STROUDWATER

# COMMUNICATING THE **RURAL VALUE PROPOSITION TO PROSPECTIVE PARTNERS**

For any rural hospital or health system evaluating its affiliation options, it is critical to ensure that prospective partners understand the unique attributes and value that they can bring as an affiliate to prospective partners. In our experience as a national and rural healthcare advisory practice, we have seen prospective partners fail to understand the value drivers of rural provider organizations to a larger health system. We have seen sophisticated, well-run, billion-dollar health systems suboptimize the organization and designations of their rural delivery systems and miss out on millions of dollars in annual revenue. Happily, we have also helped clients steer clear of prospective partners that do not understand or appreciate the unique value proposition of rural healthcare delivery systems.

The systemic failure to appreciate the value proposition of rural affiliates is a scenario that our clients face all too frequently. Unfortunately, the result can be fewer partnership options, disadvantageous affiliation terms, and chronic underinvestment in rural affiliates post-affiliation. Rural hospitals and health systems must vet potential partners to make sure they understand the unique value drivers of rural healthcare affiliates for larger health systems and have a record of harnessing those opportunities to improve healthcare delivery in rural communities.

Regrettably, not all potential partners can appropriately assess the value proposition of a rural affiliate to their health system. Undervaluing prospective rural affiliates can be the result of a lack of experience and expertise, a product of strategic misalignment or competing priorities, or the unfortunate consequence of a national narrative that is too monolithic in its negative outlook for rural America. Regardless, it is imperative for rural boards and their prospective affiliation partners to understand the unique value proposition that rural affiliates can bring to larger health systems.

# HOW TO BEST ENSURE PARTNERSHIP TERMS REFLECT YOUR VALUE

We find that designating a special or existing strategic planning committee of the board to work with senior management and an advisor on affiliation questions is a very effective approach. The entire board should be regularly updated and convened at key decision points during the process, including the decision to explore affiliation options, selecting finalists, selecting a preferred partner, approving a non-binding letter of intent, and approving definitive agreements.

**Below are steps that will help boards ensure their partnership terms are favorable for their rural hospital or health system:**

### Conduct an affiliation options process so you can compare offers and terms:

- Insist that prospective partners educate themselves and earn the right to be your partner.
- Ensure that your board has the information they need as fiduciaries to make an informed decision on the future direction of healthcare in your community by comparing competing proposals.
- Assess how knowledgeable prospective partners are regarding rural healthcare delivery.

### Vet prospective partners' track records with their rural affiliates:

- Do they have rural affiliates?
    - If so, what strategies have they employed at their rural affiliates?
- How have their rural affiliates performed pre- and post-affiliation? Key aspects to examine include market share trends, revenue and volume trends, quality results, state of the medical community, and capital reinvestment rates.

### Evaluate whether prospective partners understand and value the unique opportunities and challenges of rural healthcare delivery:

- Do your prospective partners understand the value available via home office cost allocation for CAH affiliates?
- Do they appreciate the opportunity that CAHs have related to the 340b program?
- Do they have any experience with rural health clinics and do they understand how to leverage this designation?
- Have prospective partners evaluated and optimized the designations and organization of their existing affiliates?
- How well do your prospective partners understand the operational and financial intricacies of cost-based payment? Do they have expertise in operating swing bed programs?
- To what degree have your prospective partners demonstrated an ability to develop sustainable operating models at their rural affiliates, configure facility investment programs tailored to rural healthcare delivery, create new referral channels, and expand access to services by leveraging clinical resources of the partner?

**Make sure you have an advisor that is well-versed in these opportunities and can quantify the potential benefits to prospective partners. Your advisor should:**

- Be able to educate prospective partners on these opportunities.
- Be an expert in rural operations and finance. This is essential to helping prospective partners understand they must incorporate these value drivers into their proposals and evaluate the quality of affiliation proposals.
- Understand the nexus of affiliation structures and the above-referenced opportunities, as not all affiliation structures can unlock each of the value drivers.
- Have expertise in helping large systems and rural hospitals optimize their operating models for cost-based payment, if applicable. Incorporating cost report and cost-based reimbursement considerations into the affiliation structure and post-affiliation operating model is critical.

**Remember that partnering is not a risk-free endeavor. It is essential to take appropriate steps to mitigate partner risk:**

- Select and vet a strategically aligned partner.
- Choose a structure that fits your strategic objectives and constraints.
- Craft contractually enforceable terms. Avoid weasel words like “intends to” or “commits up to $X.”

