

A 2009 AHA study found that nearly 1 in 10 hospitals surveyed had experienced a bond covenant default.¹

MANAGING A HOSPITAL TURNAROUND: A Board Primer

Even when there are no flashing red lights, a hospital can be on the verge of financial distress. An unexpected drop in an investment portfolio, an increase in bad debt, or layoffs in the local economy can push a hospital into the danger zone. The facility can quickly find itself crossing financial thresholds that render it non-investment grade, making access to fresh capital very difficult. A balanced, proactive board can help a hospital anticipate these difficulties – and can help “right the ship” faster when problems do emerge.

This paper will offer insights on the style and structure of highly effective boards – and help board members understand the stages of hospital distress so they can take action sooner. The paper will also provide strategies for successfully restoring hospitals to sustainable profitability.

QUALITIES OF A PROACTIVE BOARD

Successful boards set the tone for the entire institution – and are the embodiment of its commitment to quality, community service and effective financial stewardship. Here are some of the qualities shared by good boards, large and small:

Clear Understanding of the Local Market – Every board should have an accurate assessment of the community's current and future healthcare needs. This requires careful analysis of the latest demographic data: Is the local population growing or declining? What is the average age of the patients served?

Desire To Involve All Stakeholders – Perhaps the most important thing any board can do is foster genuine teamwork between physicians, hospital management, nursing staff, volunteers and, most importantly, the community it serves. In particular, a board must champion and successfully implement physician/hospital alignment² to position itself for future success.

Strategic vs. Tactical Mindset – Most hospitals that get into trouble don't have an actionable, measurable strategic plan. This roadmap needs to be effectively communicated to every department and employee, not just senior-level management.

Healthy Balance – Great boards strive for balance, with members who represent a variety of interests: medicine, finance, quality, compliance, and local business. Many boards are top-heavy with community leaders and thin on healthcare-related financial expertise. Financially astute board members can transform the entire board's effectiveness. It's vitally important for board members to be able to read a financial statement and understand its nuances.

Effective Use of Meaningful Metrics – It's critical for the board to have access to performance dashboards – not just on finance, but compliance, quality and other measurements tied to the hospital's strategic and financial improvement plan.

A good board will involve the entire staff in creating a dashboard. The hospital's quality and compliance committees can offer valuable input – and the medical staff can make recommendations for how to link the dashboard to the overarching strategic plan. Some measurements are critically important to include: days cash on hand, operating/net income, year-over-year performance, service line profitability, financial viability of physician employment contracts, HCAHPS, etc.

Accountable to Key Stakeholders – In the eyes of the community and financial stakeholders, the board is ultimately responsible for the quality and financial performance of the hospital. The board's challenge is to find the tools it needs to meet those responsibilities. Many boards place unconditional faith in hospital management, trusting them to monitor (but not report) the metrics outlined above. The board needs to establish a culture of accountability without putting every activity under the microscope.

Commitment To Ongoing Education – Proactive board members are eager to keep learning, whether that means attending seminars or learning how to read a financial statement. Every board member should strive to understand the prevailing trends in healthcare, not just local issues. Not surprisingly, some hospital management teams discourage these educational opportunities because informed board members might demand more accountability.

Effective Outreach To The Community – Like other successful enterprises, proactive boards manage the relationships with local business and political leaders as well as media expectations and news flow. They don't overreact to unflattering stories. And if the hospital is facing adversity, board members (or their PR professionals) should convey that the entire team is doing everything in its power to ensure ongoing quality care. [See sidebar – Crisis Management 101.]

CRISIS MANAGEMENT 101

1. **Talk to the staff before the media** – Make sure all employees understand the hospital's situation – and the role they need to play in a turnaround.
2. **Don't circle the wagons** – In difficult times, it's a huge mistake to pretend that there's no problem or to hide from the media. Draw on the reservoir of community goodwill.
3. **Don't over communicate** – The local press more than likely does not understand your hospital performance dashboard. It is important to communicate the “big picture and not the fine details”
4. **Practice absolute honesty** – This is not the time for “spin.”
5. **Be consistent** – Don't paint a grim picture on Monday and a rosy one on Friday.

1. **Loss Of Key Physician(s)** – This is the earliest of the red flags. When one or more of the hospital's key admitters/producers leaves unexpectedly, board members need to take notice. When physicians leave for another hospital, that's especially worrisome.
2. **Inpatient/Outpatient Volume Drops** – Experts agree wholeheartedly on this point: when inpatient/outpatient volume drops, that should be a “code red” for any board. Just like retail chains that analyze “same store” data, the board should ask, “How did our volume this quarter compare to what we did in the same quarter last year?”
3. **Increasing Expenses/Payables** – A simple balance sheet review will highlight the most glaring spikes in payables. A wide variety of expenses may suddenly be on the rise, such as salaries and benefits as a percentage of net revenue, higher supply costs, etc.
4. **Managed Care Problems** – Some hospitals find themselves at a disadvantage with major payers. If the facility's rates haven't been keeping up with its peer group, that's a sign of looming trouble.
5. **Lack of Actionable Financial Data** – Many boards receive mountains of raw data, but they lack the expertise to drill down and get the specific answers they need. Someone on the board needs to separate the wheat from the chaff so the board can make informed decisions.

