Pine Trees and Blue H's: Pending Hospital Affiliations and the Performance Improvement Imperative

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Pine trees. Southern yellow pines, to be more exact. Driving down any rural stretch of interstate highway in the Southeast, one will undoubtably see acreage of southern yellow pines. This hardy genus is known for its strength, ability to dry rapidly, and receptivity to various chemical treatments, making the yellow pine a key element in a number of products ranging from paper to utility poles to residential construction.[1] Officials estimate that by 2020, the amount of timberland throughout the Southeast will have quadrupled since 1980.[2]

This tour of the southeast will include another common sight. The familiar blue "H" sign can also be spotted at intervals of 25 to 35 miles along the highway. These blue H's experienced their own period of rapid growth from 1948 to 1975 as generous federal assistance allowed communities to construct new hospitals to serve growing populations across rural and urban portions of the country.[3] Both phenomena, yellow pines and hospitals, were expanded and amplified via federal programs designed to encourage their growth.[4]

Generous federal programs lowered the costs of entry in these capital-intensive businesses. The result was an increase in the available supply of both hospitals and timberland across portions of the country. In the intervening decades, though, market forces in both the forestry and hospital sectors have evolved. The new challenges brought on by the dynamism of these forces have upended the assumptions that once provided a solid foundation for these time- and capital-intensive investments.

Changing Market Forces: Declining Demand for Inpatient Services and New Home Construction

Hospitals built 40 to 70 years ago were designed to provide longer-stay inpatient episodes of care. Technology, advancements in the health sciences, a focus on cost containment, and the transformation of payment for services have moved care out of the inpatient setting and increasingly outside of the hospital.[5] For southern timber, the housing crisis of the late 2000s depressed the demand for residential lumber as fewer new homes were constructed.

Figure 1. Cumulative Change in All-Payer Hospital Outpatient Visits & Inpatient Admissions, 2006-2015

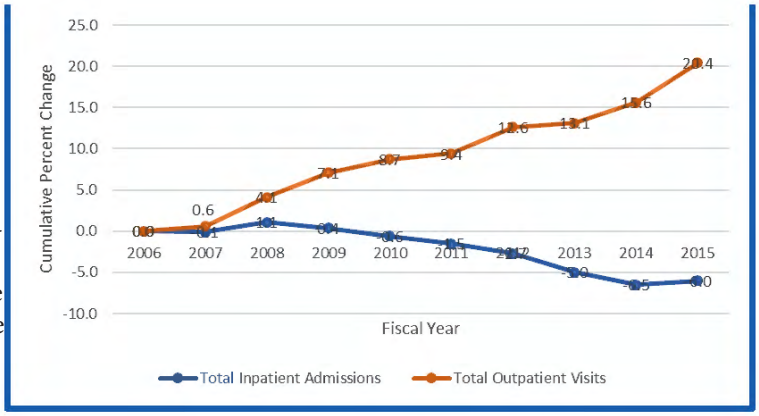


Figure 2. 2010 Census Urban and Rural Classifications and Urban Area Criteria

Areas	Number of 2010 Urban Areas	Population		Percentage of Total Population	
		2010	2000	2010	2000
United States	3,573	308,745,538	281,421,906		
Urban		249,253,271	222,360,539	80.7%	79.0%
Urbanized Areas	486	219,922,123	192,323,824	71.2%	68.3%
Urban Clusters	3,087	29,331,148	30,036,715	9.5%	10.7%
Rural		59,492,267	59,061,367	19.3%	21.0%
Note: Urbanized Areas of 50,000 people or more; Urban Clusters at least 2,500 and fewer than 50,000 people					

The Urbanization of America and the Closing of Lumber Mills & Hospitals

Based on the 2010 U.S. Census, less than twenty percent of the population in the United States lives in a rural area.[6] Over seventy-one percent of the population lives in "urbanized areas" of 50,000 or more people, up almost three percentage points from the 2000 Census.[7] This urbanization of America compounds the impact of the shift in care delivery from an inpatient to an outpatient setting. Similar to how the crash in demand for lumber in the late 2000s caused a number of lumber mill closures,[8] urbanization is now contributing to declining rural populations that make it harder to support rural hospitals.

