



# STROUDWATER

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## PERFORMANCE IMPROVEMENT AND STRATEGIC OPTIONS: KEY CONSIDERATIONS AND SUCCESS FACTORS

# MEET THE SPEAKERS

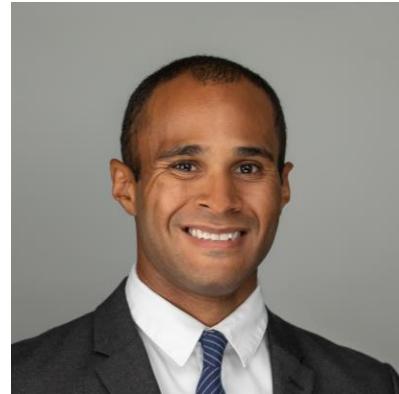


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Stroudwater is a leading national healthcare consulting firm specializing in mission-critical strategic, operational, and financial opportunities for healthcare leaders' most pressing challenges





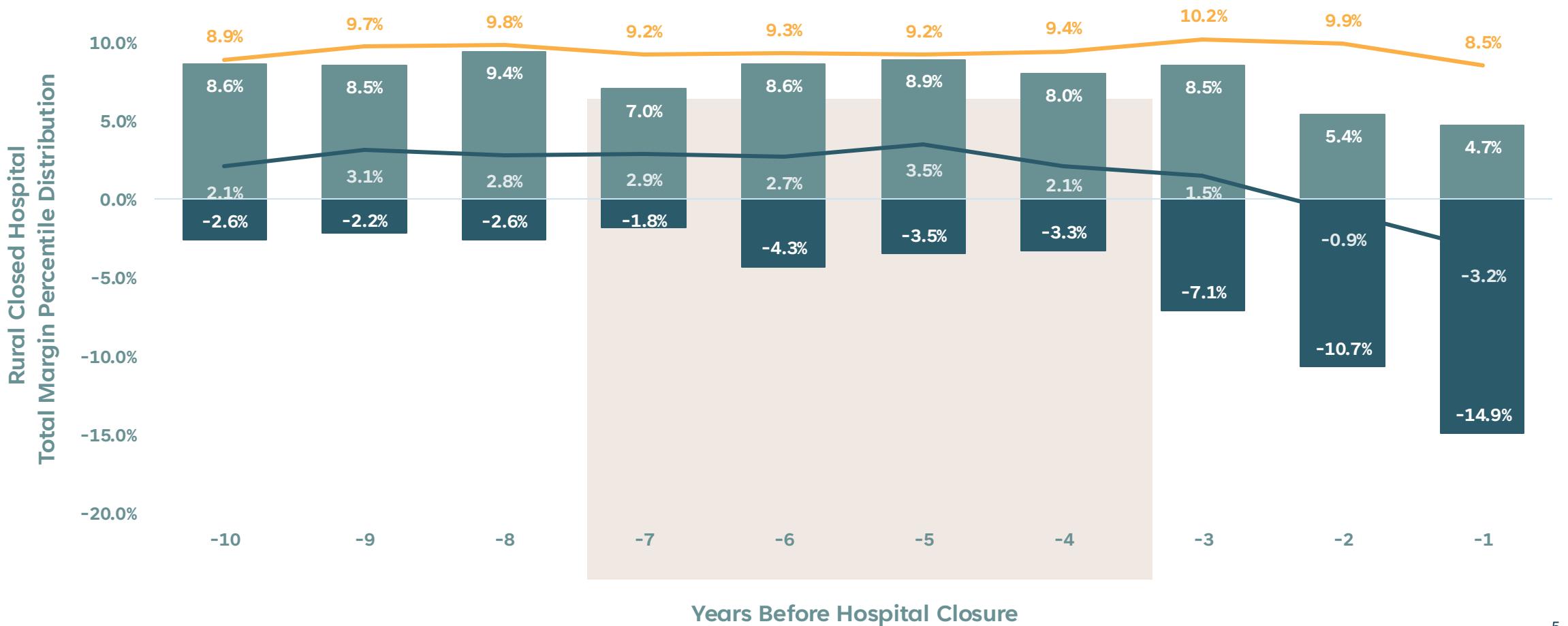
# WHY PERFORMANCE IMPROVEMENT MATTERS

# POLLING QUESTION 1



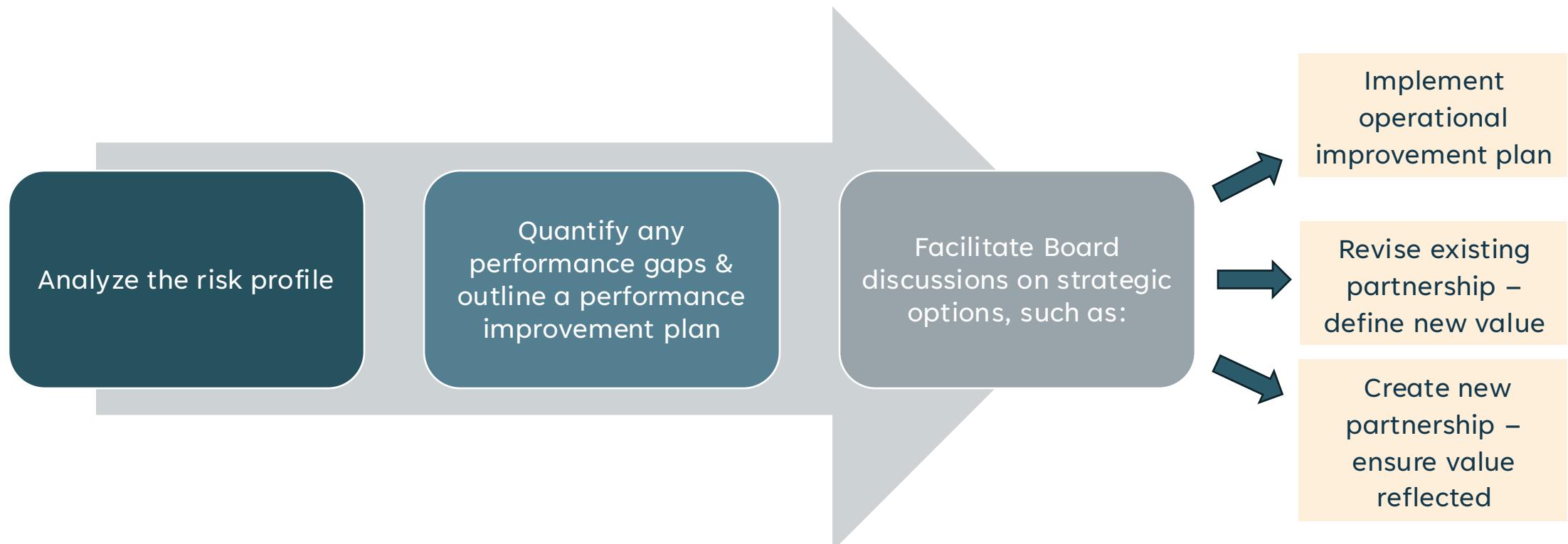
# RURAL HOSPITAL TOTAL CASH FLOW MARGIN - CRITICAL ACTION ZONE CLOSED VS. OPEN HOSPITALS

- The years between -8 and -4 years prior to rural hospital closure become a critical action zone
- The realities of data lag availability require best served organizations to actively manage multi-year trends, including cash flow
- Waiting to act on declining trends reduces latitude to maneuver and increases the magnitude of required turnaround



# KEY POINT: SOUND OPERATIONS UNDERPIN ALL OPTIONS

**When we discuss strategic options with a rural client, we focus on mitigating strategic risks. Sound operating results are foundational to those efforts, regardless of the strategic option selected. From there, we can evaluate strategic options to determine the right strategy for the organization's risk profile.**



# COMMON PERFORMANCE IMPROVEMENT INITIATIVES

Key areas to examine for potential performance improvement opportunities include:



