Q: What is the board's accountability for ensuring the right organizational structure?

The health care system is under transformation. Hospitals are seeking new ways to deliver value -based care and improve the health of their patients and communities. The lingering effects of the economic recession and now health care transformation on hospitals are well-evident, and trustees must demonstrate strong leadership to navigate through the challenges. Many hospitals and health systems are aligning and integrating services across the continuum of care, but at the same time are confronting significant financial pressures as they seek to cross the chasm from a fee-for-service based system to a value-based payment system.

The need to make changes and to ensure long term financial stability and services for the community is leading many hospitals and health systems to consider some form of affiliation with another organization that can bring financial strength and resources to help them achieve their mission and vision. In order to determine the alternative that best suits a hospital, it is imperative for the hospital's governing leadership to take a long-term view, and carefully determine the approach that will best ensure the development, continuity and security of the community's health care. The organization must be operated and structured to provide flexibility and responsiveness to the community's current health needs, and be able to effectively and successfully respond to emerging health needs.

The hospital's board of trustees should consider the following key questions as it evaluates any change to its present organizational structure:

- What is the organization's most viable and valuable health care role, both now and in the future?
- What is the organization's position in the regional health care continuum, and how can that position be solidified?
- What strengths and assets are most critical for the organization to possess?
- What types of management and operating resources does the organization need to have access to in order to meet future community and organizational needs?
- How should the organization be structured to be able to best meet the health needs of the community? Is the status quo the best alternative, or something else?

Overview of Operating Structures

Hospitals have several options for changing ownership, affiliations and structure. The best option will be determined as a result of a careful examination of the hospital's current operating performance, resources and needs, projections of future needs, challenges and opportunities, assessment of national and local health care trends, and community needs. Below is a brief summary that describes four basic organizational alternatives, which is followed by a summary of the advantages and disadvantages of each alternative.

Independence. Some maintain that an independent hospital cannot be fully effective and successful in meeting the community's health care needs in today's complex and rapidly-changing health care environment. However, a case can also be made that an experienced, professional and capable CEO, working closely and effectively with an educated, motivated, responsible and committed board of trustees and medical staff, can still be successful in today's challenging environment.

The keys to success as an independent hospital are leadership, vision, capital, and community loyalty and commitment. The administration and the board must be able to anticipate and aggressively and effectively deal with the multitude of complex issues facing the hospital, operate successfully in a climate of rapid change, offer uniqueness and distinctiveness in services and customer service, deliver high quality that meets or exceeds patient needs and earns patient and community loyalty, and be able to preserve or expand market share in the service areas provided.

Advantages of independence may include:

- Continued status as community-owned and community-governed;
- CEO reports directly to the board of trustees, ensuring clear and direct lines of local responsibility and authority;
- Flexibility in making operating decisions and changes without outside interference; and
- Preservation of current structure and identities.

Disadvantages of independence may include:

- Current financial and utilization trends may inhibit ability to improve services and long-term viability;
- Potential for narrow, isolated decision-making may cause the hospital to miss opportunities;
- Fewer options to access capital;
- Greater vulnerability to competitive threats; and
- Lack of immediate, ready access to needed personnel.

Management Contract. Operating successfully under a full-service management contract requires strong communication between the organization, its board and the management entity, and a clear understanding of and agreement to mutual objectives and expectations.

When management contract arrangements fail it is often because the hospital client does not adequately analyze and understand its true needs, select the appropriate management firm, structure an appropriate, mutually-beneficial contract, and then manage the contract to ensure that the hospital's goals, services and actions are directly related to those needs.

There are two types of management contracts a hospital could consider: 1) full-service management contract with a hospital management company; and 2) management contract with a regional hospital or hospital system that can offer access to the range of management services the organization needs.

Advantages of a management contract may include:

- Continued status of the hospital as a community-owned, community-governed and locally-managed organization;
- Governing autonomy and flexibility preservation;
- Management company experience provides access to proven and tested systems and programs that may be successfully adapted to the hospital's needs;
- Easy and immediate access to a broad range of key personnel and management company resources makes it convenient for the organization to access needed assistance quickly;
- Opportunity for information exchange with other managed hospitals with similar needs; and
- Flexibility to terminate the management contract if the board of trustees becomes dissatisfied with the management company's performance.

Disadvantages of a management contract may include:

- Added cost of the contract to already strained financial resources;
- Loss of decision-making autonomy and flexibility (based on contractual provisions);
- Potential to develop a "dependency" on the management company's products and services making any necessary return to proprietary management difficult;
- Potential to lessen somewhat the board's sense of community and fiduciary responsibility and accountability;
- Key personnel are employees of the management company, not the hospital. Management "loyalty" is to both the board of trustees and the management company; however primary loyalty will likely be to the actual employer (the management company), on which key personnel rely for future opportunities;
- The organization pays for broad access to a range of services it may not need or utilize;
- May reduce or eliminate "comparison shopping" for vendors in key areas where the management company provides products and services.

