

A Critical Decision for Single Hospital and Smaller Health System Boards

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“Can we remain independent or do we have to merge into a larger health system?”

THIS QUESTION IS BEING ASKED IN BOARDROOMS OF SINGLE hospitals and smaller health systems (those with two to three hospitals) across the country. Lower reimbursement and margins, tighter access to capital, physician integration challenges, technology investments, and the uncertainty concerning the impact of healthcare reform implementation have caught the full attention of board members. Not surprisingly, the number of mergers, joint operating agreements, and other collaborative arrangements between and among hospitals and health systems is projected to grow significantly in the foreseeable future.

Most board members are painfully aware that the decision to remain independent or to join (or create) a larger health system is, perhaps, the most profound decision a board can make. A potential change-of-control decision requires the board to perform its fiduciary duty at the highest level. In spite of the discomfort and potential political conflict among board members that may ensue, astute board members of smaller organizations know that making this decision is unavoidable.

How to Decide

The first step is for the board, senior management, and medical staff leaders to set aside a substantial amount of quality time to get up to speed (if they are not already) on the likely future of the healthcare industry. This could be dedicated time on the agenda of several board meetings or an intense board retreat arranged for this purpose.

The next step is for the board to direct management to conduct a “brutally honest” assessment of the hospital’s current situation focused on a number of key factors in order to reach a fact-based conclusion as to whether or not the hospital can remain independent over the next five to 10 years. This type of assessment is the opposite of the rosy scenarios that often form the basis of hospital strategic plans and requires benchmarking the hospital against best-in-class institutions, both in the market and nationally. The questions below are the most critical requirements for a small hospital or system to be able to stand alone:

1. How strong is our market/competitive position today and is it defensible over the long term against larger players looking to gain market share at our expense?
2. Do the demographics of our market result in a positive payer mix and is the situation likely to remain so?
3. Are we able to recruit and retain the right number and mix of physicians needed by our community now and in the foreseeable future?
4. Do we have the know-how and resources to employ physicians successfully and/or create tightly integrated relationships with many more physicians?

5. Do we have state-of-the-art facilities and medical technology? If not, do we have sufficient resources to address this issue?
6. Have we developed processes and culture to accurately measure and continuously improve clinical quality, patient safety, and service?
7. Do our quality, safety, and satisfaction scores on national benchmarks positively differentiate us from our larger neighbors/competitors?
8. Have our information technology/systems advanced to 21st century requirements?
9. Do we have the ability to handle bundled payments and value-based reimbursement schemes?
10. Has our operating profitability been strong over the past five years and will it remain so in the future?
11. Do we have sufficient access to capital to fund many of the above requirements?

If the answers to many of these questions are negative, the board then has to determine whether or not the situation can be changed on its own or if the organization needs the help of a partner. If the answers to many of the questions are: “not sure,” “don’t know,” or “maybe,” the board needs to get the answers in a timely manner to make its final determination. If the answers are overwhelmingly positive, your institution may have a long-term future as an independent organization. And, you may be able to solidify your position further by expanding the size of your health system through attracting other hospitals and physician groups to become part of your system.

Avoid Following the Herd

The health industry media would have one believe that there is not much of a future for independent hospitals or smaller systems and that you need to act immediately to either join up with a larger health system or form your own system. Over the past 30 years, similar doomsday scenarios have prompted hospitals to make hasty decisions that were regretted later. It’s true that the ranks of independent hospitals have shrunk to under 50 percent of the total number of hospitals in the country and that this trend is likely to continue. However, that doesn’t mean independent hospitals and smaller systems will become extinct any time soon, provided that the board and senior management provide the leadership to take stock of the current situation and do what is necessary to secure an independent future.

For more information on this topic, please refer to The Governance Institute’s June 2010 Webinar: *Go It Alone or Merge Into a Larger System: An Unavoidable Decision* (presented by Edward A. Kazemek and Daniel M. Grauman), and the Summer 2010 white paper, *Hospital Consolidation Trends in Today’s Healthcare Environment*. Both are available at GovernanceInstitute.com.