Revenue Cycle Improvement



340B Enhancement



ED Optimization



Cost Report Optimization



Swing Beds



Clinic Designation Strategy



# PERFORMANCE IMPROVEMENT INITIATIVES: KEY AREAS TO EXPLORE

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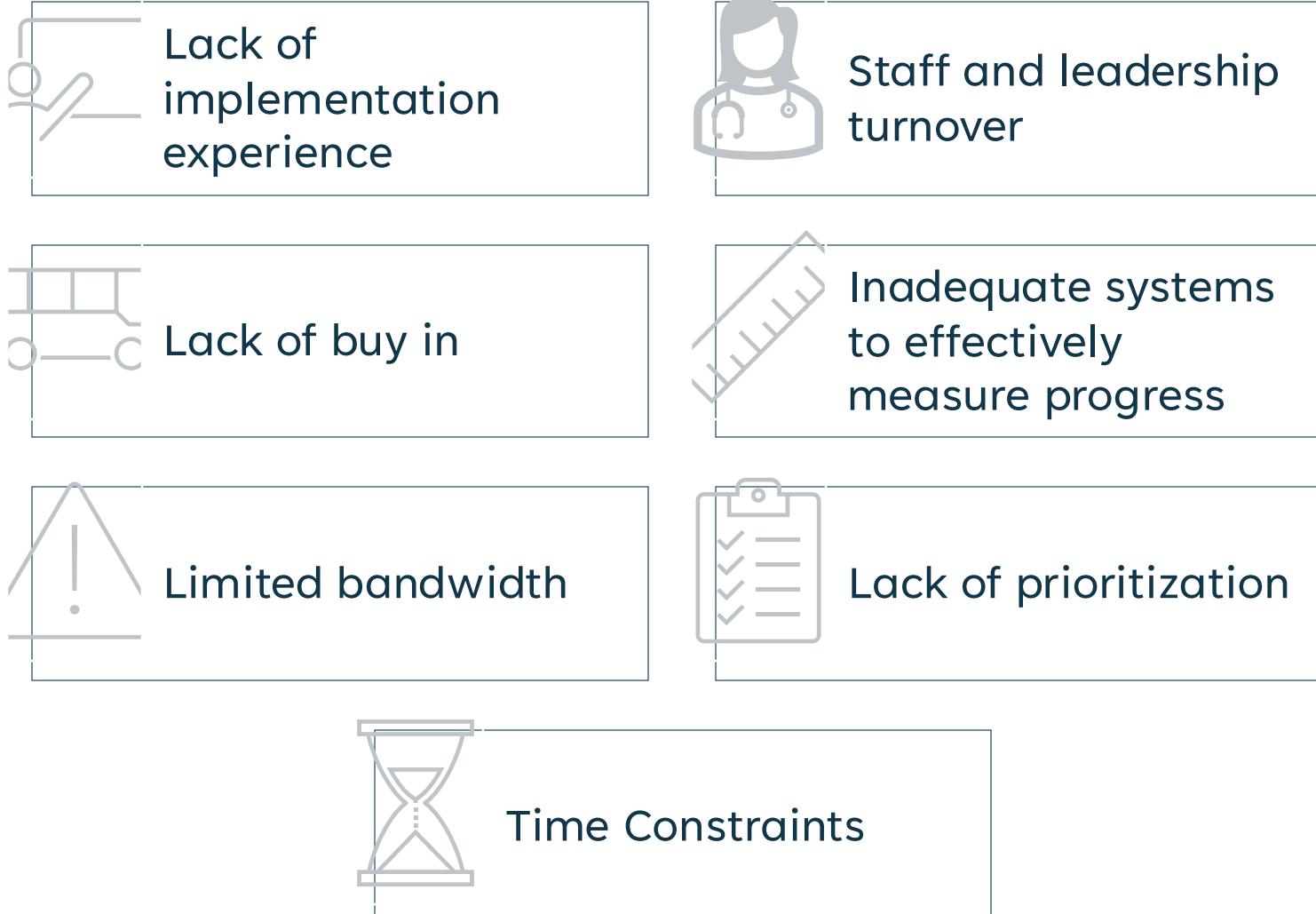
<b>Revenue Cycle Improvement</b>	Establish a Key Performance Indicator (KPI) measurement system, setting targets for all KPIs and implementing strategies to meet targets (i.e., establishing a “measurement culture”)
<b>340B Enhancement</b>	Maximize 340B benefit: track pharmacy capture rate, evaluate contract pharmacy opportunities, evaluate outpatient clinic designations, etc.
<b>ED Optimization</b>	Partner with providers and hospital staff to improve ED throughput and patient experience, recognizing it as one of the “front doors” to the hospital/health system
<b>Cost Report Optimization</b>	Ensure Medicare cost report accurately reflects operational reality
<b>Swing Beds</b>	Elevate the development and promotion of the swing bed program as a strategic priority
<b>Clinic Designation Strategy</b>	Evaluate alternative designations for existing clinics; there may be opportunity to realize additional financial benefit and improve patient care



