

Standing Strong:

How Independent Hospitals Can Survive and Thrive
In Today's Challenging Environment

Today's independent hospitals are a hardy lot. They've fought to remain independent because they prize local control for its very focus on local priorities.

Now, more than ever, independent hospitals need to understand their strategic options and risks to weather the challenges ahead.



Uncertain Times

Imagine your community without its greatest healthcare asset – your hospital.

What would that mean for local business development? Your population base? Your property value? Your future?

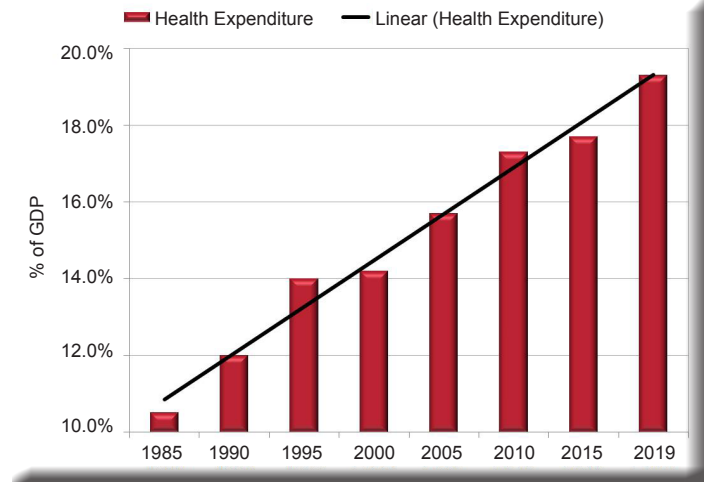
Independent hospitals -- if they've managed to compete for physicians and market share and stay in the black until now -- are straining on the uphill climb against an economic downturn. And health reform, in the form of the 2010 Accountable Care Act, poses additional challenges for independent hospitals to remain solvent.

Our nation is nearing the time when the cost of decades of federal health mandates will no longer be sustainable. Healthcare spending in 2008 was 21.6 times 1970 levels.¹ Our economy can't keep pace with the skyrocketing cost of healthcare demands, with the rate of healthcare spending projected to near 20% of GDP by 2019. Corrective action will occur. It is driven by economics.

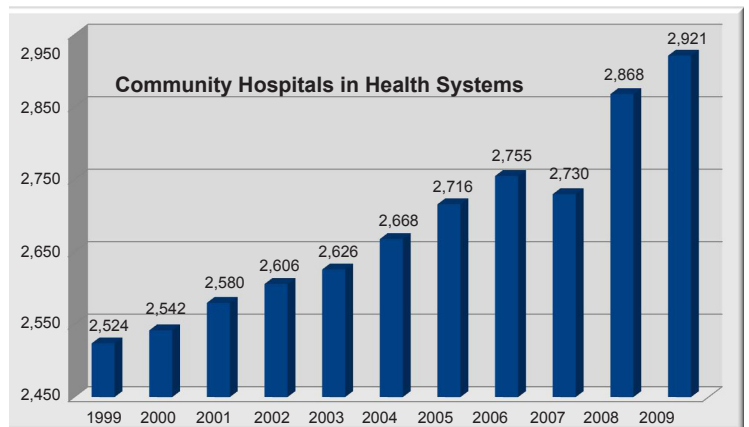
In fact, the next several years have the potential to be as disruptive to hospitals as the 1983 federally mandated transition to Diagnostic-Related Groups (DRG's), which shifted financial risk to hospitals. Those that could deliver care for less thrived, but many failed. From 1983 to 2007, approximately 2,500 hospitals entered into bankruptcy, closed, or were acquired.²

Hospitals and physicians are once again in the crosshairs of government cost cutting. Government (Medicare/Medicaid) reimbursed 47% of all hospital expenditures in 2009, with hospitals and physicians receiving more than 50% of those healthcare dollars.³

