Integrated Strategic Financial Planning for a New Era

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Jeff Kilpatrick is a Senior Vice President of Kaufman Hall and a member of the firm’s Strategic and Financial Planning practice. He focuses on strategic planning for hospitals and health systems nationwide, assisting clients in evaluating their strategic options, among other strategic responsibilities. With more than 15 years of experience, Mr. Kilpatrick has healthcare leadership expertise in program and system strategic planning, partnership and diligence activities, and service line administration.

Prior to joining Kaufman Hall, Mr. Kilpatrick was the Vice President of Clinical Programs for Loyola University Medical Center, where he was accountable for long-term planning and operations of eight service lines. At Children’s Healthcare of Atlanta, Mr. Kilpatrick was the Vice President of Strategy and Planning, where he guided the executive team and board in the creation of a new strategic plan and long-range financial plan. He also managed partnership discussions with other regional systems. Prior to this, Mr. Kilpatrick was a member of the executive team and the leader of the planning function at Northwestern Memorial Hospital. Previous consulting experience includes work at Booz Allen & Hamilton where he served clients such as health insurance plans, pharmaceutical companies, and consumer products firms.

Mr. Kilpatrick has an M.B.A. and Master of Public Policy from the University of Michigan and a B.A. in Public Policy and Political Science, with honors, from the University of North Carolina.
Agenda Slide

- Setting the Stage: Disruption in Healthcare
- The Five Components of an ISFP: Then vs. Now
  - Market Assessment
  - Capital Position Analysis
  - Strategy Formation
  - Financial Projections
  - Risk Analysis
- Conclusion
Setting the Stage: Disruption in Healthcare
Legacy Healthcare Organizations Face Disruption from All Angles

**Rising Costs Remain a Problem**

- Employees bear an increasing share of premium costs
  
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<tr>
<th>Year</th>
<th>Employers</th>
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**Investment in Non-Hospital Healthcare**

- Millennial cohort now larger than Boomers...
  - different experiences and behaviors

**Generational Shift**

**Digitalization**

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Payers Are Putting Pressure on High Hospital Costs, and Partnering to Provide New Alternatives

- No longer paying for ambulatory MRIs and CT scans performed in hospitals without medical necessity preauthorization

- Reduced payments for outpatient services provided in hospitals and off-campus hospital outpatient departments
- Removed total knee replacement from the “inpatient only” list

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New Entrants Are Challenging Traditional Health Systems

- 2018 revenues of $226 billion
- 150+ Optum locations, 140+ urgent care clinics, 200+ surgery centers, 30,000 physicians
- Have a strong presence in 35 of its 75 target markets

- 2018 combined revenue of $255 billion
- CVS: 1,100 clinics; retail stores within 3 miles of nearly 70% of Americans
- CVS: Moving into chronic care for diabetes, asthma, hypertension, depression
- Three pilot HealthHUB stores open in Houston

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Tech Giants Are Making Inroads to Healthcare

Apple

• 2018 revenues of $265.6B
• CEO Tim Cook has called healthcare “a big area for Apple’s future”
• Opening clinics for employees; hiring “designers” to reshape care
• Targeting personal health data with the launch of Apple Health Record and Apple Watch with ECG
• Partnering with the VA and more than 250 providers nationwide to support patient access to Apple Health Record

Amazon

• 2018 revenues of approximately $232.9B
• “Haven” partnership with JPMorgan and Berkshire Hathaway exploring “common-sense fixes” for healthcare
• Amazon-enabled devices recently became HIPAA compliant
• Focusing on telemedicine and online services; purchased online pharmacy PillPack in 2018

High Levels of Consolidation Continue

Hospital and Health System M&A Transactions, 2000-2018

The number of transactions reached an all-time high in 2017, more than double 2007 transactions.

