The Human Side of Affiliations and Consolidations – Part 1

May 8, 2014
Participants Will Learn

- Key features of affiliations and consolidations in 2014
- The benefits and limitations of affiliations
- Key considerations and common pitfalls of any arrangement
- The importance of physician alignment within the arrangement
- Developing your three-step action plan
Trends in Affiliations and Consolidations
Consolidation is Occurring Throughout Healthcare

Types Of Integration

<table>
<thead>
<tr>
<th>Vertical Integration</th>
</tr>
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<tbody>
<tr>
<td>Primary Care</td>
</tr>
<tr>
<td>Urgent Care</td>
</tr>
<tr>
<td>Ambulatory Procedure Center</td>
</tr>
<tr>
<td>Acute Care/Hospitals</td>
</tr>
<tr>
<td>Rehabilitation</td>
</tr>
<tr>
<td>Skilled Nursing Facility</td>
</tr>
<tr>
<td>Home Care</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Horizontal Integration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acute Care/Hospitals</td>
</tr>
<tr>
<td>Rehabilitation</td>
</tr>
<tr>
<td>Skilled Nursing Facility</td>
</tr>
<tr>
<td>Home Care</td>
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</table>
Hospital and Healthcare System Strategic Response

Hospitals and healthcare systems across the United States are evaluating their strategic options.

- **Multi-state Systems**
  - Market by market strategic assessment; portfolio analysis - invest, partner, divest, or swap
  - Clinical integration (“CI”) through physician alignment
  - Monetize non-core assets and re-deploy capital in markets with greater chance of success
  - Own or partner across continuum of care
  - Conversion to investor-owned

- **Regional Systems**
  - Assess market position, financial strength, scale, and forecast future performance
  - Consider wherewithal to be a consolidator or proactively approach most favorable partner(s)
  - Formation of “super regional” systems and explorations of joint venture (“JV”) strategies
  - CI through physician alignment
  - Conversion to investor-owned

- **Independent Stand-alone Hospitals**
  - Assess market position, financial strength, and forecast future performance
  - Approaching systems viewed as most favorable partner with skill, scale, share, and resources
  - Develop new regional systems with other independent hospitals
  - Leveraging a competitive partnering process to maximize value of assets and ensure most attractive terms
Consolidation in Physician Groups

- Average size of physician groups is growing
  - Average group responding to the American Medical Group Association ("AMGA") Physician Retention survey nearly doubled, from 164 to 248 physicians

- Physicians see traditional, independent practice model eroding

How do you believe reform will affect your private practice model?

- Will enhance its viability: 80%
- Will have little to no effect: 10%
- Will erode its viability: 10%

Hospital Consolidations on the Rise

- **1999-2009:** 597 mergers/acquisitions
  - Approximately ten percent of all U.S. hospitals
- **2007-2010:** Number of stand-alone community hospitals drops by 5.7 percent
- **2009:** An upward trend begins
- **2010:** A “transformative year”
  - Reform creating consolidation fever
  - Investor-owned companies cash-rich
- **2011–2013:** Consolidation and scale accelerates
  - Mid-sized hospitals wonder if they have scale
  - Large system transactions getting larger (Tenet/Vanguard and CHS/HMA)
  - Non-traditional relationships emerge

### Annual Hospital M&A Transactions

<table>
<thead>
<tr>
<th>Year</th>
<th>Deals</th>
<th>Hospitals Involved</th>
<th>Value (in Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>81</td>
<td>185</td>
<td>$14,349</td>
</tr>
<tr>
<td>2012</td>
<td>105</td>
<td>245</td>
<td>$2,273</td>
</tr>
<tr>
<td>2011</td>
<td>93</td>
<td>156</td>
<td>$8,305</td>
</tr>
<tr>
<td>2010</td>
<td>74</td>
<td>125</td>
<td>$5,485</td>
</tr>
<tr>
<td>2009</td>
<td>49</td>
<td>80</td>
<td>$1,992</td>
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</tbody>
</table>

Source: Modern Healthcare, Levin Associates
Multi-hospital Arrangements 1975 – 2013

By the Numbers

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td># of Systems</td>
<td>202</td>
<td>267</td>
<td>296</td>
<td>350</td>
<td>415</td>
<td>410</td>
<td>418</td>
<td></td>
</tr>
<tr>
<td>Hospitals in a System</td>
<td>1,405</td>
<td>1,796</td>
<td>2,542</td>
<td>2,716</td>
<td>2,868</td>
<td>2,921</td>
<td>2,941</td>
<td>3,100</td>
</tr>
<tr>
<td>% of US Community Hospitals</td>
<td>23.9%</td>
<td>30.8%</td>
<td>51.7%</td>
<td>55.0%</td>
<td>57.2%</td>
<td>58.3%</td>
<td>59.0%</td>
<td>62.0%</td>
</tr>
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</table>

