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Strategic Governance Practices for Turbulent Times

by Barry S. Bader

Note: "No battle plan survives the first contact with the enemy," goes a military saying, expressed in recent years by Colin Powell.

The expression is worth remembering as hospitals and health systems embrace bold strategies to participate in the industry-wide economic shift from rewarding volume to holding providers accountable for the value they deliver. Boards must balance confidence in their vision of an integrated, accountable care delivery system with the reality of turbulence and unexpected events in a competitive and highly regulated marketplace. Governance cannot go on automatic pilot in turbulent times. Boards can manage and minimize strategic risks by adopting practices that recognize the inevitable uncertainty ahead. This commentary offers several such practices: recruiting new strategic competencies; learning from the past; developing new metrics; and maintaining strategic focus.

An Industry-Wide Cultural Transformation

"Health care is moving to new performance models in which organizations are integrating financial risk and health care delivery," says a recent report from the American Hospital Association's Committee on Research. In *Your Path to the Second Curve: Integration and Transformation*, AHA recommends hospitals transform into care systems by putting four "must-do" strategies atop their strategic agendas:

- Aligning hospitals, physicians and other providers across the continuum of care.
- Utilizing evidence-based medicine practices to improve quality, patient safety and cost-effectiveness.
- Improving efficiency through productivity improvement and financial management initiatives.
- Developing integrated information systems.

Taken alone, each of these strategies would constitute a major departure from the status quo and require significant planning, major investments and careful execution. Combined, they represent nothing less than an industry-wide cultural transformation.

Consider how much AHA's four recommended strategies disrupt the status quo:

- Hospital-physician alignment: Traditionally, hospitals and physicians have worked in parallel, not in sync, and physicians are accustomed to significant deference and autonomy.
- Evidence-based medicine: Clinical practice has been driven more by individual physicians' training, judgment and financial incentives than by protocols based on large, scientific studies of the comparative effectiveness of tests and treatments.
- Rewarding value: Historically, fee-for-service reimbursement systems have rewarded higher service volumes and penalized efficiency and lower costs with lower revenues, thus limiting the return on investments from productivity improvement and cost control programs.
- Integrated information systems: Hospital information systems have been fragmented in separate business and clinical silos, and thus can't provide the critical data needed to manage finances and care delivery in a value-driven environment.

What's more, although these strategies commonly appear to be providers' current strategic plans, a "one-size-fits all" path to the future simply won't work for every hospital and health system. Differences in local markets, competitors, communities, payer mix, size, financial strength, physician relationships, and other factors rule out a universal roadmap. Thus, AHA's report lays out five possible paths to transformation that an organization may apply singly, or in tandem:

- **Redefining** to a different kind of delivery system, such as a full-service hospital becoming more ambulatory or long-term care oriented, or a regional health system expanding into a large, diversified health corporation with multiple enterprises spanning care delivery and insurance.
- **Partnering** with other care systems or health plans for greater horizontal or vertical reach.
- **Integrating** delivery with health insurance or knitting services across the care continuum.

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- **Experimenting** with new payment and delivery models, such as bundled payments, accountable care organizations and medical homes.
- **Specializing** to become a high-performing specialty provider in such fields as pediatrics, cancer, orthopedics and behavioral health.

Uncertainty and risk accompany each of these paths. Yet, with governance support and engagement, the industry's best and brightest leaders are forging ahead. Boards are committing millions of dollars to employing physicians, merging and affiliating with partners, acquiring and expanding facilities, investing in productivity improvements, and building state-of-the-art information systems.

The prevailing wisdom agrees. It seems like everyone's on the integration, consolidation and accountable care bandwagon. Transform or fade away.

What could go wrong?

Plenty. To paraphrase a movie title, hospitals, physician groups, health systems, insurers and other major players in the health care system are likely to face "years of living dangerously." Early difficulties in the rollout of health insurance exchanges under the Affordable Care Act, mixed initial results for Medicare's Accountable Care Organizations and recent credit rating downgrades of some large health systems are just a few harbingers of unpredictability to come. In February, *Modern Healthcare* reported that some of the country's largest hospital operators were reporting that "flagging hospital volumes were looking persistent and necessitating lower future expectations."

Trustees and executive leaders driving transformational strategies cannot forget that every bold strategy comes with risk. Transformations are never smooth and predictable. Every strategic initiative has unintended consequences. Every industry faces factors beyond its control, from economic downturns to legal and regulatory reverses. There is a difference between confidence in a well-developed strategy and over-confidence that breeds complacency and blinds leaders to real-world events that could upend best-laid plans. Vested with fiduciary responsibility to protect and preserve the organization's assets and mission, the board has a fundamental duty to be vigilant and responsive, with eyes wide open to how strategic plans actually play out.

