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What Would You Do?

how do we develop the scale and scope needed for the future?

The Problem

Regional Medical Center (RMC) is a prominent healthcare provider in the eastern suburbs of a major metropolitan area. Although RMC is reasonably large for a freestanding institution, its leaders believe the organization lacks the necessary size, scope of services, and geographic reach to be viable in the future. How should RMC address this need for significant growth?

The Situation

RMC is an integrated delivery system (IDS) with annual revenues of more than $900 million. The medical center has generated an operating margin of 2 to 4 percent consistently for many years. RMC also has a good nest egg of retained earnings (about $400 million in available cash) and a healthy, significant related foundation. It maintains an A+/stable rating from Standard & Poor's.

RMC operates a single-site 300-bed hospital and has an employed multispecialty medical group with 200 physicians and voluntary staff of 300 active physicians. It offers a broad range of services, typical of a major community/teaching hospital and large multispecialty group practice. Volume has been strong and growth has been consistent for at least the past 10 years; in 2010, the hospital recorded about 20,000 admissions and 20,000 total surgeries, while the medical group had 400,000 encounters.

Despite this positive picture, RMC operates in a highly and increasingly competitive regional market. By all measures, the market is oversupplied with healthcare resources, especially hospitals, tertiary services, and physicians, particularly specialists and subspecialists. There are two large systems operating in the market: One is not-for-profit and connected to a well-regarded academic medical center, and the other is for-profit. Those systems collectively have about a 40 percent share of the total metro market, while RMC's share is about 3 percent. Many smaller players remain. Implementation of healthcare reform, the residual effects of the 2008-09 recession, and the oversupply conditions in the market have created a situation where consolidation and a shakeout are inevitable in the near term.

RMC's leaders recognize that the organization will probably need to grow larger to deal with the challenges of federal healthcare reform and the market reform that are already occurring. Despite the organization's currently strong position in its market area and its good financial position, RMC's leaders believe that the organization is not well positioned to thrive (although survival is possible and even likely) under likely scenarios in the next two to three years. What should RMC do?

Alternatives Considered

RMC's CEO and CFO have estimated that even if the IDS were to remain largely focused on the eastern suburban part of the metro area in which it currently operates (although that positioning is a key strategic question), it would need to expand to at least three times its current size to flourish in the increasingly resource-constrained environment. A number of nearby community hospitals and physician groups have approached RMC about joining its system in the past six months, and both of the major systems in the region have inquired as to whether RMC would be interested in merging into their organizations. RMC currently lacks the framework to address any of these opportunities coherently.

This situation has prompted RMC's CEO and CFO to initiate an intensive system development strategic planning process. These leaders have developed future market assumptions based on a variety of scenarios they consider likely and on the size, scope, and financial parameters required for success under these scenarios. Following a review and revisions of these assumptions by a joint management/board task force, the CEO and CFO have developed a strategic evaluation framework to address the size and scope issues. In essence, there are four key questions for RMC to address:

> How do we reach the size needed to flourish in our environment?

> How do we rebalance our scope of services and broaden our scope to accommodate the full continuum necessary at the required size?

> What geographic areas should we cover?

> What should our overall posture be? Anticipatory/market leading? Opportunistic? Reactive?

With four key variables in play, RMC can choose from a multitude of potential alternatives. From the very start of the joint task force discussions, leaders for the organization have agreed that RMC should position itself as a market maker (i.e., anticipatory) and keep its geography largely focused on the eastern suburbs. Within this region, the hospital enjoys numerous opportunities relative to size and scope, all of which require it to reach out to other potential parties to achieve the critical mass its leaders believe are necessary for vitality in the future. Given this situation, how should RMC approach its system development needs?

SYSTEM DEVELOPMENT STRATEGIC EVALUATION FRAMEWORK

Geography					
East Only					
East and Adjacent Areas Only					
East and North or South					
Full Market Coverage					
	Build	Buy	Alliances/ Partnerships	Hybrids	Merge into Large System

Size/Scope

The Decision

Based on a set of criteria that largely focused on mission/vision fit, cultural compatibility, financial strength, and contribution to achieving a balanced continuum of services, the CEO's and CFO's staffs assessed every significant provider in the relevant geography and categorized the fit with RMC's needs as high, medium, or low. From this analysis, a list of priority targets (rank ordered) was developed and reviewed with the joint task force. Following their comments and suggested modifications, a case statement and future system vision was developed to use with each partner candidate, including pros and cons of linking up with RMC, alternative partnership models, and a suggested approach for negotiations leading to a transaction. RMC implemented this plan in March 2011 and expects to have made substantial progress toward building its future system by year-end. ●

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