- Build four key organizational capabilities for value
- Choose value strategies that are right for your organization
View Value Through the Purchaser’s Lens

Patients  Employers  Government and Commercial Payers

Understand the Employer’s Perspective

“Most employers don’t have the patience to deal with health care’s peculiarities.”

“The employer response is ‘be competitive the way I need to be.’”
Understand the Patient’s Perspective

Build Four Key Organizational Capabilities for Value
Choose Value Strategies That Are Right for Your Organization

- Academic Medical Centers
- Aligned Integrated Systems
- Multihospital Systems
- Rural Hospitals
- Stand-Alone Hospitals

New Research Findings: Acquisition and Affiliation Strategies
New Research Extends Value Strategies Outside the Organization

- An emphasis on value-focused acquisition and affiliation strategies
- An understanding that different needs require different approaches
- The emergence of new organizational combinations
- A blurring of lines between competitors and collaborators
- The need to change governance and organizational structures as systems change

Research Methodology

- Interviews with subject matter experts in strategic consulting, capital formation, and legal and regulatory issues
- Survey of HFMA senior finance executive members (split evenly between stand-alones and systems/system-affiliated facilities)
- Site visits and interviews at AllSpire Health Partners, Dignity Health, Froedtert Health, HealthPartners, New York – Presbyterian Hospital, North Shore – LIJ Health System, and SSM Health Care
Value Advisory Group and Sponsors

High Degree of Acquisition and Affiliation Activity

**Interest in Acquisition and Affiliation Activity**

- Entered into an arrangement in the past five years: 42%
- Considering an arrangement in the next 12 months: 34%
- Open to an arrangement longer term (e.g., beyond 12 months): 30%
- None of the above: 19%

*Note: Respondents could choose more than one answer.*
Drivers of Acquisition and Affiliation Activity Today

HFMA Survey: Cost Efficiencies and Competitive Position Are Lead Drivers

![Graph showing drivers of acquisition and affiliation activity]

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Cost efficiencies/economies of scale</td>
<td>56%</td>
</tr>
<tr>
<td>Improved or sustained competitive position</td>
<td>51%</td>
</tr>
<tr>
<td>Physician network/clinical integration</td>
<td>35%</td>
</tr>
<tr>
<td>Ability to manage the health of a defined population</td>
<td>28%</td>
</tr>
<tr>
<td>Access to capital</td>
<td>23%</td>
</tr>
<tr>
<td>Risk contracting experience</td>
<td>5%</td>
</tr>
<tr>
<td>None</td>
<td>0%</td>
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</tbody>
</table>

[Ranked 1 & 2]
Interviews and Site Visit Research Identified Similar Internal Drivers

- Improving operational efficiencies
- Creating clinically integrated care delivery networks
- Accessing sufficient networks for population health management
- Developing or acquiring new capabilities (e.g., physician practice management, health plan experience, etc.)
- Rationalizing service lines or assets

For Stand-alone Facilities, the Need for Greater Efficiencies/Economies of Scale Stands Out
Academic Medical Centers Also Have Unique Acquisition and Affiliation Concerns

- Access to even broader populations to sustain full range of tertiary/quaternary services
- “Right place” pressures to perform lower acuity procedures in lower cost settings
- Maintenance of strong brand in their marketplaces (which may be local, regional, and national)

A Significant Trend

Mergers and acquisitions are occurring more frequently between organizations that are both financially strong

- Driven by strategy more than financial need
- Financially weaker organizations are more attractive if they possess other strategic assets: market position, affiliated physician networks, outpatient clinics, good payer mix
Organizations Look to Improve a Wide Range of Capabilities Through Acquisition or Affiliation Activity

Drivers Are Influenced by Multiple Factors . . .

- Local market conditions
- Existing and desired organizational capabilities
- Organizational type (stand-alone vs. system, academic medical center vs. community hospital)
- Senior leadership and board sentiments
... And Can Be Countered by Obstacles to Acquisition or Affiliation

Potential Frustrations Arising from Provider Mergers

- Cultural alignment proves more difficult than expected.
- Physician groups are unable to come together and perform well under value-based payment.
- Regulatory concerns delay, alter or jettison the merger.
- Physicians are not sufficiently aligned with the system.
- One organization performs well below expectations.
- Management teams do not perform well together.
- Expected savings from scale economies are less than expected.
- Leakage of cases outside of the system is greater than expected, leading to higher costs of care.
- Boards chafe at new roles. Tensions continue and limit performance.
- Key players leave.

