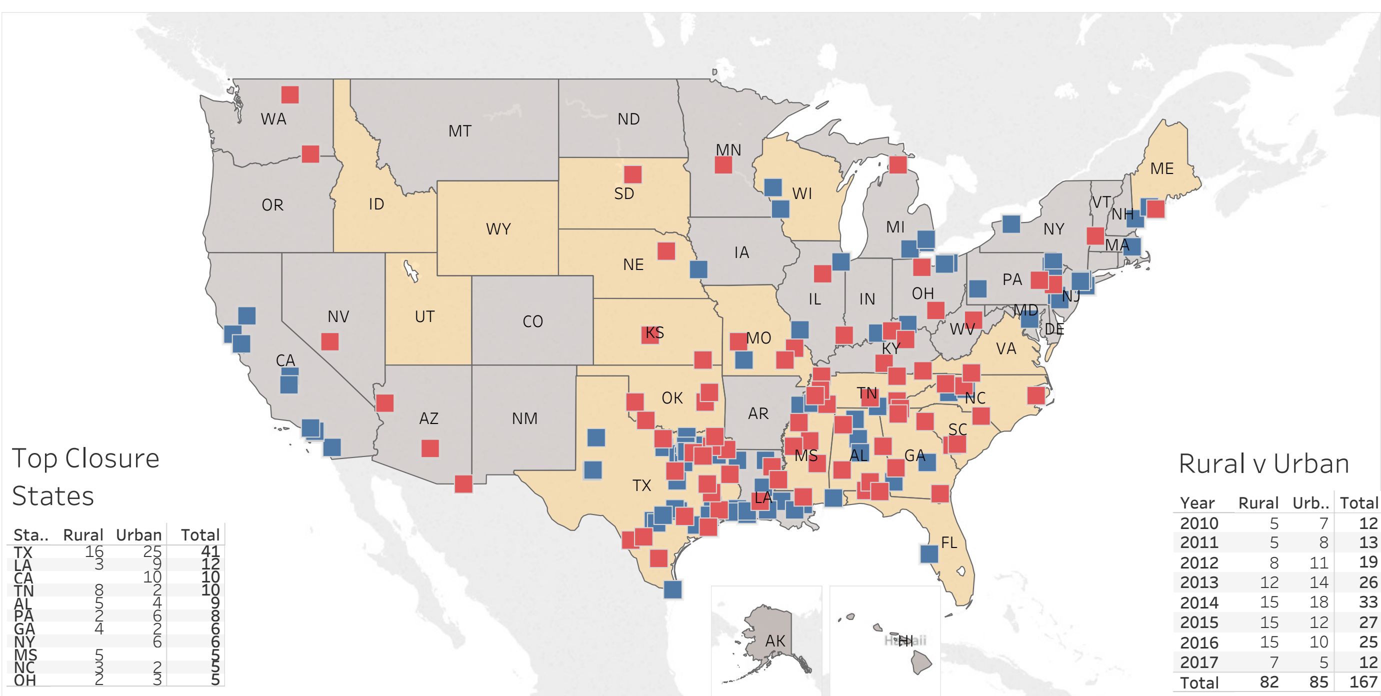
» Heightened Risks. Dysfunctional inter-entity relationships can explode into public view when the underlying operating risks and performance of the hospital change. Many counties and districts have grown apprehensive given the rash of hospital closings, increased stress on operating performance, difficulty recruiting needed providers, and the mounting cost of needed and deferred investment in hospital facilities, equipment, and technology (see Figure 1).

Hospital and district/county boards must appreciate that a hospital's operating and strategic risk profile is dynamic. The direction and severity of risk is affected by industry, market, and organization-specific factors. Economies of scale, technology, regulatory complexity, provider shortages, demographics, and payment changes all contribute to an adverse set of risks. Many districts and counties are wary of these changes and their exposure to the associated risks, while many hospital boards resist questions and heightened interest from districts/counties that can feel like second guessing or meddling.