Lease to or Merger With Another Health Care Organization. A hospital lease is essentially a contract that gives possession of hospital land, buildings, equipment and services to a lessee for a specified period. Under a lease arrangement the organization gives full use and responsibility for the facility to another party to manage and operate as it sees fit, within the parameters specified in the lease agreement. A merger is essentially a transaction through which one corporation acquires the assets and assumes the liabilities of another corporation.

Advantages of a lease to, or merger with another health care organization may include:

- Access to new sources of capital for equipment, salaries, physician recruitment, etc.;
- Streamlined, fully integrated decision making may create greater operational flexibility;
- Ability to improve competitiveness in the areas of cost, quality, and outcomes;
- Proceeds from the transaction, if any, to a newly-formed foundation (or other not-for-profit entity), which may be used in a variety of ways consistent with the hospital's mission;
- Predictable source of income over the life of the lease;
- Potential role for some form of local advisory board governance;
- Elimination of business risk;
- Single point of decision-making streamlines and speeds the decision process;
- Improved ability to align services and operations; and
- Opportunity to streamline governance and operational decision-making and direction.

Disadvantages of a lease to, or merger with another health care organization may include:

- Loss of control: policy control is in the hands of the lessee or new entity;
- At some point the hospital may seek to regain control of operations, and could be required to assume significant costs to do so successfully;
- Under a lease, the philosophy and standard of care of the lessee prevails; there is no absolute assurance that services provided will match community needs;
- Under a lease, the cost of payments to the lessor becomes a new cost to the lessee, making it more difficult for the lessee to build a positive bottom line;
- Potential reduction in autonomy and identity; and
- Community preference for an independent hospital.

Strategic Affiliation. A strategic affiliation is typically a looser arrangement under which two organizations agree to work together contractually to achieve a broad set of objectives. Strategic affiliations may take many different forms, with a variety of mutual commitments.

A strategic affiliation, under the right circumstances, may enable economic, governance and programmatic integration that could benefit a hospital and its employees, physicians and patients. It could also enable more streamlined payer contracting, and better coordinated management, governance and strategic planning. Services could be integrated and broadened, and managed care contracting strength could be enhanced.

Advantages of a strategic affiliation with another health care organization may include:

- Ability to benefit from the name and reputation of a larger, well-respected organization;
- Improved professional advancement potential for employees;
- Ability to improve competitiveness in the areas of cost, quality, and outcomes;
- Improved access to capital;
- Ability to reduce unnecessary duplication of services through appropriate service consolidation;
- Ability to be a part of a broader network of providers;
- Ability to be part of a unified managed care contracting effort; and
- Ability to develop seamless joint initiatives.

Disadvantages of a strategic affiliation with another health care organization may include:

- Potential reduction in hospital autonomy and identity;
- The philosophy and standard of care of the controlling entity prevails; there is no absolute assurance that services provided will match community needs, or how and where services will be delivered; and
- Community preference for an independent hospital.

Regardless of the organizational structure choice made in today's difficult economic environment, it is the board's responsibility to ensure that the choice strengthens the hospital's ability to achieve its mission and vision, and secures the long-term health care future of the community.

Questions to be Addressed

- How satisfied is the board with the progress the hospital has made in the last five years?
- Is the hospital mission still an accurate description of the hospital's purpose? If not, what should be changed?
- Is the vision an accurate picture of what the hospital should be striving to become? If not, what should be changed?
- What are the most significant characteristics of the hospital's current situation (e.g. market position, financial position, competition, opportunity for expansion, etc.)?
- What are the most dominant issues facing the hospital today? Short-term (next 12 months)? Mid-term (1 to 3 years)? Long-term (over three years)?
- What are the unmet or under-met health care needs of residents of the hospital's service area?
- What local market trends are most critical to understand in shaping the hospital's strategic future?
- What major assumptions should be made about the environment that will impact the hospital's ability to achieve its strategies (e.g. the economy, competition, reimbursement, inflation, etc.)?
- What is the hospital's unique, market-based vision in key success areas (e.g. managed care, community health status, premier provider, delivering value, affiliations, community leadership, public trust, accessibility, appropriate services, innovation, financial health, etc.)?
- What factors are most critical to the hospital's success over the next 1 – 3 years (e.g. cost efficiency, quality, technology, community support, information systems, patient and payer satisfaction, employee development, service innovation, consolidation, external relationships, market coverage, etc.)?
- What limiting factors will the hospital have to overcome to be successful?
- Where does the hospital have the most potential for growth? What services should the hospital consider in order to further solidify its market position?
- What are the hospital's major strengths and competitive advantages? What are its significant weaknesses and competitive liabilities?
- What market niches or opportunities are most critical for the hospital to capitalize upon (short-term, mid-term and long-term)?