U.S. Healthcare Expenditures as a % of GDP

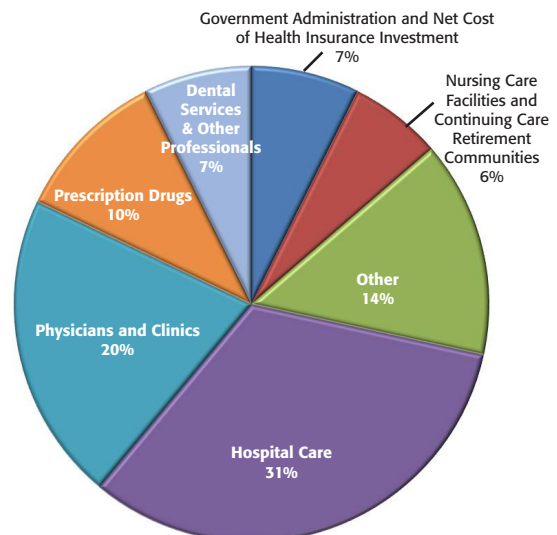


Source: National Health Expenditure Projections 2009-2019, CMS, 2010



Source: AHA Data

The Nation's Health Dollar, Calendar Year 2009: Where it Went



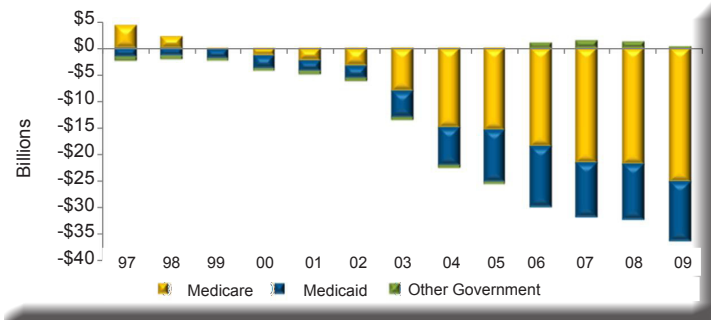
Source: Centers for Medicare & Medicaid Services, Office of the Actuary, National Health Statistics Group

Medicare and Medicaid already pay hospitals less than the cost of the care they provide beneficiaries— a shortfall of \$25.2 and \$11.3 billion respectively, according to the American Hospital Association.

The low-hanging fruit has long been picked. How much more efficiency can hospitals find? Can they squeeze more costs out of operations? How can they do this while implementing federal mandates which will challenge administrative costs?

Trustees of independent not-for-profit hospitals are being forced to carefully evaluate the strategic, financial and operational resources they need to survive in this challenging environment and to consider new alternatives that will allow their hospitals to both succeed and maintain local autonomy.

Gap in Reimbursement for Medicare / Medicaid Patients



Source: AHA Annual Survey Data, 2009

Fierce Challenges

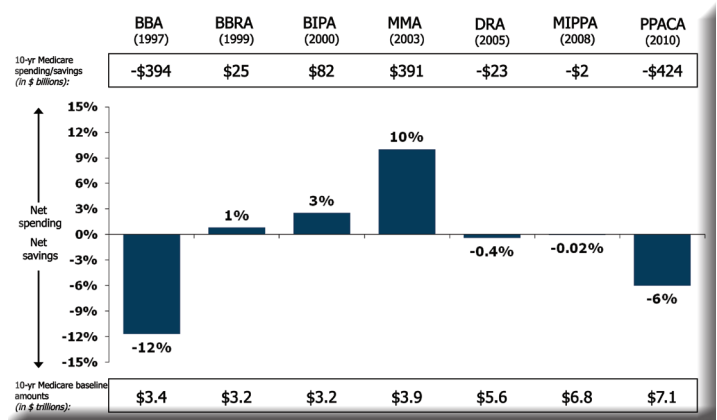
Once again, independent not-for-profit hospitals are called on to do more with less; to excel in performance even in the face of declining hospital revenues.

Re-balancing, with Fewer Resources

Hospitals must shift from procedure-based to outcomes-based reimbursement, while continuing to improve quality of care. Implementing electronic health records will cost hospitals – and failing to implement them will cost, as well. All of this comes at a time when the anticipated impact of health reform include:

- A 0.4% decrease in Medicare payments to hospitals (\$440 million) in Fiscal year 2011
- More cuts in the form of another “case-mix creep” adjustment in Fiscal year 2012
- In Fiscal year 2014, Medicare and Medicaid payments will be reduced by 1%; lower inflation increases; expanded healthcare coverage begins⁴

Net Effect of Major Legislation on Medicare Spending
Net Spending/Savings as a Share of Projected Medicare Spending Over 10 Years



Source: Kaiser Family Foundation analysis of Congressional Budget Office (CBO) estimates. Notes: Shares are rounded to the nearest whole number. Net spending as a percent of baseline for MIPPA is rounded up from -0.02%; estimate for DRA is rounded from -0.47%. Baseline amounts are based on CBO projections of 10-year Medicare baseline spending prior to enactment of legislation.

Treading a Financial Tightrope

If there is one component of a hospital's budget that is a sure thing, it's that costs (like the consumer price index) will continue to increase. Meanwhile, the downturn of a single large employer in the service area can cripple a smaller hospital. A prolonged weak economy can, at the very least, cause volumes to dip as people postpone elective procedures. Other investments may no longer make up the shortfall. The result can be a highly uncertain forecast.

