

Positioning Your Organization for Success in the New Era



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KaufmanHall

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South Texas HFMA

Today's Agenda

- Strategic Challenges Facing Hospitals and Health Systems Today
- Positioning for the New Era
 - Introduction to the New Era
 - Lessons Learned from Kaufman Hall Assessments to Date

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Strategic Challenges Currently Facing Hospitals

We Are in a Period of Tremendous Challenge for Healthcare Providers

- Declining inpatient and outpatient volumes
- Deteriorating payor mix
- Compromised financial performance and position
- Increased competitive pressures
- A physician market “free for all”
- A large capital appetite, but more limited/ difficult capital access
- Uncertain impact of reform

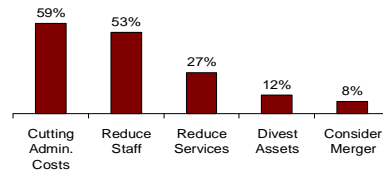
How Have Hospitals Been Responding?

The AHA issued a report titled, "Report on the Economic Crisis: Initial Impact on Hospitals," based on a survey of 736 hospitals in 30 states...

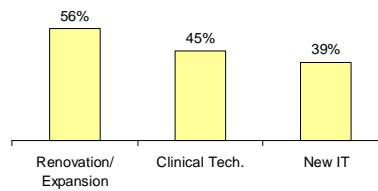
Report Highlights

- 15% increase in interest expense over last year
- 25% reported moderate decrease in elective procedures
 - 6% reported significant decrease
- 29% reported moderate decrease in overall admissions
 - 9% reported significant decrease
- 51% reported a moderate to significant increase in uncompensated care as percent of overall revenues
- Uncompensated care was up 8% from July-Sept. vs. the same period last year

Repositioning



Belt Tightening



Source: AHA: "AHA Report Provides Statistics Showing Hospitals' Struggles With Economic Downturn," *Hospital Review Magazine*, November 20, 2008.
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Positioning for the New Era

Changing Strategic Conditions

1. Change in federal budget pressures
2. Change in premise: focus on VALUE (a function of quality and price)
3. Change in prices: payment rates moving downward
4. Change in payment methods: move toward outcomes-based payments
5. Change in results: pilot projects underway
6. Change in utilization: anticipated reductions in future utilization
7. Change in competitive landscape: consolidation expected

For Hospitals and Health Systems, Strategy Is Driven by the Prevailing Reimbursement Mechanism

Prevailing Reimbursement Mechanism	Industry Reaction	Government Reaction
1960s and 1970s <ul style="list-style-type: none"> • Cost-based/ cost plus 	<ul style="list-style-type: none"> • Building boom 	<ul style="list-style-type: none"> • Control supply – health systems agencies (HSAs) and certificate of need (CON) programs
Mid 1980s – Current <ul style="list-style-type: none"> • IP discharge/ activity-based • OP units of service 	<ul style="list-style-type: none"> • Drive more admissions and outpatient procedures • Manage length of stay (LOS) 	<ul style="list-style-type: none"> • Modify payment levels
Future? <ul style="list-style-type: none"> • Outcomes-driven bundled payments • Accountable care organizations (ACOs) • Capitation-like structures 	<ul style="list-style-type: none"> • Focus on care management capabilities • Increased physician integration • Investment in information technology 	<ul style="list-style-type: none"> • Tie payment to outcomes? • Promote full capitation? • Continually raise the efficiency and outcomes bar

New Core Competencies Will Be Required of Hospitals and Health Systems for Success in the Future