Source: McManis Consulting
Potential Advantages and Disadvantages of Strategic Affiliations

<table>
<thead>
<tr>
<th>Potential Advantages</th>
<th>Potential Disadvantages/Challenges</th>
</tr>
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<tbody>
<tr>
<td>Pathway to achieving economies of scale without giving up total autonomy</td>
<td>May not address critical capital needs</td>
</tr>
<tr>
<td>Means of accessing resources that smaller hospitals would have difficulty acquiring and owning on their own (e.g., EHRs, clinical protocols)</td>
<td>Could lead to a growing dependence on a larger and more powerful institution (de facto change in control without corresponding capital benefit)</td>
</tr>
<tr>
<td>Can create opportunities for participating in value-based payment models</td>
<td>Collaboration may require capital, infrastructure, and human resources from all parties</td>
</tr>
<tr>
<td>Easier to unwind (which may be beneficial in ant-trust analysis)</td>
<td>Legal considerations include anti-trust, fraud and abuse, and tax exemption</td>
</tr>
</tbody>
</table>

Source: Doug Hastings, Epstein Becker

Acquisition and Affiliation Options
Traditional M&A Activity Leads, But Multiple Models Are Being Pursued

Options Range Across Many Degrees of Integration

- Low Degree of Integration
- Fully Integrated
- Less Than Fully Integrated

Source: Kaufman Hall
Two Possible Paths to Greater Economies of Scale

• Seeking scale through geographic breadth
  – Good potential to gain operational efficiencies
  – Fewer antitrust concerns
  – Potential difficulty building sufficient presence in local markets

• Gaining economies within more local or regional markets
  – Opportunities for greater clinical integration
  – More potential to optimize and rationalize services and staffing across locations in the market
  – Greater risk of antitrust scrutiny

Other Trends

• Diminishing significance of not-for-profit/for-profit status of potential partners

• Vertical integration activity (a health system acquiring a health plan or multi-specialty physician practice)

• Investment in disruptive innovators/new technologies

• Diminishing appetite for hospital-heavy acquisitions

• Collaborative partnerships
A Closer Look at Collaborative Partnerships

- Offer possibility of adding scale without ceding control; question is whether there is enough “glue”
- Initial focuses include:
  - Group purchasing activity
  - Back-office functions
  - Sharing of best practices (both operational and clinical)
  - Forming accountable care structures for risk-sharing managed care activities
- Not yet on the agenda:
  - Decisions on which services should be provided by which organization
  - Control over clinical decision making
  - An integrated financial bottom line for the partnership

How Does an Organization Identify the Best Options and Partners?

- Three Key Questions:
  - Can my organization remain successful in its current configuration?
  - If not, based on critical success factors and organizational goals, what type of partnership makes the most sense?
  - What partner can best help my organization accomplish its goals?
How Does an Organization Determine Its Future Course?

- What business or businesses am I in?
- What is the growth trajectory for this business, and how can I best invest in areas with the highest growth potential?
- Do I have the right executive team and governance structure in place to position for the future?
- What forms of affiliation should we consider or engage in?
- What can we stop owning, and instead obtain through partnership or outsourcing?

Assessing Your Situation: Strategic Vision and Goals

- What has your organization articulated as its strategic priorities? What business or businesses is your organization? How might answers to these questions changed in light of emerging market pressures?
- What are your organization’s long-term goals in terms of care delivery, operational performance, community service, brand reputation, other?
- How willing, and capable, is your organization to take risks to accomplish this emerging vision?
- Is your organization willing to change its tax status, or affiliate with organizations of a different tax status, to accomplish these goals?
- Can your organization accomplish its strategic priorities on its own, or is there a need to be part of a larger organization in order to be successful?
Assessing Your Situation:
Financial Position

• How solid is your organization’s financial position in terms of its ability to meet its capital requirements in the future? Why?
• Has financial performance been improving, steady, or deteriorating? Why?
• How does your organization anticipate that market trends will affect utilization and future financial performance? Can your operating margin and balance sheet weather these projected changes?
• What is the growth trajectory for your business, and what are your investment needs to support this growth?
• What are your key strategies to improve financial performance?
• How important is it to diversify sources of revenue? Why?
• Is your organization financially positioned to consider acquisition of another organization? Will it need to consider being acquired to meet its financial needs?

Assessing Your Situation:
Market Position

• What is your organization’s estimated market share? Is it improving, flat or decreasing? What are the underlying reasons?
• What estimated market share do you think you need to be successful in the future?
• How well does your organization meet your community’s needs for hospital services? How do you know?
• Where is your organization ranked in your marketplace on the basis of:
  – Service
  – Clinical Quality
  – Cost to Care Purchasers
Assessing Your Situation: Physician Network

- How strong is your existing physician network?
  - Do you have an adequate base of primary care providers to meet current and projected future needs?
  - Do you have the right mix and number of specialists to meet current and projected future needs?
- Are there opportunities in your market(s) to align with additional primary care or specialist practices to meet your current and projected needs?