Starving for Capital

It has been difficult in the past few years for community hospitals to raise money to fund strategic upgrades in their facilities, service lines and technology. Add to that the pressing need for cash to comply with federal health reform mandates, including implementation of electronic health records, HIPAA, compliance, etc. How will hospitals with so many demands on their balance sheets qualify?

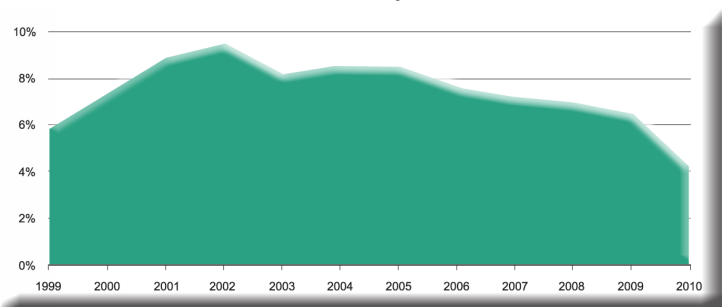
Image Is (almost) Everything

Hospitals with diminishing resources may face difficulties in recruiting and retaining a top medical staff. An inability to expand the hospital's mix of services can strain physician relationships or result in the outmigration of patients. Likewise, when physical plant and technology improvements are postponed, medical staff members may become disenfranchised and physicians may choose to refer patients to other facilities, or even leave the community. These trends can weaken community support and jeopardize philanthropic donations - challenges that can tax even the most veteran leadership.

How Deep Is Your Bench Strength?

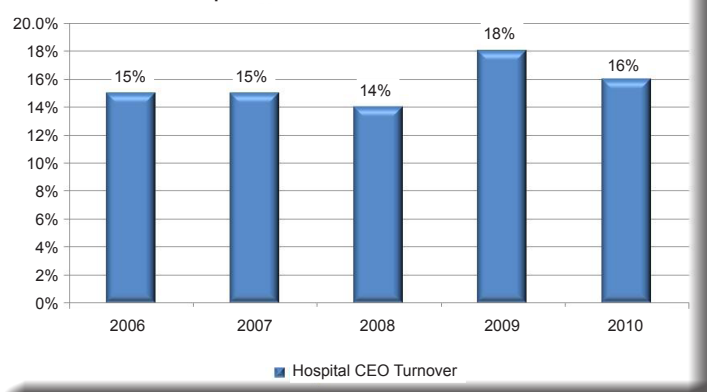
In the past decade, CEO turnover in U.S. hospitals has ranged between 14 to 18% per year, with 22% of hospitals having hired 3 or 4 CEOs in just the past 5 years.⁵ City and county hospitals account for 48% of the CEO turnover.⁶ Hospitals increasingly need support to effectively rebalance resources, recruit talent, defend against competitors and improve the hospital's value, cost and quality position.

Median Not-for-Profit Hospital Revenue Growth



Source: Moody's Investors Service, April 15, 2011

Hospital CEO Turnover 2006 - 2010



Source: American College of Healthcare Executives, February 18, 2011

What Boards Need to Know

Each independent hospital has its own unique situation. Therefore, each board should conduct its own formal, independent evaluation to determine what is best for its community. As these leaders consider what is best for their hospital's future, many will contemplate whether to continue to go it alone, align with a large tertiary system, consider a sale or merger, or maintain independence while hiring a hospital management firm for strategic, financial, operations and quality expertise.

In weighing their options and considering their own goals, boards should also keep in mind the perspectives and objectives of potential strategic partners. Does that partner embrace the hospital's mission, vision and values? Will it share in or complement the hospital's strategic priorities? And, as board members assess the alternatives, they must satisfy not only their own concerns and questions, but also those of the communities they represent and serve.

After evaluating the alternatives, many independent hospitals determine that hiring a professional management firm offers the benefits of being part of a larger system while preserving local autonomy.

How Hospital Management Firms Work

Professional management firms work for and under the direction of the hospital board. They provide an experienced CEO and CFO, recruited by seasoned hospital operators to meet the particular needs of a hospital and community. Once in place, the management team is supported by experienced operations and financial advisors.

These arrangements, structured properly and delivered by experienced professionals, do not require relinquishing hospital control as does a merger, lease, sale or management by a tertiary system. Investments made in the facility stay with the hospital upon contract termination, and boards have peace of mind, knowing they can depend on experts to guide their decision-making.