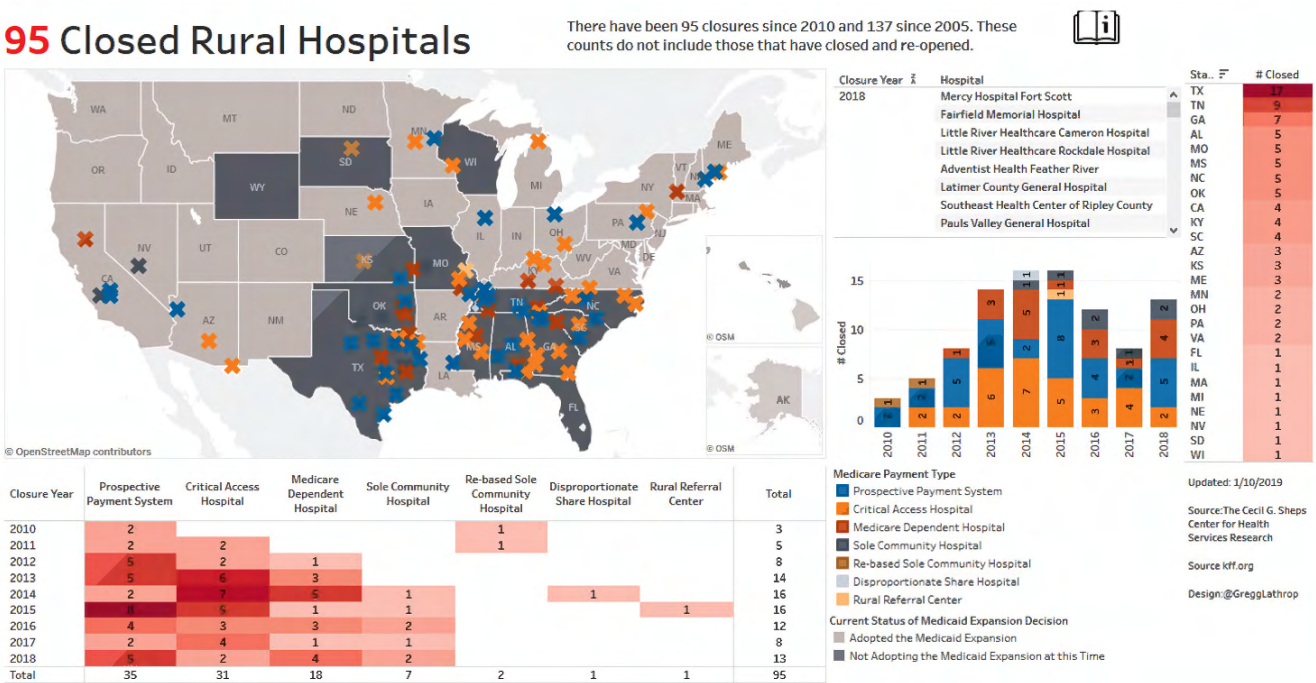
Reduced Reimbursement and Not Thinning the Pines

Just as delays in thinning out pine acreage can reduce the growth prospects of the entire timberland, hospital operators are confronted with declining reimbursement for services that hamper organization-wide growth prospects. These reimbursement declines are occurring on multiple fronts: greater prevalence of comparatively lower-paying federal health insurance programs, migration and/or collapse of private employers and their commercially insured plan members in rural areas, the move to high deductible health plans for remaining private employers, and policy decisions at the federal and state levels that have sharply reduced avenues and opportunities for government payments for indigent andreimbursement translates into a lower return on operations, which limits the hospital's ability to reinvest into other growth opportunities or maintain current operations.

Service Reduction, Alignment with Big Timber, or Closure

In the face of both the structural changes in how health care is being delivered (i.e., increasingly outpatient) and the demographic changes in the number and type of patients being treated (i.e., urbanization, aging rural communities, and impacts on a hospital's payer mix), many rural and small community hospitals have been forced to reinvent themselves over the past decade and a half.

