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to remain independent—or not?
strategies for assessing future positions

In the wake of healthcare reform and the shift toward value-based payment, many industry experts are anticipating a wave of mergers and acquisitions, with dire prognostications about the viability of independent hospitals.

AT A GLANCE

Independent hospitals should take six steps when considering the viability of maintaining independence:
- Evaluate the links between independence and organizational mission.
- Assess market factors.
- Analyze the organization's financial status.
- Perform a strategic assessment.
- Evaluate the potential benefits of partnership.
- Assess the organization's ability to implement strategy.

In 2011, the number of independent community hospitals stood at 1,966, according to the American Hospital Association's 2013 Annual Survey, down from 2,373 in 2000. In recent years, the number of independent hospitals and physician practices announcing plans to affiliate or consolidate with other providers has grown at an increasing rate.

In this rapidly changing environment, independent hospitals should assess many factors in gauging the options of whether to remain independent or find a suitable institution with which to affiliate or merge.

Independence Viability Analysis: Six Key Steps

As independent hospitals evaluate their options, they should systematically analyze their short-term and long-term market positions and options to determine whether independence is a viable goal. This analysis should include six key steps.

Step 1: Evaluate links between independence and organizational mission.

Determining whether an organization's independent status best supports the organization's mission, vision, and goals is a crucial first step. If maintaining independence is a top goal, other elements of the overall

INDEPENDENCE VIABILITY ANALYSIS: SIX KEY STEPS

Step	Questions to Consider
1. Evaluate the links between independence and organizational mission.	How does the goal of maintaining independence fit with the hospital's mission and vision?
2. Assess market factors.	What does the hospital's market and service area look like?
3. Analyze the organization's financial status.	What is the hospital's financial position? Are key metrics in line with objectives?
4. Perform a strategic assessment.	Does the hospital have the capacity to survive and prosper as an independent entity?
5. Evaluate the potential benefits of partnership.	Would partnering afford better performance of the hospital's mission, goals, and objectives?
6. Assess the organization's ability to implement strategy.	Can the hospital execute its strategic initiatives with internal resources, or is outsourcing implementation a better option?

strategic plan should support and facilitate that goal from the outset.

Step 2: Assess market factors. The matrix below outlines key market factors that should be evaluated during the market assessment phase of an independence viability assessment.

Independents should perform a thoughtful analysis of the competitive landscape—and account for the following potential changes:

> Competition-driven changes, such as consolidation, which could fundamentally alter the landscape

> Demographic and epidemiologic changes to the patient base that could shape strategic plans related to physician recruitment, diagnostic technology investments, and facility investments

> Patient satisfaction assessments that point to a need for improvement

In particular, actions taken by current competitors or the advent of new market entrants—including ancillary competitors, such as larger physician groups, physical therapy, imaging, dialysis, and other providers—could change the competitive landscape. This is an opportune time to confirm

STEP 2: MARKET ASSESSMENT

Key Factor	Questions to Consider
Organizational position	What is the hospital's position in the market? What are its strengths and weaknesses?
Bed capacity/market share	What are the options for increasing surgical, intensive care, inpatient, or outpatient capacity to capture greater market share and increase revenues?
Competitors	Who are the primary competitors? What impact might consolidation among competitors have on the market? Are competitive threats acute?
New referral sources	What strategies are in place to expand the referral pool?
Access growth markets or site locations	What options and strategies have been identified and/or implemented to enable expansion into new markets by geography or payer mix?

STEP 3: FINANCIAL ASSESSMENT	
Key Factor	**Questions to Consider**
Access to capital	Is there adequate capital to fund the strategic plan? What are the sources of that capital?
Healthcare IT investment	How will IT be funded and implemented? How will expected changes in IT hardware and software be funded for the next three, five, and 10 years?
Healthcare reform readiness	What is the level of capability to establish or participate in an ACO, or to cut costs and improve outcomes through other means?
Achievement of long-range strategic initiatives	Are there adequate resources and appropriate core competencies—financial, organizational, and knowledge-based—to achieve long-range strategic initiatives?
Physician and faculty recruitment	Are there sufficient resources to achieve physician and faculty recruitment targets? Are capital needs associated with practice acquisition included in strategic financial planning?
Physician relations	What options are available for financial alignment to achieve shared goals? Are alternative strategies available in a changing payment environment (e.g., real estate co-investments)?
Access to growth markets or ability to expand site locations	What options and strategies have been identified and/or implemented to enable expansion into new markets by geography or payer mix?
Negotiation leverage	Can leverage position be improved by negotiating with employers or payers?
Cost management	What cost management strategies have been implemented to achieve savings targets in the next three, five, and 10 years? How do the savings targets compare with those of peers and competitors?
Community outreach	Can community outreach goals and obligations be achieved?
Credit ratings	What impact do the factors determining the organization's financial strength have on the organization's credit ratings?

that an independent hospital's referral sources are diversified through multiple channels.