Services and support offered by a management firm are matched to the unique goals of the hospital, as defined by its board. Management firms can also bring vast resources, as they are needed, to help achieve the hospital's initiatives. Progress is monitored and reviewed frequently.

"We were borrowing money to make payroll! We thought we couldn't afford QHR...But the exact opposite was true. This hospital wouldn't be here today if it wasn't for QHR."

Alice Dodd, Board Chair
Sullivan County Medical Center

"To have Quorum as a resource...it's been priceless for us. It allows the board to not worry about the day-to-day minutiae. We can look to the future and be very progressive."

B.J. Swanson, Board Chair
Gritman Medical Center

QHR, the nation's leading hospital management firm, has provided community hospitals the leadership, management assistance and strategic resources they need for more than 30 years, including:

- **Top leadership expertise, with 300+ CEOs/CFOs**
- **National and regional support through veteran advisors**
- **Best-in-industry purchasing discounts available**
- **160+ unique consulting services for focused problem solving**
- **Guidance in strategic planning and physician recruiting/retention**
- **Proven educational programs for trustees, executives and department heads**



Perhaps the most defining characteristic of this type of arrangement is accountability. QHR commits to the hospital's success and is accountable to its board. The very nature of its renewable contract means that QHR must align its goals with those of the hospital and exceed expectations. It does. With a 97% annual retention rate, client hospitals remain with QHR, on average, for more than 20 years.

As a partner in spirit though not in ownership, QHR commits its impressive resources to:

- **Enhancing revenue and financial strength**
- **Improving quality, image and market share**
- **Strengthening key service lines**
- **Leveraging clinical affiliations**
- **Strategizing for sustainability**

What Happens When a Tertiary System Manages an Independent Hospital?

Tertiary hospitals and systems may appear to offer a panacea for an independent hospital. They can provide management support and savings from consolidation of administrative functions, along with access to specialists for your patients. But these organizations typically have built their success operating large urban facilities and may not be organized to support the unique needs of medium and small not-for-profit hospitals.

A tertiary system's culture, mission, vision and values may not be reflective of the independent hospital. And, trustees of the tertiary system are obligated to place priority on their own system's needs and motives. Such lease style arrangements - typically 10 plus year contracts - can reduce the independent hospital's local decision making authority and control and may even shift physician referrals away from the hospital. At contract termination, investments in technology, such as electronic medical records, may be lost.

It's an era of change. We have to be able to change with it. Our relationship with QHR has been very rewarding, very effective, very productive."

Ron Burnham, Board Chair
Holy Cross Hospital

Conclusion

A weak economy and the impact of health reform legislation are creating unprecedented pressures on independent hospitals. Many that have survived thus far lack the capital and management resources required to navigate future challenges. For these independent hospitals, functioning in isolation over the coming years may not be a viable survival or growth strategy.

Hospital trustees and senior leadership share a covenant with the communities that trust them to oversee the hospital and essential local healthcare services. Trustees also have the tremendous responsibility of overseeing the operations of a major employer and economic engine in their community. Fortunately, options exist that can provide community hospitals with the leadership, management assistance, and strategic resources they need – without a loss of autonomy.

It is impossible for a small or even a medium hospital to keep up with government regulations and still run a business. With health reform, hospitals will need QHR resources even more to stay "lean and mean" while maintaining quality.

Melissa Fraser, Board Chair
West Park Hospital

By objectively considering the benefits offered by a professional management partner strategy, trustees can remain true to their communities. In partnering with a management firm that has the strong track record of QHR, trustees can expect significant gains from their relationship with the right ally while maintaining secure ownership of the hospital and continuing to exercise local control of the community's most valuable healthcare asset.



About QHR

Quorum Health Resources (QHR) has more than three decades of hospital management experience. Our experts help hospitals survive and thrive in uncertain times. We help clients develop strategies, achieve goals and enhance the value of existing assets. Governance, management and the medical staff are aligned to help our client hospitals be successful. Don't stand alone. Stand with nearly 150 independent hospitals.

For more information call **866.371.4669** or go to **www.QHR.com**.

References:

- ¹ US Bureau of Labor Statistics, US Bureau of Census, US Department of Commerce, Bureau of Economic Analysis, Centers for Medicare and Medicaid Studies
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- ⁴ Moody's Investor Service: Risk of Payment Cuts Looms for U.S. Healthcare Providers. November 11, 2010
- ⁵ American College of Healthcare Executives (ACHE): Hospital CEO Turnover In U.S. Hospitals. March 14, 2010
- ⁶ Lippincott Williams & Wilkins, Inc: Critical Access Hospital Chief Executive Officer Turnover: Implications and Challenges for Governing Boards. March 2010