Strategic Governance Practices for Turbulent Times

At first glance, monitoring the progress of a strategic plan for transformation is hardly innovative. The standard issue board tool kit includes progress reports from management, key performance metrics, dashboards and balanced scorecards and committee oversight. A board culture characterized by active engagement, candor, accountability, competence and continuous learning will provide well-recognized ingredients for strategic, objective and diligent governance.

In times of great change, however, governance practices must be sufficiently robust to trigger early warnings and signal unexpected opportunities amidst turbulence and uncertainty. Health care boards will need to enhance their strategic governance practices. Here are several approaches worth considering.

Recruit and develop new competencies tied to the transformation strategy. The need for boards to embrace competency-based selection and education practices is a frequent topic in *Great Boards* and the governance literature generally. Integration, aggregation and accountability strategies require board competencies that may not have been as relevant for overseeing acute care-oriented delivery systems. Depending on their particular strategies, a hospital or health system board may want to enhance such competencies of knowledge and skill as:

- Community health and population health management.
- Health care risk financing and insurance.
- Enterprise risk management.
- Patient engagement.
- Implementing mergers and strategic alliances.
- Using information technology to build a "smarter organization."
- Executive or governance experience in transforming industries.

Boards also need subject matter competence in clinical care, but the way they achieve that competence may change. The shift in a hospital's traditional reliance on an independent medical staff of private practitioners to a core of physicians who are closely aligned both financially and clinically with the hospital will require rethinking how governance accesses clinical expertise and engages physicians and other clinicians in the organizational leadership and decision making. The question is not only about physicians serving as board members, but more broadly, about choosing leaders for a care system's physician enterprises, including its owned medical groups, employed physicians, clinical joint ventures and similar endeavors.

Learn from the past to identify and monitor enterprise risks. Constructive strategic oversight of the transformation journey begins by learning from experience about what could go wrong in new strategic initiatives. "The health care industry has a tendency to over-react," says Dan Grauman, president of DGA Partners and a long-time financial and strategic adviser to hospitals and physician groups. "Some organizations are moving too fast out of fear or prompted by financial advisers," says Grauman. Mergers and new ventures "can be distracting to management teams and are hard to implement to get tangible benefits."

Today's boards can gain perspective on current risks by understanding what went wrong in an earlier hospital industry rush toward integrated delivery systems. Hospitals in the 1990s invested substantial sums in physician employment and acquisition of medical groups, aggressive merger and affiliation activity, insurance risk contract-

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ing and geographic expansion. Some hospitals found success, but others stumbled badly. The causes, among many, included:

- The proposed Clinton health care reform legislation, which would have encouraged primary care driven networks and provider integration, failed in Congress.
- Providers paid too much for physician practices and didn't understand how to manage practices or compensate physicians.
- Hospitals took on fixed price and capitated contracts to cover care for patient populations without sufficient experience or infrastructure to adequately understand actuarial risk or to manage costs and care.
- Patients resisted managed health insurance products that limited their choice of providers.
- With costs still rising out of control, hospital revenues were hammered by Medicare cuts in the Balanced Budget Act of 1997 and the economic downturn when the dot-com bubble struck Wall Street.

Trustees would do well to review the post-mortems of high-profile failures such as the bankruptcy of the Allegheny Health, Education and Research Foundation in Pennsylvania to understand the risks inherent in an aggressive strategy of integration and accountability.

Another thoughtful perspective on understanding major enterprise risks in turbulent times comes from a recent Deloitte LLP study of public companies that suffered sharp declines in shareholder value from 2003 – 2012. The study identifies what it calls "value killers" that caused 38 percent of 1,000 public companies to suffer price declines of more than 20 percent over a one-month period compared to the MSCI Global Index, a measure of average market performance.

Table 1 below shows the eight top "value killers" identified in the Deloitte study and their frequency among companies suffering the largest value drops. This author adds possible future parallels in the health industry in the right-hand column.

Table 1. Drivers of Lost Value in Public Companies

Drivers of Lost Value	Frequency of Drivers Reported by 100 Companies with Largest Value Drops	Possible Future Health Care Parallel
Industry issues	68%	Major, across-the-board cuts in Medicare and Medicaid payments and incentives
Country economic issues	67%	Nationwide recession
Demand shortfalls	42%	Unexpected declines of inpatient and some outpatient procedures
Earnings shortfalls	24%	Unexpected drops in profitability when new business ventures fail to meet financial targets
High debt and interest rates	23%	Tighter Federal monetary policies lead to higher costs of capital
Merger and acquisition problems	23%	Mergers, acquisitions and strategic alliances fail to achieve synergies or grow new revenues as planned
Poor financial strategies	23%	Overly optimistic projections of the ability to manage the financial risk of caring for patient populations
Customer losses/problems	23%	Unexpected declines in patient referrals from partnering with health insurance plans and physician practices

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Develop key organizational metrics for the board to monitor the strategic plan. Armed with an understanding of the perils that have befallen others in turbulent industries, hospital and health system boards should engage in thoughtful strategic discussions about the risks embodied in their own strategic plans and goals. They should ask "What could go wrong?" and "What metrics could provide early warning signs of problems to come?"