Multi-Hospital Networks:

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Hospitals in a Network</td>
<td>N/A</td>
<td>N/A</td>
<td>1,285</td>
<td>1,455</td>
<td>1,490</td>
<td>1,485</td>
<td>1,508</td>
<td>1,508</td>
</tr>
<tr>
<td>% of US Community Hospitals</td>
<td>N/A</td>
<td>N/A</td>
<td>26.1%</td>
<td>29.5%</td>
<td>29.7%</td>
<td>29.7%</td>
<td>30.2%</td>
<td>30.2%</td>
</tr>
</tbody>
</table>

77.8% 84.5% 86.9% 88.0% 89.2% 92.2%

Systems: Corporate member and other ownership-based structures
Networks: Contractually-based arrangements

Source: American Hospital Association
What Is The Strategic Rationale For Partnering?

Common Strategic Drivers for Partnering

- Strategic Positioning
- Clinical and Quality Needs
- Operational Enhancement
- Financial and Capital Needs
What is Different NOW?

Increasingly Strategic, Not Financial Decision

- Positioning for population health
- Geographic diversification
- Service development, differentiation, and rationalization
- For-profit and private equity money is chasing hospitals
- Increased visibility for regional and national brands
- Enhanced physician alignment
- Infrastructure to support quality initiatives
- Expertise to support migration to quality/efficiency-based payment contracts
- Information technology investment requirements
- Mitigated risk
- Scale provides strength (economies of scale)
Current Configuration of Health Systems

- PCP Offices
- Urgent Care/FQHC
- Specialist Offices
- Post-acute Entities
- Behavioral Health
- Other Hospitals
Future Configuration of Health Systems
Three to Five Years
Must there Always be Winners and Losers?

Perceptions will Differ Among Parties

- Boards
- Executive team
- Management and employees
- Medical staff
- Community

- Scale of operations
- Financial performance
- Information technology
- Medical staff platform
- Facilities and infrastructure

- Scope and roles of hospitals
- Clinical programs
- Access points
- Quality scores
What Affiliations and Consolidations Can and Cannot Do
What Can Affiliations and Consolidations Do?

- Increase scale of healthcare enterprise
- Create system efficiencies
  - Staffing efficiencies
  - Non-salary supply and equipment pricing and standardization
- Enhance financial stability
- Provide additional access to capital
- Access to management talent
- Access to clinical talent
- Expansion of provider network and clinical skill sets
- Strategically position for population health
- Spread risk
- Enhances market position
- Create platform for clinical programmatic growth
The New Foundation: Pyramid for Success

- Quaternary
- Tertiary
- Community Hospital
- Surgical Specialists
- Medical Specialists
- Primary Care

Access Points
(UCC, FQHCs, ED, Health Plans, Physician Offices, Employer or Retail Clinics, etc.)

 Defined Population

<table>
<thead>
<tr>
<th>Commercial</th>
<th>CMS</th>
<th>Dual Eligibles</th>
<th>Medicaid</th>
</tr>
</thead>
<tbody>
<tr>
<td>HMO</td>
<td>ACO-MSSP</td>
<td>HMO</td>
<td>HMO</td>
</tr>
<tr>
<td>PPO</td>
<td>Pioneer ACO</td>
<td></td>
<td>Fee-for-Service</td>
</tr>
<tr>
<td>Direct to Employers</td>
<td>Medicare Advantage</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance Exchange</td>
<td>Bundled Payment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bundled Payment</td>
<td></td>
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</tr>
</tbody>
</table>
# Economies of Scale Opportunities

## Potential Integration Opportunities for an Integrated Enterprise

<table>
<thead>
<tr>
<th>Departmental Functions</th>
<th>% of Total Savings</th>
<th>Range of Potential Savings*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative</td>
<td>20%</td>
<td>$8 - 14 M</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>15%</td>
<td>$6 - 10.5 M</td>
</tr>
<tr>
<td>Support Services</td>
<td>10%</td>
<td>$4 - 7 M</td>
</tr>
<tr>
<td>Clinical Services</td>
<td>55%</td>
<td>$22 - 38.5 M</td>
</tr>
</tbody>
</table>

* Assumes $1 Billion Combined Enterprise Operating Budget

**Total Potential Savings:** $40 – 70 M

**Revenue Enhancements (TBD)**

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* Source: The Camden Group’s national experience
# System Integration and Operational Efficiencies Plan