Figure 3. Closed Rural Hospitals



Like the trend toward consolidation among southern mill owners and large timber companies, many hospital boards and leadership teams have faced difficult decisions around reducing services, aligning with larger health systems, or in more dire circumstances, suspending or closing the hospital.

Over the last several years, Stroudwater has worked with a number of rural and community hospitals that have faced these and other difficult choices. Often, the boards and leadership teams for these hospitals have sought to align with a larger health care system as a result of the market conditions that have made continuation under their traditional operating model difficult. For those hospital boards that elect to pursue an affiliation, vigilantly monitoring operating performance and assessing and addressing operational risk factors during the course of the affiliation are imperative to enhancing affiliation options and increasing the probability of a successful outcome.

Watching Out for the Pine Beetle: Maintaining and Enhancing Hospital Operations in Advance of a Pending Affiliation

Deals often fall apart due to the deteriorating operating performance of one of the parties during negotiations. Deteriorating operational and financial performance, like pine beetles, can spread across the organization and result in a dramatic adjustment to the economic value received at the transaction's closing. While it may be easy to assign a hospital's struggling operational performance to the fact that "everyone else is struggling," that reality does not remove the imperative to address the beetles inside the organization.

Checklist 1. When Should Performance Improvement Be Addressed During a Pending Affiliation?

- ☐ Significant departures from current year budgeted performance.
- ☐ Events that impact bond ratings, bond covenants, or other creditor commitments.
- ☐ Loss of key provider relationships or management resources.
- ☐ Proactively, to enhance economic value received at transaction closing.

The structural and demographic challenges that may have led the hospital's board and leadership to initiate such strategies do not vanish and are not suspended during the process of identifying a partner organization. Like a single southern pine that has turned amber red due to beetle infestation, certain triggering events can serve as clear indicators of increasing operational distress for hospitals that, if not addressed, can spread over the entire operation.

Like a good owner of timberland, hospital boards and leadership can proactively monitor the hospital's performance to prevent more systemic performance issues from emerging. These proactive measures enhance the probability of closing a transaction successfully and can potentially increase the economic value received at the transaction's closing.

Sorting the Poles from the Pulpwood: Realizing Early Wins & Improving Your Return at Harvest

For hospitals pursuing an affiliation but also experiencing financial and operational performance issues, hospital leadership should carry out those performance improvement opportunities that deliver the greatest speed-to-impact and represent early wins. To do so, it is important to know what options are available to the organization to quickly but effectively grow revenue in the short-term while longer-term revenue growth strategies can be developed.

Like towering pines that yield a larger return at harvest than gnarly trees best used as pulpwood, hospitals requiring enhancements to operating performance are well advised to focus initial performance improvement efforts on those subsets of initiatives that represent the largest potential for realizing an outsized return at harvest. Very commonly, health care organizations that need to quickly realize performance improvement can do so through addressing opportunities in the areas of revenue cycle and labor productivity and staffing practices.

✓ *Revenue Cycle and Business Office Management*

In almost every health care organization with which these authors have partnered, opportunities have existed for improving the organization's revenue recognition through focused efforts to enhance revenue cycle operation and business office management practices. Reviewing the hospital's chargemaster to ensure that prices are market competitive and properly indexed against Medicare rates is key to enhancing the organization's gross revenue and picking up additional dollars on net collections.

Similarly, reviewing charge code utilization is critical to prevent against lost revenue opportunities from errors in code utilization. Hospital leadership should have ready access to reports providing an account for how billing denials are being processed and adjudicated and how long patient accounts are sitting in receivables, relative to both internal and external benchmarks.

Checklist 2. Top 10 Considerations for Revenue Cycle Success[9]

- ☐ Set administrative expectations.
- ☐ Establish department-specific revenue cycle teams.
- ☐ Focus on the customer.
- ☐ Design and implement department-specific revenue cycle reports.
- ☐ Implement policies and procedures.
- ☐ Focus on your people.
- ☐ Establish a patient-centric defensible pricing strategy.
- ☐ Implement a proactive denial management program.
- ☐ Create a culture of quality and improvement.
- ☐ Audit, audit, audit.