In 2013, the Health Research & Educational Trust of the AHA published *Metrics for the Second Curve of Health Care*. The report contains a number of possible metrics boards and other leaders can use for evaluating the progress of each AHA-recommended strategy for transformation (see Table 2 on page 5).

The metrics suggested by the HRET report are meant not as a definitive "scorecard," but rather, as a discussion stimulator. Boards can use the report to stoke thinking about the indicators that might be equally or more appropriate for their particular organization's strategic plan.

Making the right comparisons. Providing a proper context for each metric is important for the board and other leaders to be able to assess whether performance is proceeding as expected or is a harbinger of shortfalls to come. For example, consider the first suggested measure: "percentage of aligned and engaged physicians." A health system might measure this by comparing:

- The percentage of the total active medical staff who are defined as "aligned" through employment arrangements, contracts or system ownership of physician practices — projected versus actual per reporting period
- The percentage of the care system revenues provided by "aligned" physicians — projected versus actual per reporting period
- The percentage of the hospital admissions or patient visits provided by "aligned" physicians — projected versus actual per reporting period.

A board that wants to track the pace of adopting an evidence-based, medical practice culture could ask for these metrics:

- Number of evidence-based protocols developed by the organization, versus target.
- Percentage of patients whose care is managed according to evidence-based protocols, versus target.
- Percentage of patients managed under protocols covering the full continuum of care, versus target.

Tracking milestones. Other appropriate measures might be event-related milestones of strategic progress such as:

- Integration of previously acquired, independent physician practices into a single primary care, specialty care or multi-specialty practice.
- Creation of a single medical staff and/or adoption of common clinical care and credentialing standards across multiple hospitals in a system.
- Instant access to patients' hospital and physician office records in all facilities of a system.

External forces. The board also should be kept informed of external factors that may affect implementation of the strategic plan. These include legislative and regulatory changes to Medicare and Medicaid, reductions in insurers' payment schedules, changes in financial incentive plans, shortfalls in patients' enrollment in partnering health plans and competitive factors, such as a competing health system acquiring a large medical group in the community.

Remember the core business. Traditional businesses don't necessarily evaporate overnight, nor do community health care needs for acute and emergency services. New integrated delivery products and services will take time to capture market share. Apple Computer still sells desktop computers, not just cool tablets, music, and "cloud services." As the health care sector moves from rewarding volume to rewarding value, it is important for boards to remember that a significant share of revenues and profitability will continue to come from fee-for-service care, appropriately provided. Therefore, boards should avoid the temptation to focus only on exciting, new strategic initiatives to the exclusion of monitoring critical, traditional indicators against targeted goals, such as:

- System-wide profitability and operating margins.
- Acute care admissions.
- Outpatient visits and surgical procedures.
- Market share for major clinical areas.
- Clinical outcomes for major hospital procedures.
- Patient experience ratings in each care setting.

Keep it strategic. Added to the uncertainties of the unfolding environment, health care boards face another major challenge: the growing size, scope and complexity of integrated care delivery systems. One board leader worried that when his system merged with another, the task of monitoring quality and finances in every part of the organization would dwarf the time and abilities of a single, downsized board, not to mention the critical need to monitor whether the merger was meeting its targets for reducing duplication, standardizing around best practices and achieving synergies.

The answer, his board concluded, could not be to micro-manage every enterprise, rather, to create a system of accountability and measurement that would allow trustees to monitor organizational performance, focus oversight on significant variances and leave significant time for strategic matters. The board's working committees are the frontline of oversight, freeing the full board for strategic matters. While this practice follows long-standing good governance recommendations, the need for a board to maintain a strategic context in all its work — oversight, planning, decision-making and education — is critical in times of rapid change.

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The importance of strategy in board work is underscored by a recent survey by McKinsey & Company. The report found corporate boards have significantly increased their knowledge of the company and its current strategy, although many still report not having enough knowledge of enterprise risk. "Over 90 percent of respondents also say their boards have become more effective over the past five years, most often attributing that improvement to better collaboration with senior executives and more active or skilled independent directors."

