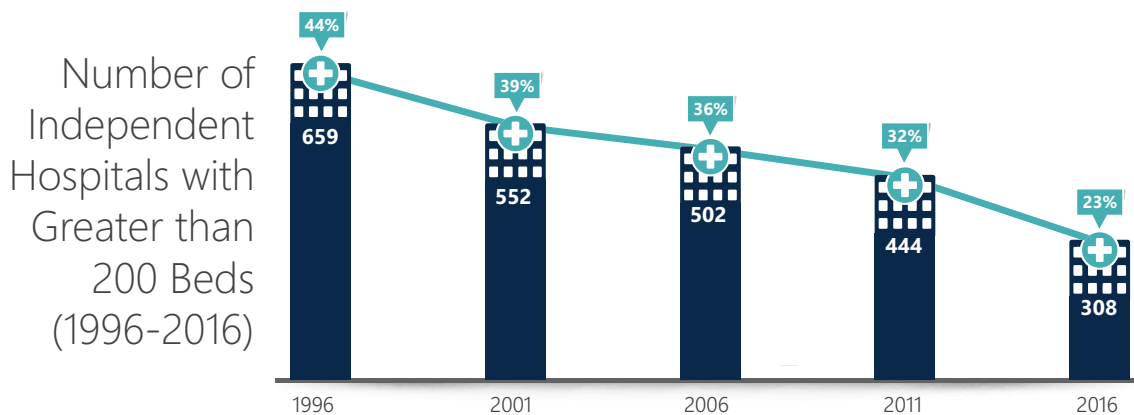


## Standalone Hospitals: Are They Really Dinosaurs?

*Examining the Circumstances Under Which Independent Institutions Can Thrive*

Over the past 20 years, the percentage of the nation's hospitals over 200 beds that are part of health systems has risen from 56 to 77. This trend continues as local, regional and national health systems expand in search of greater scale, financial stability and market presence. From 2006 to 2016 alone, the number of independent hospitals over 200 beds declined nearly 40 percent from 502 to 308. The seemingly inexorable trend toward system expansion has caused industry observers to state frequently that stand-alone community hospitals are "dinosaurs."

However, there are circumstances under which stand-alone hospitals can continue to thrive, at least for the foreseeable future. There are also a multitude of new partnership arrangements that make it possible for successful institutions to retain a high degree of independence while securing many of the benefits of hospitals that are affiliated with larger health systems. Lastly, there are proactive strategies that executives and boards of independent hospitals can pursue to maintain their independence and strengthen their market position.



In our experience, successful independent hospitals share many of the same advantages, a subset of which are described below. These market and internal characteristics enable many of the remaining stand-alone hospitals to meet their mission objectives, fund routine and strategic capital needs, build robust ambulatory and physician networks and fend off competition from larger systems. Certainly, there are other factors that support the continued success of independent hospitals; however, the characteristics summarized below frequently allow organizations to continue to operate successfully in consolidating and competitive market environments.



(As Informed by The Chartis Group Experience)



**1. The hospital is the sole or predominant community provider in the market(s) it serves.**

Many successful independent hospitals have benefited by serving a large proportion of the patients in their market(s). Not expending significant resources to compete with a substantial local market competitor is an obvious advantage. A strong market position is often the result of historical market dynamics; other times, a strong share is fortified by successful strategies and geographic barriers, such as mountains, rivers, location within a sparsely populated area, or regulatory barriers to entry, such as CON laws.



**2. The hospital is located within an attractive, stable or growing market with a favorable payor mix.**

Not surprisingly, markets that feature a growing population base and economy and a high percentage of commercial patients can help support clinical service expansion and produce fresh business development opportunities for the hospital.



### 3. The hospital is of a size sufficient to promote efficient care delivery and cost management.

Typically, this might mean having at least 20,000-25,000 admissions and a large, well-distributed outpatient network. Having scale allows an institution to manage revenue and costs effectively. Such institutions can sustain profitable subspecialty care and surgical services, and better manage their cost structure by, among other things, negotiating volume-driven discounts with suppliers. Additionally, independent hospitals that have the scale to invest in clinical service and network expansion strategies covering key geographies are well-positioned to reap the benefits of these investments.



### 4. The hospital provides a wide array of profitable specialty care services and has a high case mix index, enabling it to earn favorable margins per case.

Specialty care, particularly complex procedural care (e.g., cardiac services, neurosciences, orthopedics and cancer care), typically generates relatively high margins, aiding the hospital's financial position. Having a high percentage of surgical cases and a robust base of elective admissions reflects the benefit of having a closely aligned network of specialists and surgeons.



### 5. The hospital has a strong balance sheet, including over 200 days cash on hand and a favorable debt to capitalization ratio.