## Assess Functional Areas Of Operational Efficiency

<table>
<thead>
<tr>
<th>Administrative Departments</th>
<th>Support Departments</th>
<th>Clinical Departments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Administration</td>
<td>Facilities Operations and Maintenance</td>
<td>Physician Practices</td>
</tr>
<tr>
<td>Financials Services (accounting, billing, finance, etc.)</td>
<td>Biomedical/Clinical Engineering</td>
<td>Emergency Department</td>
</tr>
<tr>
<td>Legal and Compliance</td>
<td>Food and Nutritional Services</td>
<td>Urgent Care</td>
</tr>
<tr>
<td>Medico-administrative Functions</td>
<td>Environmental/Housekeeping Services</td>
<td>Cardiac Services</td>
</tr>
<tr>
<td>Human Resources</td>
<td>Laundry and Linen</td>
<td>Surgical Services</td>
</tr>
<tr>
<td>Strategy/Marketing/Public Relations/Governmental Relations</td>
<td>Security and Safety</td>
<td>Endoscopy Services</td>
</tr>
<tr>
<td>Nursing Administration</td>
<td>Patient Transport</td>
<td>Central Sterilization</td>
</tr>
<tr>
<td>Purchasing/Materials Management</td>
<td>Mailroom and Print Shops</td>
<td>Clinical Staff Education</td>
</tr>
<tr>
<td>Information Technology</td>
<td></td>
<td>Psychiatry Nursing Units</td>
</tr>
<tr>
<td>Quality</td>
<td></td>
<td>Nursing Home</td>
</tr>
<tr>
<td>Business Development Office</td>
<td></td>
<td>Ambulance</td>
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<td>Clinical Resource Management</td>
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<tr>
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<td>Medical/Surgical Nursing Units</td>
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<td>Pharmacy</td>
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<td></td>
<td>Laboratory</td>
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<td>Physical Therapy/ Occupational Therapy/Speech Therapy</td>
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<td>Home Care Services</td>
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<td>Cancer Services</td>
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<td></td>
<td></td>
<td>Imaging (X-ray, CT, MRI, etc.)</td>
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<tr>
<td></td>
<td></td>
<td>Hospice</td>
</tr>
</tbody>
</table>

## Assess for Potential Opportunities

- System centralization
- Centralize/Consolidate management
- Co-location
- Staffing
- Standardize processes
- Coordinate policies, procedures
- Coordinate system-wide
- Centralize management and oversight structure
- Standardize policies, procedures
- Service improvement
- Coordinate system-wide
- Maximize existing capabilities, capacity, resources
- Eliminate inappropriate duplication
- Service rationalization
- Policies, procedures standardized
- Coordinate growth initiatives
Affiliation Myths and Reality

**Myths**

- Affiliations Will Not:
  - Provide immediate financial and/or quality improvement
  - Rescue an institution that is already failing
  - Maintain the status quo (for organizations or participants)
  - Cover up the “bad apples”

**Reality**

- Affiliations Will Require
  - Time
  - Extensive planning
  - Attentiveness to current and desired culture
  - Resetting strategic goals
  - Alignment of performance metrics
  - A willingness to compromise
  - Mutual accountability
Key Considerations and Common Pitfalls of an Arrangement
Key Considerations and Common Pitfalls

1. Aligned Expectations Before Going into Negotiations

- Common Pitfalls
  - Each party has not clearly defined their own vision and goals
  - Parties have not aligned their collective visions and expectations
  - Parties have divergent visions for the future at both the system-level, and the roles each hospital will play in that vision

- How to Succeed
  - Establish clear guiding principles for the transaction that define what the system will be and what it will not be
  - Gain board understanding and endorsement
Key Considerations and Common Pitfalls

2. Finding The Right Form To Find The Function You Need

- Common Pitfalls
  - Parties believe there is a standard form/structure for every transaction that will dictate the function
  - The structure of the transaction does not support the shared vision and guiding principles of the deal

- How to Succeed
  - Clearly define the system’s shared vision and guiding principles, and then work to establish a corporate structure and transaction

DESIGN IS
not just what
it looks like
design is how it
WORKS

- Steve Jobs
Key Considerations and Common Pitfalls

3. Understanding How The Affiliation Will Affect Your Brand

- **Common Pitfalls**
  - Each individual entity will maintain their independent brands forever and will not be affected by the deal
  - Hope that the hospital brands would go away immediately after

- **How to Succeed**
  - Systems must recognize brand transformation takes time
  - All parties must commit to the new brand and not allow for legacy outliers
  - Public perception and awareness of the individual brands will remain until a system brand has taken its place
Case Study: Heights Memorial

100,000 people

Heights Memorial

- 150 beds
- Private, secular
- 20% employed medical staff
- Government payer mix
- Quality issues

31 miles

Clooney Rock

- 60 beds
- Named after town founder
- Low CMI
- Independent medical staff
- Commercial payer mix
- Moderate quality
- High debt
- Aging plant
- 15 year administration

