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TRANSFORMING GOVERNANCE



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From Surviving to Thriving

The board's obligation is to consider all options to achieve its mission, including gleaning lessons from the movie "Grease!"

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With the well-documented headwinds of workforce issues and cost inflation leading to significant financial challenges, what is a community hospital board to do? One consideration is affiliation with a health system or with other independent hospitals. Yet, "our board has taken a vow of independence" is a frequent refrain from hospital boards about this topic.

Does this position breach the fiduciary duty of care? Should the

vow instead focus on maintaining the mission by providing high-quality, affordable care and meeting community needs? Boards and executives are wise to take a long-term view and consider all options, paths and strategies to attain their goals for their stakeholders and communities.

In the movie "Grease," the song "You're the One That I Want" offers a pivotal moment that represents transformation and taking control. Sandy Olsson, the good girl, transforms into a greaser girl to get what she wants (and needs, oh, yes,

indeed.) The song is not just about a character getting the boy, Danny Zuko; it's also about Sandy taking control of her life and making her own decisions very intentionally.

Similarly, there are moments when every hospital board needs to take control and make thoughtful, intentional decisions that will improve the lives of those they serve. With a lens on the lyrics of "You're the One That I Want," this article explores the deeper meaning behind the "independence" pledge and outlines the range of affiliation options and how they might be considered.

All hospitals and health systems want to maintain their missions. They want to thrive, not merely survive.

Financial Challenges

"I got chills, they're multiplying."

The financial realities for hospitals and health systems are genuinely daunting: Expenses outpacing revenues; stagnant reimbursement rates; value-based and bundled payments increasing hospital risk; patients shouldering more cost of care; and investment income dwindling.

Then add the negative impact of national financial drivers: The sluggish economy; tight capital markets; CMS priorities regarding site-neutral payments and 340B fixes; federal and state tax reform; and insurance coverage fluctuations.

With all these factors leading to more than 50% of all hospitals and

health systems in America experiencing red bottom lines in 2022 — and with no real relief on the horizon thanks to workforce shortages — hospital boards should not be afraid to face these challenges head-on and consider all possible options, including affiliation. Beyond the financial crunch as a motivator, many studies show measurable benefits in cost, quality and access with affiliation and added scale.

Independence vs. Scale

“And I’m losing control.”

The fear of losing control is real and a powerful motivator for hospital boards to maintain their independence. In many instances, a board’s declaration of independence is short-hand for maintaining control of these often-cited control considerations:

- **Local Governance:** Boards desire to retain local decision-making authority and input on important matters.
- **Community Investments:** Boards seek to ensure assets built and donated over the years remain focused on the community.
- **Retain and Grow Services:** Boards want to maintain access to high-quality care locally and avoid becoming a referral center or “band-aid station.”
- **Local Employment:** Boards aim to protect local jobs and preserve the hospital’s role as a significant employer in the community, contributing to economic stability and growth.
- **Community Support:** Boards intend to maintain strong relationships with the community.
- **Brand and Reputation:** Boards aspire to protect the hospital’s brand

and maintain trust and credibility.

- **Agility:** Boards strive to retain the ability to respond swiftly to local health care needs, market dynamics and emerging opportunities without bureaucratic hurdles or interference from outside the community.
- **Collaborations:** Boards yearn for the ability to enter strategic partnerships, alliances or joint ventures to meet community needs.

All these control considerations often lead boards to unofficially adopt the vow of independence.

However, the vow should be about maintaining the hospital’s mission of providing access to high-quality, affordable care and meeting community needs. It is essential for hospital boards not to let the fear of losing control prevent them from considering all the options — including affiliation.

Of course, in a perfect world, every hospital would have adequate resources to meet all the community’s health-related needs and maintain total local control.

The Benefits of Scale and System Growth

“Cause the power you’re supplying, it’s electrifying!”

Overall, affiliation transactions have fluctuated dramatically throughout the years, with 2021 seeing the fewest affiliation deals in the past 30 years.

The pandemic simultaneously focused hospitals on internal operations, temporarily increased resources and highlighted many organizations’ shortcomings. New affiliations are rising again due to the financial challenges noted above.

The largest hospital systems keep getting larger. Despite that, when lumped together, the top 10 largest hospital systems account for only 20% of hospital industry revenue, which is fragmented compared to other industries. Affiliation can bring many benefits, including structural, operational and skills economies:

- Structural economies include local market coverage, risk sharing and advocacy.
- Operational economies comprise lower operating and capital costs, shared services and information technology.
- Skills economies consist of standardization of operations management, improved quality protocols and standards, access to resources, talent and management and — significantly — physicians.

“I need a man (er, umm, hospital) who can keep me satisfied.”

Prudence is the key for board members considering affiliation. Every deal is not alike, and every community has a different need. Drawbacks to scale include the cost of coordination, complexity, agency issues (like ambiguity over accountability and risk) and unanticipated cultural changes.

Thorough consideration by a board of all the alternatives will help boards ensure the hospital, the board and the community get the deal that they want.

The Board’s Fiduciary Obligation

“You better prove that my faith is justified.”

Just as Sandy and Danny go through a period of self-discovery

and exploration in “Grease,” the hospital board must engage in a thoughtful process to explore its options.