Integration Attributes	Key Characteristics of the Best Prepared
Physician/ Hospital Integration	A highly aligned medical staff characterized by shared goals, outcomes-based contractual arrangements, significant planning input, and adequately represented in organizational governance
Care Coordination/ Management Capability	Use of care coordination tools and processes by an empowered and integrated workforce to meet performance goals that are regularly measured and reported
Information Systems Sophistication	An IT platform that supports clinical decision making, information management, facie communications, and access by all stakeholders (physicians, patients, administration) to proper treatment and strategic decision making
Service Distribution System Effectiveness	A rational service distribution system that has accessible primary care and easy access (both physically and through referrals) across the care continuum, delivered in contemporary facilities with contemporary equipment
Cost Management	A right-sized organization-wide cost structure, highlighted by appropriate levels of staffing, capital spending, overhead support, and supply chain costs; constantly reviewed based on comparative peer group studies and benchmarks
Scale and Market Essentiality	Sufficient scale to attract competitive clinical and administrative talent, realize economies, drive marketplace innovation, and be an essential provider to health plans and patients
Brand Identification	Well recognized and respected, associated with high-quality and service excellence.
Payor Relationships/ Contracts	Maintaining strong relationships with payors and the ability to negotiate support for "new era" business practices
Financial Strength/ Capital Capacity	Strong appeal to capital markets through sustained operations, revenue growth, and balance sheet strength

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Preparedness Assessment – How Are We Currently Positioned?

	<i>Unprepared Hospital</i>	<i>Emerging alignment, integration with medical staff</i>	<i>Economically-aligned medical staff; strong physician leadership</i>
Physician Integration	Unaligned, unintegrated medical staff; limited physicians in leadership	Emerging alignment, integration with medical staff	Economically-aligned medical staff; strong physician leadership
Care Coordination	Limited care protocol/ EBM adoption; lacking culture to support	"In progress" care protocol/ EBM adoption; variable cultural support	Extensive care protocol/ EBM adoption; culture to support
Information System Sophistication	No EMR, limited connectivity/ accessibility	EMR implementation plan in place; moderate connectivity/ accessibility	Sophisticated/ distributed EMR; IT platform in place/ operational
Balanced Service Distribution System	Poor primary care access extensive unnecessary service duplication	Adequate primary care access and/or limited service duplication	Highly accessible primary care; rationalized advanced care/ technology
Cost Management	Little focus on managing cost		Robust and on-going cost containment efforts
Scale/ Essentiality	Smallest in market; undifferentiated from competitors	Competitively positioned within market (size/ share); limited differentiation	Largest in market; differentiated from competitors
Payor Relationships/ Contracts	Activity based; limited ability to accept market innovation	Activity based; limited payer interest in innovation	Highly innovative market; strong participation in leading-edge contracts
Financial Strength/ Capital Capacity	Weak/ unsustainable financial performance; limited capital capacity	Moderate/ questionable financial performance; limited capital capacity	Strong/ sustainable financial performance; sufficient capital capacity
Composite Position	Weak		Strong

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How Ready Is the Industry for the New Era? *Some Observations from Kaufman Hall*

Observations and Lessons Learned (so far)

1. Self-awareness of an organization's current level of preparedness is critical to effective planning
2. Industry-wide preparedness varies, but leans toward "less prepared;" thoughtful planning will be critical
3. Scale and market essentiality are likely the most critical attributes of an organization on a go-forward basis
4. The current model is not sustainable for physician or many healthcare organizations
5. There are common, key attributes of successfully integrated physician organizations
6. Patient care coordination is in the emergent stage
7. Organizing and coordinating care beyond the hospital's four walls will be a major challenge
8. Many hospitals and health systems are not achieving a balanced service distribution system
9. In general, the industry is not really ready to accept risk
10. Cost management and financial performance management will be of (even more) importance

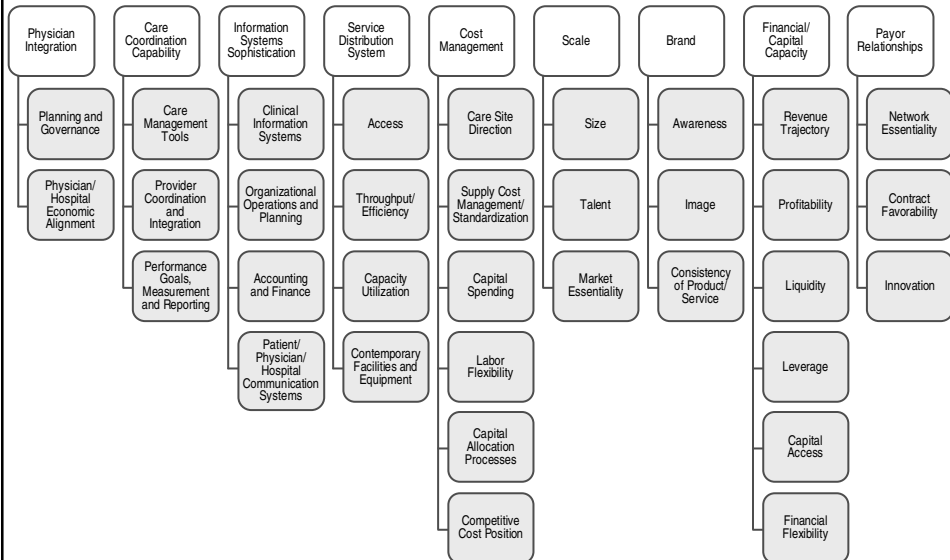
1. Self Awareness of an Organization's Current Level of Preparedness Is Critical to Effective Planning