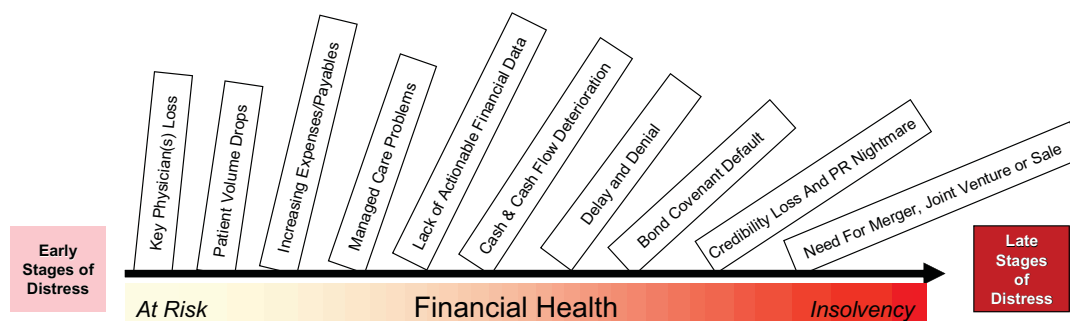
6. **Cash & Cash Flow Deterioration** – This is the dreaded drop in days cash on hand. Many boards mistakenly view this as the earliest indicator of a problem. It's actually the first sign of a crisis. There's no simple rule-of-thumb for how much cash to have

on hand. In general, almost any event can push a hospital over the edge if it has less than 90 days' operating cash. And it's equally important to monitor cash flow. Most boards

THE STAGES OF DISTRESS

A Board Perspective

Here are the sequential stages of distress that every board member should be able to identify:



are not trained to look at earnings before interest, depreciation and taxes.

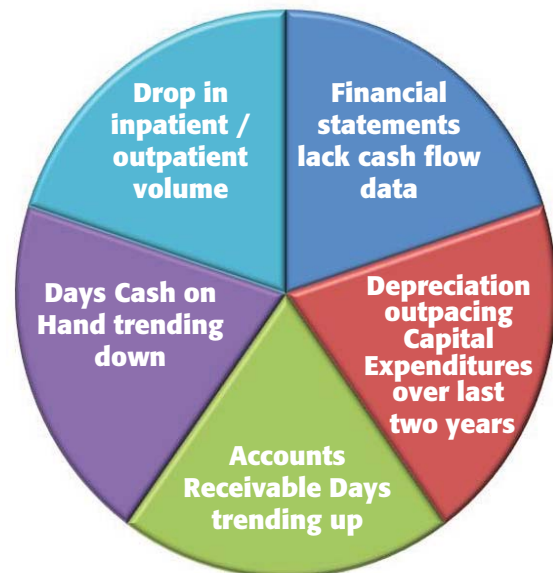
7. **Delay and Denial** – When a hospital finds itself cash-poor, it's time to act swiftly.³ This is not the time for hand-wringing, finger-pointing or denial. If board members don't have financial monitors in place at this point, they're not going to know the gravity of the situation until it's far too late: when an audit firm gives them a going-concern opinion – or bond counsel and creditors are at the door. By this point, other key physicians and staff members are beginning to jump ship.

8. **Bond Covenant Default** – This is the stage when the hospital management team is experiencing high levels of stress, and the situation often dictates that outside experts are brought in. At this point, however, the hospital doesn't have the time or money to fix the problems painlessly. The facility doesn't have the means to expand or refurbish. Finding fresh capital is all but impossible. Just like a battleship, it takes time to turn a hospital around: 180 days minimum if you're lucky, but usually longer.

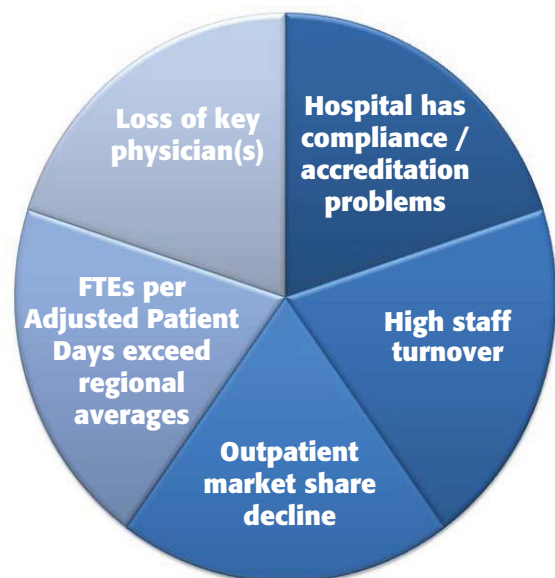
9. **Credibility Loss And PR Nightmare** – By this point, inpatient/outpatient volume drops further because of the perceived drop in quality. The board loses credibility in the community because problems are mounting and solutions are few. This makes public relations particularly difficult.⁴ Taking a wait and see attitude and shunning the media, will allow matters to worsen. In some cases, the hospital's financial situation is so dire that the board can't afford to retain a PR firm adept in crisis management.