Hospitals often seek affiliation partners to bolster weak balance sheets or provide access to capital. Consistently strong margins and a healthy balance sheet are enduring advantages that give successful hospitals the ability to weather internal and external market challenges. These advantages make it easier for institutions to invest in internal organizational needs and to capitalize on growth opportunities.



**6. The hospital has built an integrated, closely-aligned physician network that is growing and well distributed across the service area.**

A strategically-deployed network of highly-aligned providers is among the greatest assets a hospital can possess. Developing a strategically-sized, integrated physician network is more challenging for independent hospitals; they may encounter greater difficulty recruiting physicians and developing the infrastructure to successfully support them in growing their practices. A high level of physician alignment across primary care physicians and specialists gives hospitals the ability to better execute against system-wide goals related to quality management, clinical variation reduction and enhanced access to care.



**7. The hospital benefits from strong community support, including philanthropy.**

Successful independent hospitals translate their strong community support into productive philanthropic initiatives. The donations of grateful patients and community donors aid in the formation of strategic capital, positioning the hospital to grow and support critical services.



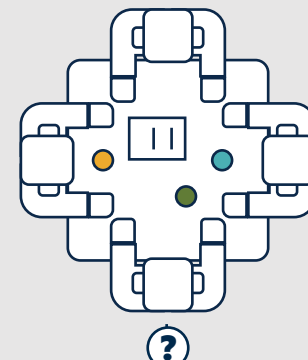
**8. Many successful independent hospitals have been able to create a level of “network essentiality” that enables them to negotiate favorable commercial and other payor contracts.**

While it is more difficult to achieve the same degree of network essentiality as a leading academic center or large regional health system, it is possible for a stand-alone hospital to be considered essential at the local or sub-regional level. Network essentiality provides some buffer from payor renegotiation risk. With supportive payor relationships, the hospital has the opportunity to explore value-based and other innovative payment arrangements and to better manage care through the use of data-driven analytics.



## The Need for Periodic Review of the Benefits and Risks of Remaining Independent

While stand-alone hospitals will continue to join local, regional and national health systems, a subset of institutions that are well-positioned across the above dimensions will continue to enjoy independence, support their communities and demonstrate the ability to thrive. At the same time, the markets and circumstances surrounding individual institutions will continue to evolve. It is critical for all organizations to periodically conduct a rigorous, thoughtful evaluation of their current positioning and future prospects; they should assess the range of options that best preserve the mission and meet their needs and those of the communities they serve.



This assessment should involve a thorough board and executive team evaluation process that considers the following types of questions:

- 1. Does our institution fit the profile of a strong, independent hospital?**  
Begin by examining the hospital's current situation and prospects from an objective viewpoint. It may be beneficial to seek support from an outside advisor to assess the organization's strengths and weaknesses without bias. As very few hospitals will have all the characteristics highlighted above, it is important to focus on those elements that are most pertinent to the specific market and internal context. A valuable output of this exercise is the identification of potential gaps in performance and other areas that may require attention.
- 2. Is it realistic to think we can independently close gaps in our positioning and operational performance?**  
Some areas of deficiency are more mission-critical than others. Evaluate each opportunity for improvement, gauge its relative importance to the future success of the organization and identify options to address each opportunity, including the potential role of partners. For example, if a gap in the provision of specialty care services is identified, possible solutions may include viable organic growth strategies or a targeted partnership with a nationally-known system or a nearby academic medical center. Addressing issues such as long-term access to capital or the ability to create a differentiated position in the market may require a proactive evaluation of how affiliation partners can help address current or future shortfalls. Exploring affiliation options, before a crisis develops, will better position the institution to attract a partner that is well-suited to meet the needs of the communities served. To achieve a successful outcome, it is vital to evaluate these questions through a deliberate, thoughtful process that engages stakeholders and forges leadership consensus.
- 3. How should we involve the board in an objective, periodic evaluation process?**  
Evaluating whether an institution can and should remain independent is among the most strategic fiduciary matters a board can address. Active board involvement and leadership is critical. A periodic evaluation process should review the internal state of the organization and the external context, including market evolution, new competitive threats and other external challenges. Even if most indicators suggest that the hospital is well-positioned for current and future success, boards and hospital leadership should regularly consider options to further solidify their market position. These opportunities include forming networks with smaller independent or critical access hospitals, considering options for vertical integration to expand the continuum of care and continuously strengthening the physician enterprise. Opportunities may also involve the consideration of a variety of looser affiliation models (e.g., cost sharing collaboratives, academic affiliations, etc.) that may bring significant benefit while preserving a high degree of independence. Such options frequently support a plan for future growth that does not have to involve a tight affiliation with a larger health system; these options may even serve as a catalyst to bring together other like-minded hospitals in the region.

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# THE CHARTIS GROUP

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