***Example**: Performance Improvement and Revenue Cycle Enhancement Strengthens Affiliation Process*

This need to focus on restoring the integrity of the revenue cycle drove a $40M net-patient-revenue community hospital to retain Stroudwater to assist it in an affiliation process. When Stroudwater first began working with the organization, the hospital was losing between $300K and $700K per month and was on track to deplete cash reserves within six months. To assist it in both enhancing its affiliation prospects and stabilizing operations, Stroudwater performed an operational assessment that identified over $5M in performance improvement opportunities.

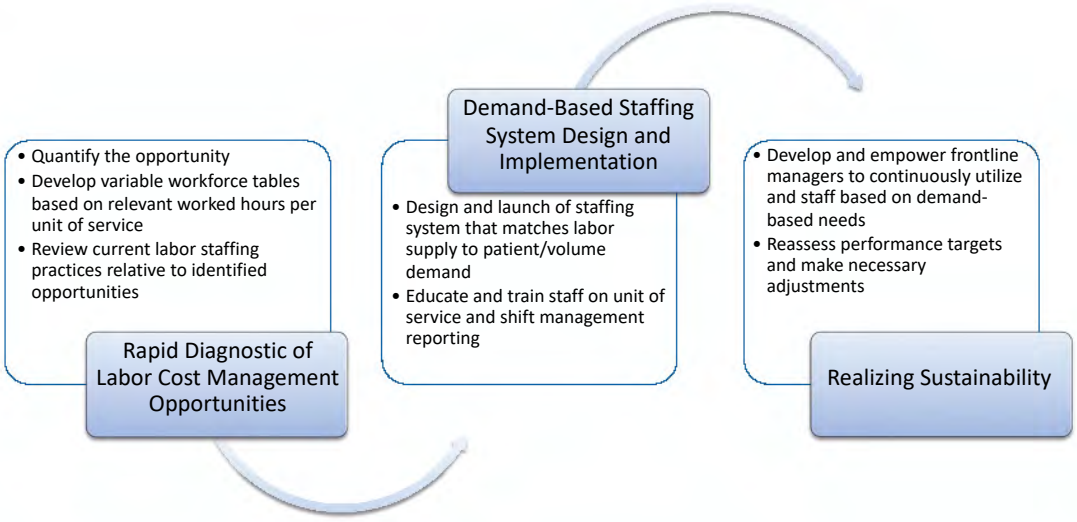
In partnership with the local leadership team and utilizing an interim revenue cycle director that Stroudwater provided to the organization, staff were trained in a more robust denial management process. Additionally, the hospital's chargemaster and code utilization files were reviewed. Improvements were made to the chargemaster, consistent within the constraints of the existing major commercial contracts. This initiative resulted in an annual net improvement of $3.7M to the organization. An additional $1.1M annual net revenue improvement was realized through review and correction of billing practices for operating room procedure codes.

Alongside multiple other performance improvement initiatives, the hospital was able to reach breakeven and profitability within a twelve-month period and build its cash position. Due to the hospital's improving operating profile, its affiliation process yielded stronger responses and has allowed the organization to secure an LOI with the largest not-for-profit health system in its state.

✓ *Labor Productivity and Staffing Practices*

For most hospitals and health systems, labor costs represent anywhere from fifteen to sixty percent of the organization's operating expenses. For health care organizations that need to realize performance improvement, managing staffing levels to match service demand or patient volume can represent a key opportunity for reducing labor expenses from ten to fifteen percent. This flexible or demand-based staffing model has the opportunity to provide health care organizations with immediate cost savings while simultaneously improving operational workflows and enhancing the patient experience.

Figure 4. Designing and Executing a Demand-Based Staffing System



To enhance labor productivity, hospital leadership should design and implement labor cost management systems that provide individual cost centers/departments with productivity targets. Realizing these productivity targets will require hospital leadership to provide front-line managers with the necessary tools and training that allow them to track and monitor staffing levels on a day-by-day, shift-by-shift basis. All too often, health care organizations wait to make adjustments to their staffing practices on a quarterly or monthly basis. Making staffing adjustments this far in retrospect falls far short of real-time labor cost management.