10. **Need For A Merger, Joint Venture or Sale** – Turnaround experts play a vital role when hospitals reach this final phase. They have the expertise to help find new funding or partners who can help the hospital survive. But there could have been a happier ending if the turnaround professionals had been brought in much earlier – to provide a strategic plan, review financial and operations trends, and provide board education that could have prevented the worst-case scenario.

Financial Red Flags:



Operational Red Flags:



MANAGING A HOSPITAL TURNAROUND

Many distressed hospitals, both large and small, fail to take decisive action until there's a significant drop in patient volumes or an unexpected dip in days cash on hand. But turnaround experts can get better

results – faster – if they're brought in earlier in the process. Turnaround specialists agree that the job must begin with strong leadership and a team effort to rally community support.

Find The Right Leaders – Some hospital CEOs and CFOs are ideal for good times, but lack the tenacity to effectively turn around an ailing organization. It's essential to find energetic leaders who have the buy-in of the entire hospital and have some familiarity with the dynamics of a turnaround. Consultants can assist the board in finding a permanent or interim leader who's a turnaround expert.

Create/Revamp the Strategic Plan – Planning prevents panic. If your facility doesn't have a strategic plan, work with hospital leadership to create one. If there's already one in place, take a fresh look at your goals based on recent setbacks.

Start Multi-tasking – When a hospital is in financial and operational turmoil, the board needs to tackle the problem from multiple perspectives. For example, one board member might take charge of local fundraising, while another oversees efforts at raising capital from the investment community. Other board members are then freed up to evaluate potential new revenue streams or ways to improve quality.

Leverage Community Support – Just like Jimmy Stewart in the movie *It's A Wonderful Life*, a distressed hospital can count on the vast goodwill of the community. People know that the hospital is an indispensable asset, and they're eager to help it weather hard times. At this juncture, your local fundraising efforts should be in high gear.

Reduce Costs – The board's first impulse is to cut staff, but other options should be explored first. The board should view all costs as controllable and every cost should be evaluated. For example, a hospital can dramatically lower supply chain costs by closely examining and enforcing existing purchasing contracts.⁵ An institution can also enjoy savings by closely examining other existing vendor contracts.

Increase Revenue – It's always possible to find new revenue streams, even for distressed hospitals. Some rural hospitals have significantly boosted revenue by starting or enhancing a cardiology service line. Volume increases because patients can get quality care without driving an hour or more to a city hospital.

Find Innovative Solutions in Care Management – Some distressed hospitals are entering into joint ventures like low-cost clinics to handle uninsured patients. This puts less financial and operational strain on the hospital's Emergency Department.

Improve Revenue Cycle Management – An outside team can make an immediate impact here by helping a hospital with chargemaster updates, documentation reviews, coding training and more. That means a dramatic drop in Accounts Receivable days and more accurate charges.

Boost Case Management Productivity – If this is unfamiliar terrain for the CEO, turnaround consultants are highly proficient in improving operational processes and training staff. In many hospitals, they've worked closely with case managers to send productivity soaring.

Improve Quality and Customer Satisfaction – Once a hospital is out of the IC ward, it's time to resume the push for excellence. This is a perfect time to pursue joint ventures with area physicians to build high-quality, high-margin patient and diagnostic services.

Reduce Staff Turnover – One of the keys to a sustainable turnaround is reducing turnover and boosting employee morale. Hospital leadership, in tandem with turnaround experts, can help a board craft innovative programs that can reduce a runaway turnover rate (20% or higher) to 4% or lower.⁶

Promote Physician/Hospital Alignment – Health reform is dictating greater physician integration. Many board members don't grasp the new strategic importance of physician/hospital alignment and joint ventures. An outside team can show them how to

build and nurture those relationships. For example, when a hospital and surgery practice jointly finance an ambulatory surgery center, surgical volumes and hospital market share almost invariably increase.⁷

CONCLUSION

It's imperative for board members to recognize the early stages of hospital distress so that solutions can be found as soon as possible. With swift intervention, the hospital can continue to serve the community – and there's less risk for financial stakeholders.

QHR Intensive Resources provides short-term, high-intensity support to hospitals and health systems at every point on the distress spectrum discussed in this paper. Our experts can help refine the board's strategic plan and improve financial/operational oversight. We also help hospitals deal with the later stages of distress: bond covenant default, loss of accreditation, sale/merger issues, and bankruptcy.

Intensive Resources is a wholly owned subsidiary of Quorum Health Resources (QHR), the market leader in hospital management, serving about 150 multi-year clients across the U.S. QHR is the seventh largest healthcare management consulting firms in the U.S. and a leader in continuing education, the QHR Learning Institute reaches more than 10,000 healthcare professionals each year.

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