Strategic discussions enable the CEO to benefit from the experience and perspectives of trustees who have been recruited for needed subject-area competencies. As corporate governance expert Jeffrey Sonnenfeld and his colleagues recently wrote in *Harvard Business Review*, the common view that CEOs want board passivity and concurrence is wrong: "...CEOs say the opposite is true. They are disappointed by the absence of energetic debate in the board room." CEOs want boards to focus on risks crucial to the future, do their homework, bring their knowledge not their celebrity and challenge strategy constructively.

The techniques for ensuring a board allocates sufficient time to strategic matters include:

- A regular board meeting agenda item devoted to one or two important strategic issues.
- Forming a board committee (sometimes called "futures" or "horizon" committees) to specifically consider future-oriented issues for eventual board consideration. (Note: This committee should work in tandem with, not separate from, other governance entities overseeing strategy such as a Strategic Planning Committee or a Strategic Issues Task Force.)
- Planning board education at meetings and retreats around strategic matters.
- Framing board discussions around "true" strategic questions.

That last practice is often overlooked. The way an agenda item is posed to the board influences whether a discussion will be prospective or backward-looking, in-depth or perfunctory, open to creative thinking or narrower in purpose. For example, consider a management report of an unexpected, sharp decline in hospital admissions in the first two quarters. Management and the board chair can introduce the subject with different questions depending on whether the intent is to have a limited or more strategic discussion:

- Limiting questions
  1. What are the causes of the decline?
  2. How much will revenues be affected?

Table 2. Second Curve Evaluation Metrics (applicable to the hospital or the health care system)
Strategy 1: Aligning Hospitals, Physicians and Other Physicians Along the Continuum of Care
Percentage of aligned and engaged physicians
Percentage of physician and other clinical provider contracts containing performance and efficiency incentives aligned with ACO-type incentives
Availability of non-acute services
Distribution of shared savings/performance bonuses/gains to aligned physicians and clinicians
Number of covered lives accountable for population health (e.g., ACO/patient-centered medical homes)
Percentage of clinicians in leadership positions
Strategy 2: Utilizing Evidence-based Practices to Improve Quality and Patient Safety
Effective measurement and management of care transitions
Management of utilization variation
Reducing preventable admissions, readmissions, ED visits, complications and mortality
Active patient engagement in design and improvement
Strategy 3: Improving Efficiency Through Productivity and Financial Management
Expense-per-episode of care
Shared savings, financial gains or risk-bearing arrangements from performance-based contracts
Targeted cost-reduction and risk-management goals
Management to Medicare payment levels
Strategy 4: Developing Integrated Information Systems
Integrated data warehouse
Lag time between analysis and availability of results
Understanding of population disease patterns
Use of electronic health information across the continuum of care and community
Real-time information exchange

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3. Is management taking appropriate steps to manage expenses and maintain operating margins?

- Strategic questions

1. In analyzing the decline in admissions, are the causes likely to be short-lived or more indicative of a longer-term trend, such as reduced utilization in response to new payment incentives to keep patients out of the hospital, or loss of patients due to enrollment in networks that exclude the hospital?
2. To what extent would a longer-term trend of fewer admissions affect our willingness to enter into risk-based contracts with public and private payers?
3. Are other providers in our market experiencing similar declines, and if so, might that alter current thinking on the wisdom of mergers to achieve critical mass?

A new resource from the AHA's Center for Healthcare Governance, *Governance Tools for Transformation*, offers a practical board self-assessment of governance readiness for transformation.

Act – Hesitation Can Be Costly

Ultimately, a board's role is not merely to discuss but to act — decisively, prudently and promptly based on the best information it has.

The health care industry's last flirtation with integration and consolidation led to various excesses, from overpaying for physician practices to forging strategic alliances and even mergers that failed to produce savings or synergies. A case in point: One health system lost more than $20 million on physician practices over three years before it had the necessary strategic discussions and then took steps to fix the practices. A trustee reflected at the time, "We should have had that discussion after the first year." The bottom line for governance in a transformational era is to apply its competence, education, metrics and strategic discussions to making the tough decisions. While patience and confidence in the long-term vision and strategy are important board values, confidence must be weighed against sometimes harsh reality. Course changes should not be hasty, but they should not be avoided.

Some board decisions will endorse retooling current strategies, while others will abandon failing service lines, divest underperforming facilities and even unwind mergers and alliances. Some board decisions in transformational times will support management, others may not. And sometimes, the board will conclude what's needed is not a change in strategy but rather a change in the leaders executing the strategy.

The biggest obstacle to changing course or horses could be the board itself, if trustees are reluctant to admit they and management were well-intentioned and justified but ultimately flawed in their strategic plans. Turbulence will also bring unexpected opportunities as others stumble – but only if the board is open and flexible.

Governance of hospitals and health systems in the coming era will not be for the faint-hearted. The times call for candor, courage and a willingness to face reality. As Warren Buffet has said, "Should you find yourself in a chronically leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks."

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