Key to the success of a demand-based staffing model is equipping and empowering front-line managers to own and sustain these enhanced labor practices across their units. Providing these managers with properly tailored management tools to capture and adjust staffing practices on a daily or shift-by-shift basis allows managers to begin making forward-looking staffing decisions informed by historic volume.

Checklist 3. Necessary Components to Realizing Enhanced Labor Cost Management

- ☐ Rapidly identify and quantify the performance improvement opportunity under a demand-based staffing system.
- ☐ Design, implement, and track the improvement of the organization's financial performance from utilizing a demand-based staffing system.
- ☐ Train and transfer responsibility for continued execution of demand-based staffing practices to frontline managers to ensure sustainability of results.

Productivity targets should be assigned that are based on the organization's previously achieved levels of productivity. In attempting to realize these previously achieved levels of productivity, operational barriers or limiting conditions are discovered that reveal inefficient designs or redundancies that create organizational waste.

Empowering frontline mangers and department leaders to lead functional teams in addressing and resolving these limiting conditions results in broad, organizational ownership of performance improvement and has the ability to positively transform the hospital's culture. These functional teams commit to addressing these limiting conditions and developing new intra-department practices, rooted in enhancing the patient experience.

Example: *Demand-Based Staffing Saved a Community Hospital $4.5M in 12 Pay Periods and Extended Runway for Sourcing a Partner Organization*

Stroudwater's staffing productivity specialists recently assisted a regional community hospital in the Southwest to address its need to better flex staff to service demand. This $100M-net-patient-revenue organization faced significant challenges in managing its labor force to meet declining patient volume. Working in partnership with hospital leadership and frontline managers, Stroudwater supported the organization in developing and implementing a rapid-cycle change process focused on controlling labor cost across 72 cost centers/departments.

Utilizing the Stroudwater Demand-Based Staffing System, hospital leadership, front-line managers and Stroudwater quickly identified and quantified productivity opportunities and implemented systems and management tools that allowed the organization to save $4.5M in salary costs within just 12 pay periods.

This $4.5M labor cost savings represented a 16% reduction in labor costs and 4.3% reduction in overall operating expenses. The ability to rapidly adjust staffing levels to match volume levels preserved critical fiscal resources and afforded the organization much-needed time to explore affiliation and partnership options.

Prescribed Burns: Removing Underperforming Operations to Support Overall Growth

One of the challenges that rural and community hospitals face is an attempt to be "all things to all people." Whether it is because the hospital has "always" provided a certain clinical service or because a new medical device is sold as a "must have" piece of equipment, hospital boards and leadership teams find themselves overseeing and managing specific clinical operations that may not meet the evolved health care needs of their communities. As a result, leadership teams may spend outsized amounts of effort on a small set of issues that ultimately do very little to address the long-term strategic objectives and growth opportunities of their organizations.

Just as prescribed burns can eliminate underbrush and a competing understory,[10] hospital boards and leadership teams should reexamine their operating platforms to ensure organizational resources are devoted to both services that represent critical community health needs and services that contribute to the organization's ability to sustain and grow operations.

Checklist 4. Attributes of a Successful Rural Community Hospital

- ☐ Foundational clinical and services requirements:
  - ☐ Community alignment
  - ☐ Personalized care
  - ☐ Provider alignment, emphasizing primary care, general surgery, and post-acute care
  - ☐ Highly utilized and competitively priced imaging and labs
- ☐ Market differentiation:
  - ☐ Not all things to all people
  - ☐ Service lines that address gaps in community health needs and offer attractive reimbursement

Example: *Critical Review of Operating Platform Allows Management to Focus on Growth and Secure Tertiary-level Clinical Partnership*

With declining operations and scarce human resources to support existing service offerings, a local community hospital in the Southeast recently engaged Stroudwater to help the organization evaluate its current operating platform. This assessment focused on evaluating opportunities to expand or change services delivered at the hospital given the changing demographics and health needs of the region.