Hospital and county/district stakeholders must appreciate how the risk environment is changing and how these risk factors may affect the local hospital. A common fact base regarding these operating and strategic factors is essential to creating a shared vision for local health care delivery. We often recommend that hospital boards complete an annual organizational risk profile and examine the results over multiple years across key operating and strategic metrics (see Figure 2 on the next page).

Figure 1. Hospital Closures Since 2010

Rural and Urban Hospital Closures since 2010



Top Closure States

Sta..	Rural	Urban	Total
TX	16	25	41
LA	3	9	12
CA		10	10
TN	8	2	10
AL	5	4	9
PA	2	6	8
GA	4	2	6
NY		6	6
MS	5		5
NC	3	2	5
OH	2	3	5

Rural v Urban

Year	Rural	Urb..	Total
2010	5	7	12
2011	5	8	13
2012	8	11	19
2013	12	14	26
2014	15	18	33
2015	15	12	27
2016	15	10	25
2017	7	5	12
Total	82	85	167

Current Status of Medicaid Expansion Decision
- Adopted the Medicaid Expansion
- Not Adopting the Medicaid Expansion at thi..

Rural v Urban
- Rural
- Urban

Rural v Urban based on cost report designation

Sources: Cost Report data, The Cecil G. Sheps Center for Health Services Research, KFF.org

STROUDWATER

Case Studies

Not all Fun in the Sun

In a large and growing southern state, Stroudwater was retained to work with a $250M health system and its local hospital district to develop a shared vision for the future of the local health care system. The foundation of this effort was the good working relationship between the new hospital district president and the hospital board president.

Stroudwater worked with both leaders to convene a small committee that included community, district, and hospital board members. The committee vetted and reviewed a common fact base of strategic market and operational data and findings. The members also explored alternative strategic options for the local delivery system. All of this work was done within the context of a highly dysfunctional relationship between the district and hospital. With effective leadership and a commitment to make a fact-based set of recommendations, members of the committee were able to put aside the history of distrust and develop a unanimous vision for the future of the local delivery system. This vision, which was adopted by both the hospital board and district board, ultimately brought the hospital into an affiliation agreement with a leading not-for-profit academic health system.

A Second Opinion Leads the Way

The two hospitals in this community had merged recently. The resulting combined entity had committed to the phased development of a consolidated replacement hospital facility. Bonds were issued and construction completed on the initial phase of the new campus. Unfortunately, just as the hospital began operating Phase I of its new campus (while continuing to operate its larger legacy campus), operations deteriorated. The county, which owned the hospital assets and leased those assets to a 501(c)(3), became concerned about the feasibility of the hospital's plan.

The hospital board was fiercely critical of this unwelcome oversight. The board decried the negative impact that such public scrutiny imposed on the hospital. The county, as steward of the public asset, felt obligated to examine the feasibility of the hospital's apparently stalled replacement project. Stroudwater was retained to conduct an analysis of the project's feasibility. Shortly before the Stroudwater report was shared with the county and hospital boards, the hospital's bond rating was downgraded two levels. The Stroudwater report raised significant concerns about the feasibility and timeline of the phased replacement project. These concerns were based on three factors: (1) the overcall cost of the project relative to the hospital's baseline cash flow; (2) the large, necessary investment in non-revenue-producing infrastructure comprising a large portion of the initial phases of the project that compromised the feasibility of subsequent phases; and (3) deteriorating operating results that limited the hospital's access to capital for subsequent phases of the project.

Based on the ratings downgrade and Stroudwater's analysis, the county and hospital board agreed to examine the hospital's strategic options and find the best path forward. As a result, the county, hospital, and a health system entered into a joint venture that ensured completion of the project and uninterrupted local access to essential health care services.

Loose Lips Sink the Strategic Ship: County and Hospital Authority Power Struggle in the Midwest

Stroudwater was retained to assist a community hospital in the Midwest to undertake an affiliation process. The $50-million-net-patient revenue organization was an authority-structured hospital with a board appointed by the local county government's elected officials. Before Stroudwater was retained, the county backed a significant bond issuance. This debt refinancing provided the authority with significant debt relief, shifting debt payment responsibilities from the authority (i.e., the hospital) to the county (i.e., county taxpayers). Any transaction of the hospital would provide the county with some level of debt relief.