# POLLING QUESTION 2



# BARRIERS OR CHALLENGES TO IMPLEMENTING PERFORMANCE IMPROVEMENT INITIATIVES



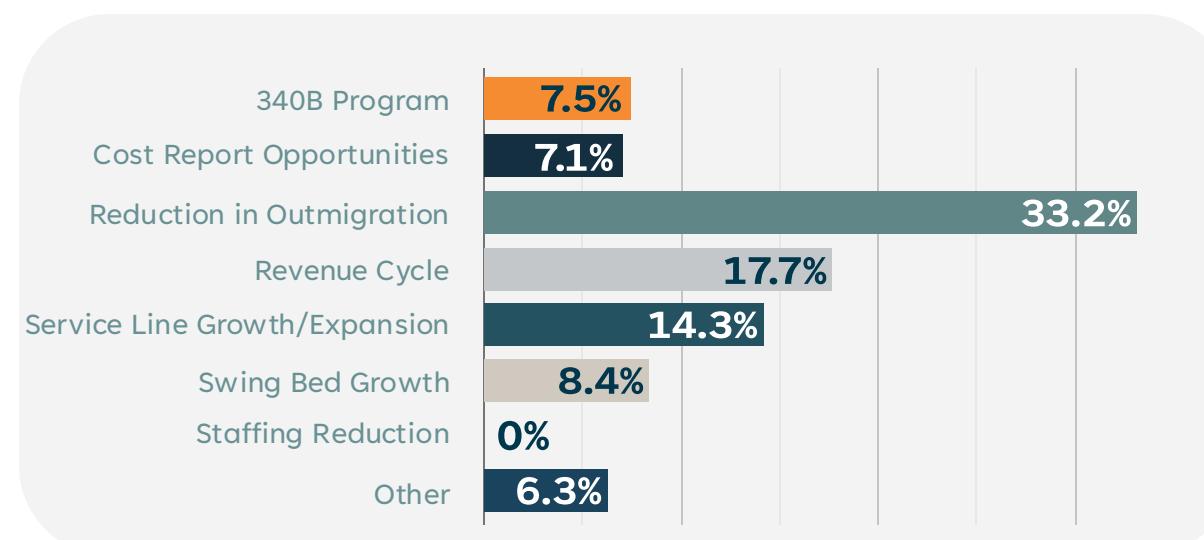
# RISK MITIGATION VIA IMPROVED PERFORMANCE

- Nearly 30 rural performance improvement projects led by Stroudwater over 30 months delivered a median of \$1.7M in financial improvement per organization, equating to nearly 8% of net patient revenue per organization

<b>Total Estimated Impact</b>	
25th	\$ 1,300,000
Median	\$ 1,700,919
75th	\$ 3,727,000

<b>Impact % of Net Pt Revenue</b>	
25th	4.1%
Median	7.8%
75th	11.1%

- These engagements spanned an array of functional areas, with the average share of total improvement realized broken out as follows:





# HOW PERFORMANCE IMPROVEMENT CAN IMPACT STRATEGIC OPTIONS

# VALUE LEVERS FOR RURAL HEALTH SYSTEMS IN EXISTING OR POTENTIAL PARTNERSHIPS



- If the organization elects to explore partnership options while pursuing performance improvement initiatives, there are various value levers that can be estimated and tend to be undervalued by both existing and potential partners:
  - *Reimbursement methodologies*
  - *Home office cost allocation*
  - *Leveraging sites of service*
  - *The value of attributed lives and a primary care base that is cash flow positive*
  - *The “true” value of incremental referrals*

**These value levers, combined with performance improvement initiatives, can change the financial profile of an affiliate to a partner**



# THE IMPACT OF VALUE LEVERS

## Advantageous reimbursement methodologies

- Cost-based reimbursement if rural hospital is a CAH along with 340B and ability to convert some clinics to RHCs