To assist the hospital's leadership team, the organization's reinvestment needs relative to current operating performance were first quantified. This quantification of reinvestment needs provided the leadership team with a goal for measuring its overall performance improvement and allowed the leadership team and board to evaluate how each opportunity for expanding or changing the hospital's various service offerings would impact the hospital's ability to reach its identified reinvestment goal.

Working alongside the leadership team, Stroudwater evaluated over a dozen operating platform initiatives. These initiatives spanned a mix of contract modifications with service providers (clinical and non-clinical), new service lines and clinical equipment upgrades, enhancements in operational practices and modification of facilities, and provider recruitment.

This operating platform provided hospital leadership and the board with a critical opportunity to transparently evaluate the hospital's operations in the context of the organization's long-term strategic objectives and needs. From this assessment, the board and leadership were able to prioritize strategic capital investments, and the leadership team isolated necessary areas for improving the organization's operating performance. After several months of careful execution of these identified strategic and operational priorities, the hospital secured a clinical partnership with a tertiary-level regional health care system. With this partnership, the hospital is able to address a number of its long-term strategic objectives, including continued access to providers for its patients at its facility.

Example: *Changing Market Conditions and Inability to Reinvent Contribute to Hospital's Closure*

Unfortunately, delays in addressing changed market conditions and a reluctance to make necessary changes in operations can leave hospital leaders and boards with few options for realizing growth. Stroudwater recently evaluated a rural hospital that faced this reality. Over the prior decade, the hospital's medical staff dwindled to fewer than ten providers and its market share fell to less than two percent within its service area. Other regional health care facilities and providers had chipped slowly away at the hospital's market position, leaving the hospital entirely dependent on governmental subsidies to support ongoing operations.

In such a circumstance, the remaining viable strategic option to the hospital was to seek a partner organization immediately while simultaneously undertaking performance improvement. As a necessity, this performance improvement would require the hospital to suspend its inpatient unit and pivot operations to focus on outpatient operations, ambulatory care, and emergency medicine. The hospital's board deferred a decision to suspend inpatient operations and chose not to address other necessary performance improvement initiatives. Many months after both Stroudwater's delivery of its assessment and recommendations and the Board's subsequent deferral of decisions, it was announced that the hospital would close.

Preparing the Field to Yield: Invest into Value-Adding People and Processes

The boom in reforestation across the Southeast arose, in part, as legacy family farming operations—primarily, livestock and roadside crops—became costlier and more difficult to operate on a smaller scale.[11]

As these family farmers made the transition to pine plantation owners, varying strategies were available to transition legacy pastureland and fields into pine groves.[12] While natural reforestation provided a lower cost option for transitioning existing acreage into pine tree farms, those natural groves took longer to mature and lacked the established lanes that came with manually planted farms. While manual planting increased operating costs, the process resulted in higher yielding acreage that reached maturity in a shorter period of time.

Checklist 5. Guiding Principles for Realizing Performance Improvement

- ☐ Utilization of experienced turnaround operators to improve speed to impact.
- ☐ Quantification and prioritization of initiatives.
- ☐ Effective communication with stakeholder groups to instill confidence and preserve volume.
- ☐ Aligning performance improvement efforts with enhancing clinical quality and the patient care experience.
- ☐ Access to a flexible set of resources to fill critical resource gaps.
- ☐ Establishing processes that ensure the long-term sustainability of present initiatives.

Similarly, an affiliation process represents a significant investment of the hospital board and leadership's time and attention. The demands placed on both the board and the hospital's leadership in ensuring that an affiliation process is run effectively represent an additional set of responsibilities for the board and leadership outside of their standing commitments to organizational oversight and day-to-day operations and strategy, respectively. With deal terms like "Material Adverse Change" looming large in the background, it becomes critical that hospital boards and leadership ensure that proper resources are being devoted to support the ongoing or enhanced performance of the organization.

Hospitals or health systems exploring partnership options and facing challenges in operating performance need access to experienced practitioners who can quickly assist the organization in correcting financial performance. Ideally, these practitioners should have a track record of performance, reflecting extensive experience in financial and operational performance improvement. These practitioners are not a substitute for existing hospital leadership; rather, they are critical partners who will assist the hospital in more quickly realizing its available performance improvement opportunities.