Preparedness Assessment - How Are We Currently Positioned?

	Very Weak	Weak	Fair	Strong	Very Strong
Cost Competency					
Physician Hospital Integration					
Care Coordination/Management Capability					
Information Systems Sophistication					
Service Distribution System Effectiveness					
Cost Management					
Scale and Market Essentiality					
Payer Relationships/Contract					
Financial Strength/ Capital Position Capacity					
Marketing					

- Few organizations have an accurate understanding of how well prepared they are relative to future demands
- Preparedness is a function of **quantitative** and **qualitative** measures
 - **Quantitative:** financial position, throughput/ efficiency, cost competitiveness
 - **Qualitative:** “culture” of care coordination, “trust” amongst providers (hospital and physicians)
- Much of what has worked in the current operating environment (much of which as led to success for many organizations) will not work in the new era

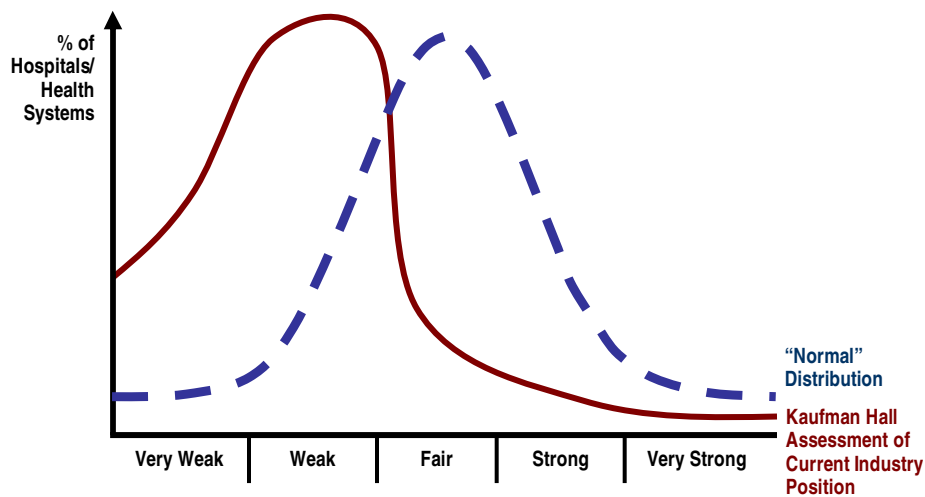
Measuring Readiness – Art and Science



2. Industry-wide Preparedness Varies, but Leans Toward “Less Prepared;” Thoughtful Planning Will Be Critical

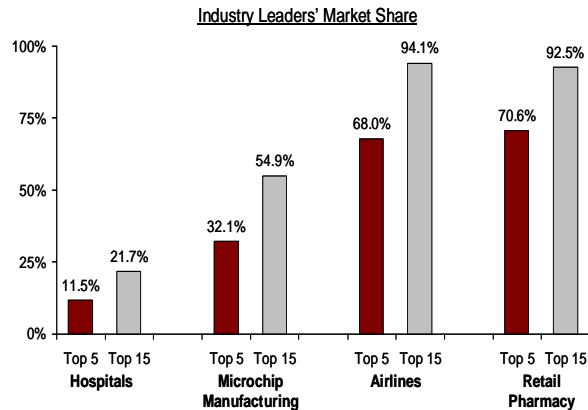
- “Innovators” who link quality and outcomes with financial reward are few in number
 - These organizations are significantly in the lead
 - Despite their progressivism, many of these organizations state that they have significant work to do for effective positioning
- Key areas of weakness/ focus identified
 - Physician alignment
 - Care coordination and service distribution
 - Scale and market essentiality