**Don’t delay exploring a partnership. Rural hospitals and health systems that explore partnering options from a relative position of strength will garner more interest and receive stronger proposals than organizations that wait until they must find a partner:**

- Delay consumes value. Reserves are burned up by cash flow losses, investment is deferred, and uncertainty and drift make it more difficult to recruit and retain top talent. All this can result in a depleted balance sheet and erosion of market position.
- For many potential partners, a prospective partner that requires a turnaround is a red flag. It requires two types of scarce resources (management time and cash) with an uncertain ROI. Given competing priorities, they may pass.
- If your operating results are poor, define an operational improvement plan to change the trajectory of the organization. By showing improvement and demonstrating that management is working on a credible plan, your story and value are significantly improved.

# EXAMPLES FROM THE FIELD

## Case Study A Mistake Averted

A distressed critical access hospital (CAH) had a preferred affiliation candidate identified and a signed letter of intent when they approached Stroudwater for assistance because the affiliation process was stalled. It quickly became apparent that their preferred partner—a large regional referral center—did not understand the value proposition of having a CAH as part of their health system and was uncertain of how to proceed. The partner had no rural affiliates and no experience with rural healthcare delivery. Stroudwater recommended that the client conduct a process to evaluate a broader selection of affiliation options alongside their preferred partner. During that process, Stroudwater educated all interested parties as to the unique value proposition of having a CAH affiliate (home office cost allocation, rural health clinics, 340b eligibility, swing beds, etc.). During that process, an alternative preferred partner emerged that had previous experience with distressed rural hospitals, a track record of successful turnarounds, and expertise in operating rural affiliates. While the initially preferred partner was unable or unwilling to grasp the value of a rural affiliate, this health system had already evaluated and quantified the benefit. Our client vetted its options and selected the newly identified partner based on its expertise, track record, and the quality of the terms of its proposal.

## Case Study A Troubling Track Record Discovered

Stroudwater was retained to help a rural affiliate evaluate its affiliation options. During the process, our client received multiple competing proposals. One of the leading proposals was from a natural referral partner, a leading not-for-profit system in the region. This prospective partner was highly regarded and had multiple rural affiliates. They spoke convincingly of their commitment to their rural affiliates and the rural communities they served. As part of our due diligence process for finalist candidates, Stroudwater examined the pre- and post-affiliation performance of the rural affiliates of each finalist. Surprisingly, every rural affiliate of this finalist had a significant drop-off in market share post-affiliation. This track record was not consistent with the values and approach that they had shared with our client. In each instance, this prospective partner was able to identify the underlying cause of the market share decline; what they could not explain was how to reconcile their rhetoric with their reality across all these communities. Fortunately for our client, the other finalists had experience that better matched their rhetoric, and our client was able to select a preferred partner with an excellent performance history of investing in and enhancing their rural affiliates.

## **Case Study** A Win-Win

A large CAH with a significant employed provider base was experiencing several years of deteriorating operating results. Poor operating cash flow jeopardized needed investments in technology, facilities, and services. Stroudwater was engaged to assess strategic options and provide the board and medical staff with an options analysis that quantified performance gaps and strategic options. Upon review of the options analysis, the board and medical staff agreed to evaluate affiliation options. Our client received multiple proposals from prospective partners. The prospective partners were vetted, with proposals clarified and improved via a negotiation process. The board identified its preferred partner as a natural referral partner with an excellent history at its rural affiliates, including the introduction of new clinical programs, investments, and increased clinical coordination and management resources. The preferred partner's proposal specifically addressed the needs and constraints of the hospital, including commitments to invest in technology, services, and facilities. These commitments were secured as part of asking finalists for term sheets detailing their proposals. After the affiliation, needed investments in the CAH were completed and clinical programs and the medical staff received a boost via education, training, and clinical integration opportunities with the new partner.

These examples reveal the opportunity and downside risk that rural affiliations pose. An affiliation between a rural hospital or health system and a larger partner is a once-in-a-generation decision. It is vital for the community and the organization that the preferred partner understand, and appropriately value, rural affiliates. If a prospective partner does not initially understand the value proposition of the rural affiliate, your advisor must be sufficiently expert to educate them. Our experience suggests that many prospective partners do not have sufficient rural expertise to understand and quantify the value that a rural healthcare system can bring. Following the above steps and ensuring your organization has an advisor well-versed in the unique financial and operational constraints and opportunities of rural healthcare delivery are essential to a positive outcome for your community and organization.


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