Most importantly, all aspects of the organization's performance improvement efforts must be rooted in enhancing the patient experience and improving clinical quality. Such a focus is consistent with the performance improvement effort with the long-term interest of the organization and ensures that the outcome aligns with the hospital's mission.

Leaving a Legacy that Supports Future Generations

While the motivations that led family farmers, commercial enterprises, and institutional investors to become owners in pine tree plantations are varied, the long maturity cycle on southern pines (25 to 35 years) typically means that those who planted these trees did so for the benefit of the next generation. In this way, pine tree farms and hospitals provide an opportunity to support multiple generations if they are well tended and well led.

When hospital boards and leadership teams view their positions as stewards of key community assets, it becomes clear that the management and governance of these organizations are not activities undertaken for personal benefit or public accolade. Rather, stewardship requires hospital boards and leadership to balance the immediate challenges and constraints against the impact on future generations. Proactive, prudent actions to address risks and realize opportunities, as detailed throughout this article, often make the difference between long-term success and a compromised and diminished future. ◆

Endnotes

1 The Southern Pines: An American Wood, United States Department of Agriculture Forest Service (available https://www.fpl.fs.fed.us/documnts/usda/amwood/256spine.pdf).

2 See Dezember, Ryan "Thousands of Southerners Planted Trees," The Wall Street Journal, October 9, 2018 (available https://www.wsj.com/articles/thousands-of-southerners-planted-trees-for-retirement-it-didnt-work-1539095250).

3 Chung, Andrea Park, Martin Gaynor, Seth Richards-Shubik, "Subsidies and Structure: The Lasting Impact of the Hill-Burton Program on the Hospital Industry," National Bureau of Economic Research, Working Paper 22037 (Feb 2016) (available https://www.nber.org/papers/w22037.pdf) (citing the impact of the Hill-Burton program in increasing access to inpatient health care services across the country, especially rural counties and the South).

4 See Dezember (noting the impact of federal programs in the 1980s designed to encourage reforestation of exhausted farmland).

5 Ironically, this movement from inpatient to outpatient care can be seen as early as 1972, near the end of Hill-Burton program. See Davis, Karen and Louise B. Russell, "The Substitution of Hospital Outpatient Care for Inpatient Care," The Review of Economics and Statistics, Vol. LIV Number 2 May 1972 (available at https://www.jstor.org/stable/1926271?read-now=1&seq=1#page_scan_tab_contents) (beginning with "The rising cost of inpatient hospital care has generated considerable interest in the possibility of promoting the use of outpatient care as an alternative to hospitalization.")

6 See Measuring America: Our Changing Landscape, United States Census Bureau, Dec 6 2016 (available at https://www.census.gov/library/visualizations/2016/comm/acs-rural-urban.html).

7 See generally 2010 Census Urban and Rural Classification and Urban Area Criteria, United States Census Bureau (available https://www.census.gov/geo/reference/ua/urban-rural-2010.html).

8 See Dezember.

9 Stroudwater Revenue Cycle Solutions (available in detail at http://www.stroudwater.com/wp-content/uploads/2017/03/Top-Revenue-Cycle-Considerations.pdf).

10 See Gordan, Dr. Jason S. "When Will a Prescribed Burn Help My Pine Stand?" (revised) Mississippi State University Extension Service (2016) (available https://extension.msstate.edu/sites/default/files/publications/publications/p2262_0.pdf).

11 See Dezember (noting the impact of the 1980s farm crisis on agricultural commodity prices and the federal payments provided to farmers to plant acreage in trees or grasses).

12 See Hatch, Nathan S., Becky Barlow, John S. Kush, "Uneven-aged Management of Longleaf Pines: An Often Overlooked Option for Landowners," Alabama Cooperative Extension Service (Dec 6 2018) (available https://www.aces.edu/blog/topics/forestry/uneven-aged-management-of-longleaf-pine-an-often-overlooked-option-for-landowners/) (noting, among other options, natural self-perpetuating forestation and artificial regeneration through structured planting).

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