

What Would You Do? Should We Develop a Children's Hospital?

Strategy Challenge

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The Problem

University Medical Center (UMC) has many elements in place to move from an important provider of pediatric services to a real children's hospital. But this strategic move will require a major capital investment and resources that arguably might be put to better use elsewhere in the medical center. The clinical department chairs and the senior administrative staff are divided on whether to proceed. What should UMC do?

The Situation

UMC is a mid-sized academic medical center located in a medium to large and highly competitive metropolitan area with a rapidly growing and relatively young population of about 1.5 million. UMC also serves a much larger region, with a total population of 6 million, that also is growing, although less rapidly. UMC's competition in the metro area and, to some degree, in the larger region consists mainly of three systems: a Catholic-sponsored system, another religiously sponsored system, and a nonsectarian system. The systems range in size from six to 12 hospitals each, have large physician groups associated with them, and generally have good geographic coverage of the metro area and some adjacent areas. The systems are financially healthy and provide good to very good care.

UMC is anomalous in that it has one main location in the metro area, although it does have 15 primary care sites distributed throughout the area. It, too, is financially sound. It has a faculty practice plan with 600 physicians (including the 100 primary care physicians in satellite offices). The practice plan has a well-distributed mix of medical and surgical specialists and, like most major teaching hospitals, an abundance of subspecialists and part-time clinicians, whose principal interest is teaching and/or research.

UMC recently completed a strategic plan in which it renewed its commitment to centers of excellence in cancer and cardiovascular disease. The plan also indicated that development of up to three centers of excellence in the next five years would be possible, including children's health care with a children's hospital as one possibility. Other candidates for centers of excellence are neurosciences and musculoskeletal services. With much work remaining to be done to build and strengthen the initial centers of excellence, and a variety of other high-priority strategic initiatives to be carried out, management believes that at most two additional centers of excellence might be launched in the next five years, and more likely one. Should children's health care be a strategic priority?