Current Industry Position vs. “Normal” Distribution



3. Scale and Market Essentiality Are Likely the Most Critical Attributes of an Organization on a Go-Forward Basis

- The hospital/health provider industry is highly fragmented
- Depth and breadth of intellectual capital is limited in most organizations
- Relatively few providers are essential beyond their core markets



4. The Current Model Is Not Sustainable for Physicians and Healthcare Organizations

Integration Matrix

Proactive	<ul style="list-style-type: none"> • Employment model (strategic) • Physician joint ventures • Clinical transformation/accountable care organizations • Service line management 	<ul style="list-style-type: none"> • Technology • Customer relationship management • Referring physician • Traditional managed care contracting
	Reactive	<ul style="list-style-type: none"> • Employment model (defensive) • Physician joint ventures • Gainsharing?
	Partner/Employ	Customer Service

- Employment will be more necessary but significant contractual arrangements will also be required
- Organizations making more rapid progress with physician alignment offer multiple points of entry
- Successful alignment will also require physician leadership at meaningful levels within the organization

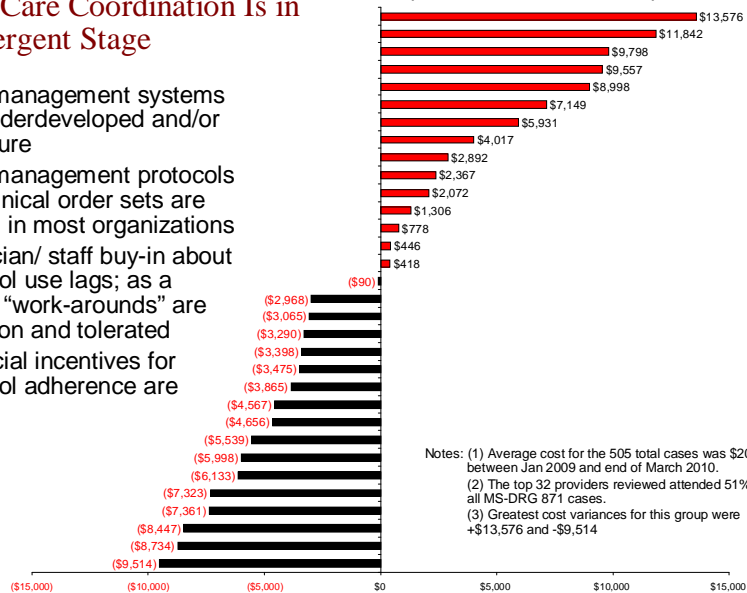
5. There Are Common, Key Attributes of Successfully Integrated Physician Organizations

- Strong physician governance and leadership across multiple constituencies
- Strong practice management base capabilities (i.e., revenue cycle, contracting, physician compensation models, etc.)
- Strong criteria for physician selection and continued participation
- Financial incentives tied to volume, quality of care and citizenship
- Significant investment in technology to enable all employed, faculty, and independent physicians to operate on a common platform (either directly or via interfaces)
- Adherence to strict quality guidelines