## Estimated home office cost allocation

- A cost-sharing methodology that may allow a partner to transfer overhead costs incurred for providing administrative services to a CAH, which would allow for enhancements to cost-based reimbursements for a CAH and a reduction in expenses for the partner

## Leveraged sites of service

- Lower acuity patients can remain closer to home, preserving partner hospital beds for higher acuity patients
- For example, utilizing a CAH as a relief valve for swing bed patients to refer patients finishing an acute stay in need of post-acute care could:
  - Free up an occupied bed for the next complex acute patient
  - Reduce variable costs of care incurred from keeping patients longer under DRGs

## The value of attributed lives and a primary care base that is cash flow positive

- Access to additional covered / attributed lives as well as an enhanced primary care base which serves as the backbone for many rural hospitals

## The “true” value of incremental referrals

- Estimated contribution margin benefit based on a change in referral patterns due to the partnership



# POLLING QUESTION 3



# COMMON STRATEGIC OPTIONS

Option 1	Option 2	Option 3
<b>Remain Independent and Pursue Performance Improvement Initiatives</b>	<b>Pursue Performance Improvement Initiatives and Explore Strategic Partnership Options with Value Levers</b>	<b>Pursue Performance Improvement Initiatives in an Existing Partnership with Value Levers</b>
<b>Benefits</b> <ul style="list-style-type: none"><li>Enhanced operations and market position through focused performance improvement initiatives</li><li>Operational improvements to generate improved cash flow</li></ul>	<b>Benefits</b> <ul style="list-style-type: none"><li>Enhanced operations and market position through focused performance improvement initiatives</li><li>Operational improvements to generate improved cash flow</li><li>Due to the ongoing partnership process, competitor response is delayed and or “frozen” in place</li><li>Greater leverage in negotiations through enhanced operations and market position as a result of performance improvement initiatives</li></ul>	<b>Benefits</b> <ul style="list-style-type: none"><li>Enhanced operations and market position through focused performance improvement initiatives</li><li>Operational improvements to generate improved cash flow</li><li>Greater leverage in negotiations through enhanced operations and market position as a result of performance improvement initiatives</li></ul>





# CASE STUDY

# INCREMENTAL CASH FLOW OPPORTUNITIES AT HOSPITAL A

Performance Improvement Initiatives		Client
Swing Bed Estimate	\$ 120,000	
340b Opportunity	\$ 250,000	
Cost Report Opportunity	\$ 170,610	
Home Office Cost Allocation Low Estimate	\$ 470,000	
Home Office Cost Allocation High Estimate	\$ 780,000	
Total Savings Low Estimate	\$ 1,010,610	
Total Savings High Estimate	\$ 1,320,610	
Required Investment Over 5 Years		
Required Investment	3,587,639	
Percentage Debt Financing	100%	
Cost Based Reimbursement	40%	

- Through the strategic performance initiatives and partnership, Hospital A would, on a conservative level, be able to fund its required investments and increase operating performance by about \$670,000 annually, per the Net Change in Operating Performance – Low Estimate below
- Performance improvement initiatives require minimal investment from a partner other than the affiliation process and negotiation of the pharmacy contract