Evaluating multiple drivers and their implications will help ready an organization for a worst-case scenario and mitigate the speculation inherent in this type of forecasting exercise.

The organization's reputation and brand, and how independence figures into both, are also important factors to consider. Integrity and an enhanced ability to deliver community benefit derived from independence can be defining characteristics of an independent hospital's brand.

An in-depth assessment of the competitive landscape and physician relationships also may help the organization identify opportunities to collaborate with other providers by sharing clinical programs and services, revenue cycle and back-office services, technology, or facilities; by integrating medical staff; or by achieving supply chain savings.

Step 3: Analyze the organization's financial status. To evaluate their financial position, independents should consider creating a "bottom up" five-year financial forecast reflecting their current mission, objectives, and strategic plan. The forecast should address the factors outlined in the exhibit on page 3.

A key component of the institutional financial assessment is estimating the practical useful life of assets to avoid incurring debts that extend beyond that period, such as taking on a 15-year debt to pay for software. Another component is evaluation of physician relationships and the financial incentives that bond physicians to the practice and to the hospital. Are financial incentives aligned to achieve shared goals? To what extent are capital needs associated with practice acquisition included in strategic financial planning?

Aligning financial incentives can improve financial and operational performance while facilitating and funding additional practice acquisitions. Alignment practices also should mitigate risks associated with practice acquisitions that do not work and must be "unwound." The valuation of physician-owned real estate, which often constitutes a large percentage of the total value of a practice acquisition, also should be addressed.

Finally, as independent hospitals explore their options and sources of capital, they should also examine the concomitant impacts on their credit ratings.

Step 4: Perform a strategic assessment. In this phase, all of the data compiled in the previous three phases are examined and used to answer several key questions:

Profile in Independence

Virginia Hospital Center (VHC), an independent hospital in suburban northern Virginia, evaluated a number of strategic and capital factors in assessing the viability of maintaining its independent status. VHC remains independent, a decision VHC leaders revisit often to help ensure the organization's ongoing fiscal health and stability.

VHC is a 342-bed, $357 million net revenue healthcare system with a state-of-the-art facility offering comprehensive health care and multiple centers of excellence in metropolitan northern Virginia. Established in 1944, VHC remains independent in a very competitive suburban Washington, D.C., market, where it is surrounded by larger players. VHC CFO Robin Norman notes that three key conditions have helped the hospital maintain its independence:

> A disciplined, conservative approach to creating and maintaining financial strength, including building strong reserves
> A size that gives the organization a degree of agility—an important competitive advantage in a market that includes "behemoth" healthcare systems as competitors
> A culture that is supportive of patients, physicians, and staff

For VHC, remaining independent is an important strategic goal that is achieved through ongoing assessment of organizational resources and strengths, along with careful planning. Results of an analysis in which VHC applied the six steps described in this article have been instrumental in helping the organization to set its strategy for independence.

In evaluating the links between independence and organization mission, VHC considers the best way to continue providing high-quality healthcare services to the community it serves, at a lower cost than its competitors. It is achieving these goals as an independent, as evidenced by the best value-based purchasing score as compared with other northern Virginia facilities, no readmission penalty, and the lowest cost per adjusted admission in the state (as calculated by the state).

VHC found the second step involving analysis of market factors to be particularly illuminating. As Norman notes: "We can control costs and quality. The point we watch is access to patients. Being cut off from a large group of insured patients would likely present a tipping point. Such a change would require a dramatic realignment in our market."

Reputation and brand also have been key considerations for VHC. Indeed, VHC public relations director Kristen Peifer Dugan says that independence is the cornerstone of the organization's reputation. "We have become well-known in the community as an independent hospital," Dugan says. "Our ability to remain flexible and competitive is tied to community benefit and physician relations. Our patients

> Can the organization survive and prosper as an independent entity? If so, for how long? If not, why not?
> How should the mission implications be weighed against financial projections? Can the organization fund its long-range strategic goal? If not, can and should the mission be changed to accommodate the financial forecast?
> What opportunities are tangible in the current and longer-term competitive environments? How can the organization position itself to thrive?
> What needs or deficiencies have been identified? How can these be mitigated or resolved?