12 miles

All Saints

- 200 beds
- Catholic, national system
- Unionized
- Competing medical staffs
- Commercial payer mix
- High quality
Key Considerations and Common Pitfalls

4. Attaining External Buy-in At The Right Time And In Right Way

- Common Pitfalls
  - Transacting parties do not communicate to their external stakeholders
  - Parties do not adequately articulate the benefits an affiliation can offer the community
  - Parties say too much too soon (or) too little too late
  - Parties are not consistent in what they say

- How to Succeed
  - Understand the impact the transaction will have on both internal and external stakeholders
  - Develop a listing of local and regional officials, payers, regulators, and medical staff to meet with to discuss the potential affiliation or merger
  - Create a common set of message points and communication schedule, and follow them rigorously
Key Considerations and Common Pitfalls

5. Expectations For Time Frames

- Common Pitfalls
  - Parties expect the affiliation process to move rapidly
  - Parties anticipate that the benefits of the partnership will occur immediately upon the execution of the deal

- How to Succeed
  - The parties should jointly work with legal counsel and consultants to establish a realistic time frame for the transaction, and communicate it effectively to the necessary parties
  - Recognize that while some benefits occur immediately after transaction, most will take time and resources to achieve
6. Willingness To Make Sacrifices

Common Pitfalls

- Both organizations will look and feel the same way as they do today, while having all of the benefits of the affiliation as well
- Unwillingness to touch the “sacred cows”

How to Succeed

- Recognize that affiliations and mergers are designed to enhance the overall position of the system and its hospitals collectively, and the impact may vary between hospitals
- Highlight the shared vision as well as common goals and objectives of the affiliation, and how they had bearing on individual decisions
- Commit to transparency and equal treatment of all areas
Key Considerations and Common Pitfalls

7. Historical Ties To Individuals

■ Common Pitfalls
  ▸ He/she has performed exceptionally well within the hospital setting for years, so he/she will surely be a high performer at the system level
  ▸ Political ties

■ How to Succeed
  ▸ Positions should be filled by the most skilled individual available, whether internal or external to the system at the time of transaction
  ▸ Each role and the individuals that fulfill those roles should be re-evaluated based upon the system needs
8. Ignoring the Medical Staff

Common Pitfalls
- The medical staff should not worry, their lives will not change
- The medical staff will only slow the process down and may prevent it from occurring
- We can engage the medical staff after we sign the agreements

How to Succeed
- Engage the medical staff and understand the financial and operational impact the affiliation will have on:
  - Each of them
  - Their practice
  - Their specialty
  - Their department
  - The medical staff
Call to Action
Call to Action

- Start now
- Do the necessary analyses: SWOT, payer mix, revenue forecast, expense ratios, capital budgeting
- Engage your key stakeholders
- Get your house in order:
  - Operational efficiency
  - Clinical quality
  - Medical staff engagement / alignment
  - Strategic positioning
Next Webinar: Tuesday June 10, 2014, 12:00 P.M., EDT

- Key Objective
  - To present specific actions that your organization can take to be successful in discussions of affiliations and consolidations

- Participants will learn:
  - Case discussions of when things go wrong and what you can do to avoid them
  - Tips for engaging your key stakeholders
  - Avoiding the five pitfalls that sabotage success
Questions?
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http://healthcarecollaboration.com
**What Is The Strategic Rationale For Partnering?**

**Common Strategic Drivers for Partnering**

<table>
<thead>
<tr>
<th>Operational</th>
<th>Finance</th>
<th>Programs/Service Lines</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improved community access to care</td>
<td>Improvement in operating and financial performance</td>
<td>Quality enhancement</td>
</tr>
<tr>
<td>Enhanced access to payers</td>
<td>Reduction in infrastructure and overhead costs</td>
<td>Acceleration of strategic investments</td>
</tr>
<tr>
<td>Improved capabilities to support mission-driven services</td>
<td>Increased revenue opportunities</td>
<td>Key service line development</td>
</tr>
<tr>
<td>Enhanced position for healthcare reform</td>
<td>Better support investment in information technology</td>
<td>Strengthening of tertiary/quaternary referral base</td>
</tr>
<tr>
<td>Ability to attract and retain the best</td>
<td>Better support investment in physician infrastructure</td>
<td>Physician retention and recruitment</td>
</tr>
<tr>
<td>Management and board leadership</td>
<td>Improved access and lower cost of capital</td>
<td>Achievement of key volume thresholds for select subspecialty programs</td>
</tr>
<tr>
<td>Ability to attract philanthropic support and commitment</td>
<td>Increased capital capacity</td>
<td>Leveraging clinical talent and expertise</td>
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