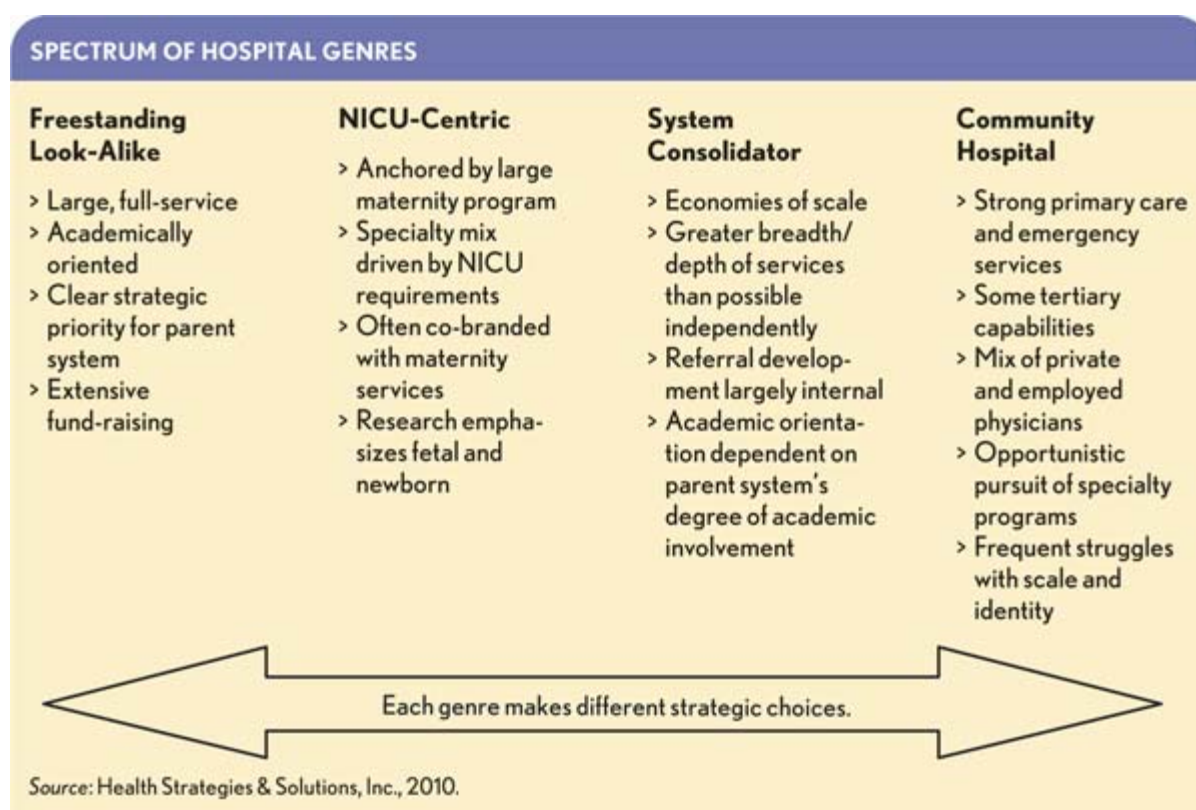
Alternatives Considered

UMC's pediatric department has 50 faculty members, with full, but not extensive, coverage in all subspecialties. Like other similar medical centers, surgical specialists are based in the department of surgery. UMC has a few pediatric general surgeons, and a handful of other surgical subspecialists. Likewise, the hospital-based departments are staffed, but thin, except for emergency services, which is fully staffed to support the pediatric emergency department (ED) adjacent to the main department.

The hospital has 36 general pediatric beds, a 12-bed pediatric intensive care unit, a 26-bed neonatal intensive care unit, the previously mentioned pediatric ED, and a broad range of pediatric clinics. Services are generally well utilized, and payer mix (hence margin) is not bad for a service of this type. Overall, pediatric services generate a slightly positive operating margin for the hospital. Despite all these resources, the state-level database shows that, on average, 2,000 inpatient cases annually have been outmigrating from the region to children's hospitals in other metro areas. The other competing systems in the metro area have not historically competed effectively for pediatric patients, although two of the three are of sufficient size to consider expanding their pediatric services into an array of subspecialty areas. Both are reportedly considering developing major women's and children's healthcare centers.

To move to the next level—i.e., from essentially an NICU-centric model to a freestanding look-alike—UMC would need to make a significant investment in faculty, program development, and facilities. A task force, which studied the subject during the strategic planning process, estimated that the magnitude of the investment over a five-year period would be as follows.

Exhibit 1



Faculty. UMC would require at least 20 new faculty, especially in hard-to-recruit surgical subspecialties, anesthesiology, radiology, and pathology. Faculty recruitment packages and subsidization up to three years could approximate \$15 million to \$20 million.

Facility development. Including an attached but separate children's hospital, facility development could cost \$100 million to \$150 million, and associated academic space might entail another \$10 million to \$20 million in capital investment. However, great potential exists for fund-raising to cover a substantial portion of the capital investment requirements.

Program development. Extra-budget expenditures of up to \$10 million might be necessary, especially for a pediatric cancer center (to tie into the overall cancer center), but also in a few other areas. So a real children's hospital could be a very expensive undertaking.

The pediatric strategy task force has considered three alternatives:

- Full children's hospital development as outlined above
- Essentially maintaining the status quo
- An in-between strategy, likely some hybrid of the current situation and the children's hospital model

The strategy task force is enthusiastic about the first option; however, the UMC strategic planning committee has three very attractive proposals for centers of excellence development to consider, and both of the other proposals call for about half as much additional capital and operating expenses as pediatrics. And the financial return on both of the other proposals is estimated to be much greater. Yet if UMC doesn't proceed now with development of its children's hospital, the likelihood is great that one or both of its competitors will pursue major children's healthcare developments of their own, effectively precluding UMC from proceeding in the future. In the other service lines, major near- or medium-term competitor initiatives seem far less likely.

How should UMC's leadership proceed?

The Decision

Although based on these circumstances, the decision seemed straightforward on a purely financial basis. Management was divided and strongly influenced by timing and competitive and academic-related concerns. Some thought the timing and competitive issues outweighed the other competing considerations, and a few felt that the academic need to strengthen the pediatric department was, itself, the overriding factor to consider. Not surprisingly, debate was healthy, extensive, and even somewhat emotional at times.

Development of a freestanding look-alike children's hospital was not selected as one of the centers of excellence for UMC to pursue at this time. Ultimately, the decision turned on the attractiveness of the other potential centers of excellence to UMC's future strategic position and financial health.

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