At this stage, deficiencies in financial performance, market position, managed care contracting, and economies of scale should be considered carefully, as they could impede the goal of remaining independent. This assessment should also examine necessary strategic and infrastructure investments (which may be capital intensive) along with needed clinical and community service lines, and identify appropriate capital sources to fund those endeavors.

Ultimately, this analysis should serve as a baseline for determining whether independence is the best way to fulfill the organization's mission and achieve organizational goals and objectives.

Step 5: Evaluate the potential benefits of partnership. Independent hospitals should carefully consider whether they would be better able to fulfill their core mission by partnering with another organization. Although this exercise may seem counterintuitive, it can shed important light on an independent's ability to fulfill its core mission over the long term.

know they are going to receive top-quality care. Our market is full of savvy consumers, and from a branding perspective, we are well-known in and beyond our regional market."

Analysis of VHC's financial position confirmed the organization's financial strength, to which VHC credits its sustained ability to succeed independently. VHC has used collaboration as a strategy to strengthen its position. For example, the hospital recently forged a relationship with Kaiser Permanente of the Mid-Atlantic States to serve as one of the health plan's core hospital facilities. Norman notes that VHC's strong performance on patient satisfaction and other quality metrics helped solidify the relationship.

VHC's assessments of strategy and the benefits of partnership have been informed in large part by its past experience with a strategic collaboration. In the mid-1990s, VHC found itself at a crossroads. Concerned about whether it needed a bigger footprint in an environment marked by significant managed care network formation, VHC entered into a joint venture agreement with a for-profit system. The agreement allowed for a two-year exit window, pending the outcome of an IRS ruling on the not-for-profit portion of the joint venture. When it became clear that VHC was viewed as an essential facility to be included in local managed care networks, the hospital exercised its option to exit the venture (at a time when the IRS ruling was still pending) and reemerged as an independent entity in 1999. The hospital learned a lot from the process. "The reasons we entered the joint venture were good, and the reasons we got out of it were equally strong," Norman says. "Now, we understand that we need to keep our eye on changes in our market. In the mid 1990s, there were 30 independent hospitals in this market. Today, it's just us and several larger systems."

In the end, VHC has determined that it has the ability to implement its independence strategy. The hospital therefore plans to remain independent and has aligned its strategic and capital plans to achieve that goal. Going forward, VHC expects to engage in continuous assessment of its market position, financial strength, and strategic goals to assess whether independence remains the right structure to fulfill its mission. Although financial strength is critical to its independent status, that strength alone may not be enough in other markets, or for other providers.

"All health care is still local," Norman says. "Our situation is our situation. Go to the next city, to the next independent, and the situation will be different. We are partly able to maintain independence because of the strong demographics in our market."

As part of this process, independents should determine what criteria to use for evaluating potential opportunities. Partnership could take many forms, including limited collaborations that would enable the hospital to remain viable as an independent. Ultimately, independent hospitals may have to weigh the trade-offs between remaining independent and ceding some control to continue their mission.

Independents also should examine more substantial partnership options, including a merger with or sale to a larger regional or national health system. Alternatively, some independents may be in a position to consider merging with or acquiring one or more other independent hospitals to create a new health system that is better positioned to compete, both strategically and financially. Approaching these options with an open mind as part of the overall strategic planning and evaluation process can yield important insights that can enable independent hospitals to address deficiencies and proactively prepare for rapidly changing market conditions.

Step 6: Assess the organization's ability to implement strategy. The final step is to develop a plan for implementing the chosen strategic initiatives. If it has been determined that a collaboration or partnership is the best path to pursue, the implementation plan for the new relationship should be tailored to the specific mission, needs, and goals of the independent hospital (and the intended partner) and rooted in the overall strategic plans of both entities. The implementation plan also should specify how any initiatives to be undertaken will be financed.

Before an optimal implementation plan can be crafted, several additional issues must be considered:

- Is the timing optimal? If not, can it be adjusted?
- How will capital markets and economic or political conditions challenge any potential partners or collaborators?
- How might collaboration or partnership discussions affect the organization's brand or its relationships with key constituents?
- What will happen to the independent hospital's brand and relationships with key constituents if a planned partnership or collaboration is not successful?
- How will key competitors respond?
- Who should be involved in the final decision and implementation?

Careful consideration of these questions will allow an independent hospital to formulate a thorough plan for implementation, mitigate associated risks, and prepare for challenges that may complicate or delay implementation. ●

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