Understandably, the county was keenly interested in the success of the affiliation process. Unfortunately, the long-standing personal relationships between individual county representatives and hospital authority board members made trust and effective communication between the two entities exceptionally challenging. Additionally, members of the hospital authority had grave concerns that confidential information concerning the affiliation process could not be shared with key county representatives without eroding the integrity of the process. This distrust between key leaders was further compounded with hardline negotiation tactics by the prospective buyer.

Suspected leaks of confidential deal information and the hospital's own declining operating performance led the prospective buyer to rescind its offer. Unfortunately for all local stakeholders, internal distrust, poor communication, and a loss of focus on the hospital's operations resulted in a lost opportunity to secure commitments to maintain the local delivery of health care services and address the county's need for debt defeasance.

Performance Improvement as a Prerequisite: Distressed Rural Community Hospital in Southeast

After receiving funds from the local county government as a part of a bond issuance, the board of directors of a community hospital in the Southeast with $40 million net patient revenue asked Stroudwater to assess its strategic options and identify performance improvement opportunities. The hospital was losing several hundred thousand dollars each month, had a negative EBIDA, and had cash reserves only sufficient to fund six months of operations at its then-current loss rate. Officials with the local county government provided the hospital board with a mandate to realize performance improvement and provide the hospital with a sustainable path forward.

Stroudwater's team undertook a strategic options and operational assessment. As part of this assessment, Stroudwater analyzed the hospital's operations and identified over $5 million in performance improvement opportunities. These performance improvement opportunities included both cash and revenue enhancements through revenue cycle improvement, clinical efficiency designed to improve the hospital's length of stay and other quality-based reimbursements, and staffing efficiency. Given the hospital's limited management resources, Stroudwater also identified a specific leadership resource to oversee the implementation of the hospital's performance improvement plan.

Additionally, Stroudwater assisted the board in developing a set of strategic objectives. The board determined that these strategic objectives would best be realized via an affiliation with a larger health system. To support that affiliation process, the board immediately began necessary efforts to realize financial and operational performance improvement.

As part the engagement, Stroudwater presented its strategic options and operational assessment to the county government's leadership. This presentation provided the county with the assurance that necessary and corrective action was being taken and established a transparent and continuous open dialogue between the hospital's board leadership and county leadership. This dialogue aligned the county government with the hospital board's efforts to improve the hospital's operations through necessary performance improvement initiatives that supported the strategic direction established by the board.

The Need for Functional and Effective Governance

The health care industry's current period of disruption is contributing to tension and anxiety between county and hospital district lessors and their community hospital board lessees. Declining reimbursement and stagnant or increasing operating costs are exposing community hospitals to increasing levels of stress and distress. Out-of-date governance practices, poor communication, and fraught personal relationships can fan the flames of these challenges.

Navigating this difficult terrain necessitates key commitments from all involved stakeholders. Sound leadership and effective governance and communication are essential. Parties must be willing to engage one another in collaborative and constructive ways. In addition, stakeholders from the various entities must work from a common set of facts to arrive at a shared vision for the future of local health care delivery. It is this shared vision that provides the basis for a consensus on how best to address the challenges that confront the local health care system.

The challenges facing community hospitals in the present environment are significant. These challenges require hospital boards to focus on the specific issues facing their organizations and increasingly require collaboration and assistance from district and county governments. While this assistance may carry issues of broad public or political interest, all stakeholders can and should find alignment on the primary strategic objective: preserving and enhancing access to quality health care services in their community. ◆

Endnote

1 *See* Ayla Ellison, *Fitch Issues Negative Outlook for Nonprofit Hospitals*, Becker's Hospital Review (Dec. 16 2017), *available at* https://www.beckershospitalreview.com/finance/fitch-issues-negative-outlook-for-nonprofit-hospitals-4-things-to-know.html; *see also Ellison Moody's: Outlook is Negative for Nonprofit Hospital Sector*, Becker's Hospital Review (Dec. 4 2017), *available at* https://www.beckershospitalreview.com/finance/moody-s-outlook-is-negative-for-nonprofit-hospital-sector.html.