Projection Estimate	Year 1	Year 5	Year 10	Year 15	Year 20	Year 25	Year 30	Year 35
Principal Balance Outstanding	\$ 3,587,639	\$ 3,114,290	\$ 2,491,503	\$ 1,684,434	\$ 777,344	\$ 350,054	\$ (0)	\$ (0)
Annual Depreciation Expense	\$ (160,148)	\$ (160,148)	\$ (160,148)	\$ (158,498)	\$ (140,165)	\$ (59,315)	\$ (39,254)	\$ (39,254)
Annual Interest Expense	\$ (195,209)	\$ (174,450)	\$ (141,196)	\$ (98,039)	\$ (48,818)	\$ (22,109)	\$ (2,340)	\$ (2,340)
Total Annual Depreciation Plus Interest	\$ (355,357)	\$ (334,598)	\$ (301,344)	\$ (256,537)	\$ (188,983)	\$ (81,424)	\$ (41,594)	\$ (41,594)
Incremental Cost-Based Payments	\$ 141,041	\$ 132,802	\$ 119,603	\$ 101,820	\$ 75,007	\$ 32,317	\$ 16,509	\$ (0)
Net Interest and Depreciation Cost	\$ (214,316)	\$ (201,796)	\$ (181,741)	\$ (154,718)	\$ (113,975)	\$ (49,107)	\$ (25,086)	\$ (25,086)
Annual Principal Payment	\$ (84,575)	\$ (105,334)	\$ (138,588)	\$ (179,596)	\$ (201,854)	\$ (95,084)	\$ (77,897)	\$ (77,897)
Total Annual Cost to (after Cost Based Payment)	\$ (298,891)	\$ (307,130)	\$ (320,329)	\$ (334,314)	\$ (315,829)	\$ (144,191)	\$ (102,983)	\$ (102,983)
Projection Low Estimate								
Total Annual Operating Improvements	\$ 1,010,610	\$ 1,010,610	\$ 1,010,610	\$ 1,010,610	\$ 1,010,610	\$ 1,010,610	\$ 1,010,610	\$ 1,010,610
Net Change In Operating Performance - Low Estimate	\$ 711,719	\$ 703,480	\$ 690,281	\$ 676,296	\$ 694,781	\$ 866,419	\$ 907,627	\$ 1,010,610
Projection High Estimate								
Total Savings High Estimate	\$ 1,320,610	\$ 1,320,610	\$ 1,320,610	\$ 1,320,610	\$ 1,320,610	\$ 1,320,610	\$ 1,320,610	\$ 1,320,610
Net Change In Operating Performance - High Estimate	\$ 1,021,719	\$ 1,013,480	\$ 1,000,281	\$ 986,296	\$ 1,004,781	\$ 1,176,419	\$ 1,217,627	\$ 1,320,610



# INCREMENTAL REFERRAL OPPORTUNITY FOR PARTNER

- Since the potential partner currently maintains market share capture within Hospital A's service area, a conservative market share growth percentage of 2.5% was used to estimate the incremental referral opportunity benefit to the potential partner as a result of a partnership with Hospital A
- The potential partner would realize a conservative estimated contribution margin benefit of \$1.05M, after consideration for incremental variable costs associated with increased patient volumes, from increased market share within Hospital A's service area as a result of a partnership with Hospital A

<b>Market Share Transfer Benefits</b>	
Total 2020 Est. Discharges for Rural Affiliate Service Area (Source: Truven Health)	1,333.36
Current Partner Medicare Market Share (Source: 2019 CMS Data)	2.1%
Estimated Partner Discharges from Rural Affiliate Service Area	27.73
Estimated Partner Net Revenue Per Discharge (Source: costreportdata.com)	\$ 9,424
Estimated Partner Net Inpatient Revenue from Rural Affiliate Service Area	\$ 261,364
Partner OP Rev relative to IP Revenue (2020 Cost Report WS G-2)	318.53%
Estimated Net OP Rev From Rural Affiliate Service Area	\$ 832,523
Total Net Transfer / Referral Dollars to Partner from Rural Affiliates	\$ 1,093,887
Estimated Contribution Margin % (Source: Estimated)	80%
Estimated Contribution Margin on Net Revenue from Rural Affiliate Service Area	\$ 875,110
Contribution Margin Per 1% of Inpatient Market Share	\$ 420,726
Estimated Change in Market Share % with Competitive Entry into Rural Affiliate	2.5%
<b>CM from Loss of existing or potential gain of Rural Affiliate SA Market Share</b>	<b>\$ 1,051,815</b>





# KEY TAKEAWAYS

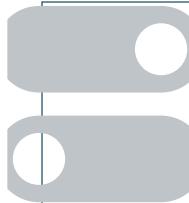
# KEY TAKEAWAYS



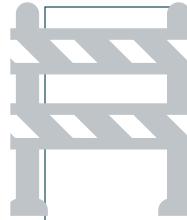
A strong performance improvement plan is an asset to any strategic option including for rural hospitals evaluating partnership opportunities



Many performance improvement opportunities, if realized, can have a substantial financial benefit for a rural hospital



Improved financial and operational performance will increase the options available to rural hospitals to pursue their strategic objectives



It is important to recognize and address potential barriers when pursuing performance improvement work



Performance improvement options combined with value levers can benefit both the rural hospital and potential partner and positively influence deal terms





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## THANK YOU



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