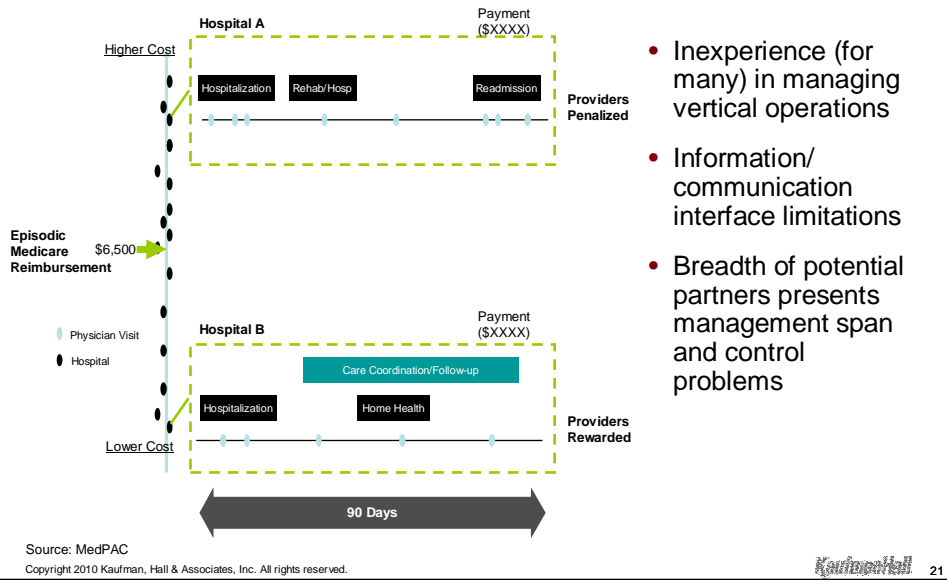
6. Patient Care Coordination Is in the Emergent Stage

- Care management systems are underdeveloped and/or immature
- Care management protocols and clinical order sets are limited in most organizations
- Physician/ staff buy-in about protocol use lags; as a result, "work-arounds" are common and tolerated
- Financial incentives for protocol adherence are limited

Cost per Case Variance for Septicemia Care



7. Organizing and Coordinating Care Beyond the Hospital Will Be a Major Challenge

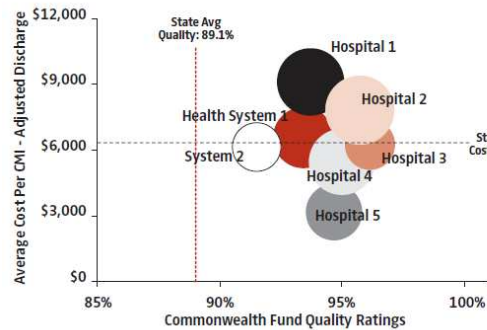


- Inexperience (for many) in managing vertical operations
- Information/communication interface limitations
- Breadth of potential partners presents management span and control problems

8. Many Hospitals and Health Systems Are Not Achieving a Balanced Service Distribution

- Inadequate preventative and primary care access
- Duplication of expensive technology/ resources
- Hospital-centric approach
- Inconsistencies in quality of facilities and equipment
- Lack of a “systems” approach to regional service distribution and delivery

9. The Industry Is Not Ready to Accept Risk



- Scale insufficiency to absorb normal variation
- Inconsistent care management approaches increase variation
- Lack of experience with risk management
- Some providers are beginning to proactively approach payors to share risk and begin the process of managing “value” – starting small

Note: Commonwealth Fund; Ingenix

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10. Cost Management and Financial Performance Management Will Be of (Even More) Importance

- There is significant interest in the near- and longer-term financial impact of health reform and broader industry changes, but few are completing detailed modeling work
- Delivering services at the lowest possible cost is a goal recognized by most organizations
- Despite aggressive efforts, there is still a long way to go in resetting the cost bar

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About Kaufman Hall

Kaufman Hall at a Glance

- Kaufman Hall provides corporate finance and corporate strategy services and related software analytical tools exclusively to healthcare providers
- Practice established in 1985
- Over 80 professionals in offices based in Chicago, Atlanta, Boston, Los Angeles, and San Francisco, with clients throughout the United States
- Senior-level consulting exclusively
- Service and product mix supportive of successful strategies and financial performance for healthcare providers
- Impeccable industry credentials
- AHA endorsed

What We Do

DEBT-RELATED FINANCIAL ADVISORY

Since 1985, Kaufman Hall has acted as financial advisor to more than 860 healthcare debt transactions. Total debt and swaps issued on behalf of our clients exceeds \$89 billion and \$42 billion, respectively.

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Introduced concept of strategic financial planning to healthcare field in 1983. Kaufman Hall has prepared financial and capital plans for over 800 hospitals and healthcare systems.

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STRATEGIC SERVICES

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