Governance Restructuring: *A Needed Change Management Initiative*

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The number of organizations revising their governance structures and practices has increased substantially over the last few years. Key drivers of this activity include: increased consolidation; the addition of entities along the continuum of care; employment and other business arrangements with physicians; and board members' desire to do their jobs effectively and efficiently.

Key Drivers of Restructuring

THE CONSOLIDATION OF HOSPI-tals and health systems continued in 2011. During that year alone, 212 hospitals merged or affiliated.[1] Now, two-thirds of community hospitals are part of a system.[2]

In addition, systems are building their ability to provide care across the continuum in preparation for managing population health. As a result, they are adding services such as sub-acute, rehabilitation, long-term care, and hospice. Some systems are also including an insurance component.

One of the most complex trends has been the growth in transactions with physicians. Anticipating bundled payments and other reimbursement changes, hospitals and systems are using different methods to align with their physicians. Physician employment has grown by 32 percent over the past 10 years,[3] and now the majority of physicians in the country are employed. Beyond employment, hospitals and health systems are creating joint ventures, co-management models, accountable care organizations, and other business arrangements with individual physicians and groups to improve care and lower costs.

Increased merger and affiliation activity has led to the creation of large, often cumbersome, corporate and governance structures. Some small systems now have as many as 40 legal corporate entities, each with their own board. And, to complicate matters, these systems often contain a combination of for-profit and not-for-profit legal entities.

Resulting Governance Challenges

This situation creates challenges for those who are trying to govern their not-for-profit health systems effectively and efficiently. These issues include: difficulty responding quickly to changes in the healthcare landscape; inability to function as a fully integrated system; lack of clarity regarding governance roles and authority; insufficient discharge of legal duties and core responsibilities; duplication of effort; and wasted time.

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Some board members attend more than 30 meetings annually, and many of those meetings cover the same information (e.g., identical reports at the subsidiary board finance committee, subsidiary board, system finance committee, and system board). This is a lot to ask of board members, the vast majority of whom are volunteers. (According to The Governance Institute's 2011 survey, only 15 percent of hospital and health system board members are compensated.[4])

It is not only board members who question whether this is an appropriate use of resources. Some CEOs spend over 50 percent of each month preparing for and attending board and committee meetings—time that could have been spent ensuring their organizations are thriving in these complex times.

An additional challenge is the increased scrutiny of not-for-profit boards. The Internal Revenue Service (IRS), the Senate Finance Committee, and attorneys general are concerned about whether boards of not-for-profits are appropriately overseeing the public's assets. These regulators and legislators (and other entities) are looking closely at boards' decisions regarding key areas such as executive compensation, audit, and community benefit. Boards are now expected to be "competent" (include members with experience in key areas), to be right-sized (small enough for effective decision making), and to function in a transparent, independent, and accountable manner.

Governance Assessments

As a result of these pressures, many systems are choosing to revisit their corporate and governance structures and practices. The purpose of these assessments is to enhance the system's overall governance effectiveness and efficiency

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1 Paul Barr, "Dealing Them in: Annual M&A Report Shows Industry Changes Drive Another Year of Growth," *Modern Healthcare,* January 30, 2012.

2 *AHA Guide*, American Hospital Association, 2012.

3 Molly Gamble, "Physician Employment up by 32% at Hospitals Over Past Decade," *Becker's Hospital Review,* January 12, 2012.

4 *Dynamic Governance: An Analysis of Board Structure and Practices in a Shifting Industry,* 2011 Biennial Survey of Hospitals and Healthcare Systems, The Governance Institute.

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in support of its mission and strategic plan. A typical governance restructuring initiative includes revisiting the following:

- Number and type of corporations and boards
- Number and type of board committees
- Roles, responsibilities, and authority of each board and committee
- Size, composition, and competencies of the boards and committees

Systems interested in assessing their entire governance function also look at board and committee policies (e.g., executive compensation and conflicts of interest), procedures (e.g., recruitment, selection, orientation, education, goal setting, and evaluation), and practices (e.g., meeting frequency, length, agendas, and culture).

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On the surface, this work seems straightforward. Many would think that the first step is to determine the ideal "boxes on the organization chart" by selecting which corporations to eliminate (e.g., organizations that can become operating divisions); which to consolidate (e.g., all hospital corporations); and which to add (e.g., one corporation for all employed physicians). They would then create boards for the remaining corporate entities and decide on their composition, size, and committee structures. Lastly, they would engage attorneys to revise the bylaws and other legal documents to be consistent with the desired changes.

However, the individuals who are currently serving on the existing corporations' boards and committees will not see this as a simple exercise. To them, this work *could* result in lost "jobs" (as board or committee members), reduced authority and/or influence, and, perhaps, less connection to an organization about which they care deeply. Understandably, they become concerned about the potential impact of the changes on themselves and on the organization.

If this dynamic is not recognized, well-intended governance restructuring can create division, result in hurt feelings, and engender resistance to change. In other words, the restructuring can fail—fail to be approved and/or fail to be implemented.

Governance Restructuring as Change Management

Successful governance restructuring is the result of a carefully designed process that is firmly grounded in proven change management theory. One of the foundational models of change management was developed decades ago by Kurt Lewin,[5] and it is still a useful way to think about managing organizational change.

Lewin states that change is a process with three distinct phases: unfreezing, changing, and freezing. During the unfreezing stage, the organization is helped to understand that change is necessary. This occurs through developing a compelling message of why the existing way of doing things cannot continue. In governance restructuring, the compelling message may be that the system cannot improve quality and lower costs without the ability to truly function as an integrated organization. Education programs on healthcare industry trends and not-for-profit governance can help build this case.

Once the affected individuals understand that the current methods (e.g., governance structures) must change, some may begin to feel uncertain. They may fear they will be left behind, and resistance surfaces. At this stage, it is important to understand their concerns so those issues can be addressed in the solution. For instance, foundation board members may worry that if their board is combined with other foundation boards, their community will not be willing to donate. Once understood, this issue could be addressed in the recommendations.

During the second phase (changing) there must be open, honest discussion and debate of the current situation and the need for change. In the case of governance restructuring, it is wise to secure input from key stakeholders regarding the strengths and weaknesses of the current governance structure before developing alternatives.

Then, a common vision of the future state must be created and differences must be resolved (not just ignored). The common vision (in this case, of the ideal governance structure) must be based on the mission, history, and culture of the organization. This takes time, more stakeholder engagement (e.g., feedback sessions regarding structural options), and continual communication.

In the freezing phase, the new way of doing things (e.g., new boards and committees) is approved and the changes are internalized as the new norm. A sense of stability emerges, and the organization can move confidently into the future.

Summary

Given the significant changes in the healthcare industry, boards should ask whether their corporate and governance structures are aligned with their mission and vision. If a board decides to assess its governance, it should design a process that is respectful of the real concerns of those who will be asked to approve and implement the changes. Through education, engagement, and communication, each hospital and health system can develop a unique corporate and governance structure that is understood and supported by all key stakeholders.

The Governance Institute thanks Pamela R. Knecht, president of ACCORD LIMITED and Governance Institute advisor, for contributing this article. She can be reached at pknecht@accordlimited.com or (312) 988-7000.

5 Kurt Lewin, "Frontiers in Group Dynamics," *Human Relations*, Vol. 1, No. 2, 1947.