Assessing Your Situation: Current Readiness

- What are your organization’s internal strengths and weaknesses?
- Do you have the right executive team and board members in place to position for the future? If not, what types of people do you need?
- How well do you understand the health needs of your patient population? What investments are necessary to manage these needs?
- What capabilities does your organization have to improve care delivery processes and outcomes? What is its track record?
- Has your organization been able to make significant cost reductions in any of its service lines or clinical processes? If not, what are the barriers to achieving cost reductions?
- How capable is your organization of change? How do you know? How has leadership enabled flexibility, or made it more difficult?
- How prepared is your organization to accept contracts involving value-based reimbursement?
More Acquisition and Affiliation Toolkit Resources

- Assessing Your Situation
  - Organizational assessment
  - Market assessment
  - Common goals
- Determining Your Options
  - Common approaches
  - Identifying potential partners
  - Educating your board
- Moving Forward
  - Communicating your strategy internally
  - Key steps in finalizing an agreement

Does Organizational Type Affect Acquisition and Affiliation Options?

- Academic medical centers and children’s hospitals
- Aligned integrated systems
- Multihospital systems (local, regional, national)
- Rural hospitals
- Stand-alone hospitals
- Others?
Academic Medical Centers

- Align the complex organization around value improvement
- Reduce overall cost structures while improving care processes
- Recognize the importance of thinking and acting as a single, unified organization, rather than one with three missions

Aligned Integrated Systems

- Work to prove the value of the integrated care delivery model
- Align network providers to the system and its approach to clinical practice
- Leverage cost effectiveness to increase market share and/or reduce health plan pricing
Multihospital Systems

• Reevaluate the balance between centralized and decentralized elements within the system
• Add scale while expanding across a broader continuum of care
• Determine how best to work with varying degrees of financial alignment with physicians

Rural Hospitals

• Plan for potential reductions in revenue
• Define role within accountable care/population management strategies
• Seek the right balance of primary care & specialty services to meet community needs
Stand-Alone Hospitals

- Pursue opportunities to improve scale
- Differentiate through superior clinical and financial performance
- Foster a culture that embraces change

Understand New Payment Models in the Context of Stakeholder Risk

<table>
<thead>
<tr>
<th>LOW PROVIDER INCENTIVE TO LOWER THE NUMBER OF EPISODES OF CARE</th>
<th>HIGH PROVIDER INCENTIVE TO LOWER THE NUMBER OF EPISODES OF CARE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fee for Service</td>
<td>Per Diem</td>
</tr>
</tbody>
</table>

| Providers | Lowest financial risk | Highest financial risk |
| Payers | Highest financial risk | Lowest financial risk |
| Consumers | Risk of overtreatment | Risk of under treatment |
| Employers | Risk of high costs from inefficiency | Risk of high costs from under treatment |

Develop Strategic Agility

- Simplify organizational structures
- Empower front-line staff
- Align with physicians
- Experiment with payment methodologies

Align Value Metrics

- Replace process measures with outcome measures
- Align measures with Triple Aim (patient experience, population health, per capita costs)
- Focus on a limited set of metrics
- Use incentives to drive outcomes
- Make performance reporting actionable
Explore Strategic Partnerships

Differentiate on Value

- Be clear about your value equation
- Focus your efforts on achieving it
- Improve value delivered to care purchasers—and communicate value improvements
Lead a Collaboration Around Value

“Leadership has nothing to do with titles; it has everything to do with, “Do you inspire other people? Do they want to follow you? Do they want to be with you?”

- Tom Atchison, author of Followership: A Practical Guide to Aligning Leaders and Followers

Leverage Your Change Leadership Strengths

“CFOs are often better leaders than they think they are. They are good at setting goals, measuring results, and looking at variances.”

- Quint Studer, CEO & Founder, Studer Group

“The CFO is really in a role to help the various stakeholders understand how the pieces fit together.”

- Noblis Health Innovation Senior Principal, Paul Breslin

“When asked what role finance officers can play in transforming our healthcare system, David Walker said to remember what the ‘P’ in CPA stands for.”

- Former HFMA Board member Edward Giniat, quoting the former U.S. Controller General & CEO of the Peter G. Peterson Foundation
Providers Are Not Seeking a Reputation Based on Value—Yet

Resources for Building Value

hfma.org/valueproject
“Somebody has to do something, and it’s going to be—and it has to be—you.”

Former Senator and Senate Majority Leader
Bill Frist, MD
Speaking at
ANI: The HFMA National Institute