At its core, the fiduciary obligation of the hospital board is to do the right thing for the right reasons in the right way at the right time. This obligation is manifested in a board’s three fiduciary duties of care, obedience and loyalty. The issue of independence is only appropriate if the board has fulfilled its duty of care in obtaining all pertinent information and carefully considering all the options for maintaining the hospital mission.

Although this article focuses on the board’s obligations to consider all options for affiliation (or not), these explorations are obviously done in concert with the hospital’s administration. The board should recognize that the C-suite may have trepidations about the impact of any affiliation on their jobs and careers. Understanding and taking steps to mitigate any negative impact an affiliation may have on the leadership team is an integral part of the process.

If the analysis of all the options leads the board to conclude that independence is the best way to thrive (and not merely survive), then the fiduciary duty of care has been fulfilled. The board must set aside any preconceived notion that independence is best, period. If the vow to independence leads to substandard performance, a fire sale or hospital closure, then the board has breached its duty of care.

Neither affiliation nor a vow of independence should be the sole focus of a board’s process. Instead, a board should vow to ensure the

hospital’s mission of providing high-quality, affordable care and meeting community needs.

Be Proactive

“Meditate in my direction, feel your way.”

Jack Welch, former CEO of General Electric famously implored, “Change before you have to.” While this is true of many areas in life and business, it is especially applicable when considering strategic positioning. Waiting until finances have deteriorated may lead to forgone investments in facilities and care resources, negatively impacting patient organizational performance. A position of relative strength allows the board to have time and focus to explore a full range of possibilities carefully. Integration with a partner, if that is the path ultimately selected, is more easily achieved from a solid starting point.

While a strong position offers flexibility and an attractive profile, sophisticated potential partners recognize the common industry challenges facing many hospitals. The best systems can identify how their operational approach and infrastructure should help address these challenges.

The appetite for significant change is lower when times are good. The conundrum is that few organizations can look far enough into the future to predict their performance. The trick is to decide whether to affiliate or not (the right thing) for the right reasons, in the right way, and as noted here, at the right time. The critical point is that a board should go through the process of considering its optimal

strategic positioning continuously.

If a balance of local control with the benefits of affiliation (scale) is the most desirable outcome, after all issues and options are considered, then timing is important. The strength of the local hospital impacts the balance of local control vs. affiliation. If the brand reputation, balance sheet, breadth of services, market share and more are strong, a relationship with a partner will likely garner the most local control. If, on the other hand, the hospital’s position is weak or, worse yet, desperate, then the likelihood of dominant local control will be diminished.

Conduct a Thoughtful Process

“Are you sure ... (yes) I’m sure down deep inside.”

The hallmark of good decision-making is having a basis of comparison. A well-designed process to explore affiliation options should not start with a specific solution in mind. Instead, it should begin with a thorough and candid review of the organizational needs and environmental factors to establish agreed-upon objectives.

These objectives could include financial, clinical and administrative goals — or, more likely, a combination of several targets — and should reflect the input of key stakeholders. A ranked list of objectives is critical to measuring potential options against real-world organizational priorities.

Once the board is aligned on the approach, engaging a broader set of stakeholders can help ensure greater alignment and community understanding of the “why” and

the “how.” The process should simultaneously identify several interested potential partners and elicit a vision of how they are prepared to work collaboratively.

Considering a broad range of partners and options helps ensure that any eventual decision meets internal and external challenges. Given the unique nature of this undertaking, many boards choose to engage experienced advisory firms for real-time guidance on the process’s financial, legal and communications aspects.

One cautionary note for boards considering dipping their toe into a partnership through focused arrangements: Be careful not to unwittingly give away leverage when these partnerships involve essential offerings such as electronic medical records and clinical staffing.

Affiliation Options

“You’re the one that I want, the one I need.”

“Grease” ends with Danny and Sandy leaving in a magical flying car after Sandy does much soul-searching and transforms herself. How does a hospital board find the happily-ever-after solution for its community?

Many organizations assume affiliation means joining a larger system, but the actual range of potential solutions offers more flexibility to match the underlying objectives. A hospital aiming to bolster its clinical and administrative resources may consider an affiliation with a leading national system. These range from specialty-focused arrangements on cancer or cardiac care, for exam-

ple, to broader offerings, including care resources, access to virtual consults, best practice sharing, quality improvement and more. Proffered services often are based on a subscription model and do not provide capital and other scale advantages.

Hospitals have found value in focusing on their immediate regions and linking with others of similar size to offer a new service line, enhance their capabilities, broaden their clinical networks and split infrastructure costs. This regional approach could take the form of a joint venture as a first step or extend up to a full consolidation of organizations.

Hospitals seeking broad objectives, including capital commitments, clinical resources and information technology, may join a system with demonstrated competency in these areas. Regardless of the affiliation option, appropriate due diligence is required to ensure the potential advantages are real and the partner is a strong cultural fit.

Conclusion

In the finale of “Grease,” the chemistry between Sandy and Danny is palpable, but it occurs only after they both commit to their authentic selves. The lesson here is that no one should change for anyone but themselves (or, in this case, your hospital.) Rather than changing for her man, Sandy transitioned throughout the movie — and only when she was ready and comfortable to do so. In the end, Sandy chose Danny. What will your board do? Our recommendation? Do the due diligence to find the best option

that aligns with your hospital’s mission and objectives.

And remember, Grease is the word!

“Nothing left, nothing left for me to do!”

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