Sources: Kaufman Hall Transactions Data, S&P Median Credit Rating Reports, Moody’s Median Credit Rating Reports, Moody’s Credit Rating Changes Reports.
The Largest Health Systems Are Dwarfed by Emerging Competitors

|$29B$ | $46B$ | $226B$ | $232B$ | $255B$ | $265B$ |

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Changes occurring in healthcare require all new levels of investment. Having an Integrated Strategic Financial Plan (ISFP) is more critical than ever.
An ISFP Is Just One Component of an Integrated Decision Making and Management Framework

**Mission-Based Market Strategies**
- Can the strategies be implemented within an acceptable credit context?

**Integrated Strategic-Financial Planning**
- How much debt?
- Under what structure?
- At what cost?
- Under what terms?
- How much can/should we be spending?
- Where are the capital dollars best deployed?
- How much can/should we be spending?
- Where are the capital dollars best deployed?

**Annual Budget**
- Completely integrated with strategic plan, financial plan, and capital budget
- Accountability, credibility and results are key.

**Capital Structure**
- Support strategic implementation within single credit profile
- Optimize flexibility and cost

**Capital Allocation**
- System-based approach
- Quantitative rigor, NPV
- Monitoring of results

**Feedback and Control**
- Integrated Strategic-Financial Planning
- Mission-Based Market Strategies
- Annual Budget
- Capital Allocation
- Capital Structure
Much of the Old Framework Still Applies…

...But a New Set of Analytics Is Required Across the Five Components of an ISFP
The Five Components of an ISFP: Then vs. Now
Market Assessment: Then vs. Now

**Then**
- Focused on other hospitals/health systems in immediate market area
- Largely inpatient focused

**Now**
- Incorporates immediate market area, as well as broader regional, national scope, emerging non-hospital competitors, and potential regulatory/payment model shifts
- Includes a provider/product landscape evaluation to determine how consumers are aligned with networks, and how that influences utilization, market share, and payment
- Expands focus to understand outpatient competition in high-margin areas
- Requires a deeper understanding of strategic intent of individual services:
  - Where is the organization making money? What is a commodity? Where are my risks?
  - What should be grown/phased out? What should have costs reduced?
  - Who are the traditional competitors?
  - Who are the new competitors and how much margin can they take?
Capital Position Analysis: Then vs. Now

**Then**
- Used basic profitability, leverage, and liquidity metrics to establish financial goals, assess capital capacity, and evaluate the overall affordability of a strategy

**Now**
- Involves new ratings methodologies and debt capacity models
- Requires advanced capital allocation processes and methodologies in order to support decision-making around greater levels of capital for innovative and/or non-traditional initiatives
The Capital Position Assessment Defines Financial Parameters, Targets, and Requirements by Balancing Sources and Uses

How much cash?

How much capital?

How much debt?

How much profitability?

Philanthropy, Innovation, and Other Sources?

How should these tradeoffs be optimized within an appropriate credit and risk context?
Strategy Formulation: Then vs. Now

Then
- Focused on building volumes: “Build it and they will come”
- Largely siloed, determined by individual departments and facilities

Now
- Focused on alignment and creating opportunities for broad performance improvement
- Increasingly comprehensive to consider capital and operating cost efficiency opportunities across the hospital and physician enterprise
- Requires building new capabilities for the organization’s future role/vision; emphasizes building value and customer loyalty
- Strategies are outcomes focused and developed with operationally accountability leaders; focused on protecting higher margin areas and finding new margin sources
- Involves freeing capital for non-traditional initiatives; growth plans are based on differentiated capabilities and often include partnership discussions
- Tackles harder issues of service distribution and portfolio rationalization
### Financial Plans Identify Sources of Margin by Initiative and Service Line

**ISFP Projected Incremental Margin Resulting from Strategic Growth**

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<th>Initiative</th>
<th>Target Incremental Margin (in Millions)</th>
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*Integrated Strategic Financial Planning*
Systems Review Their Entire Service Portfolio to Evaluate the Strategic Value – Potentially Partnering or Exiting

Kaufman Hall Composite Client Example

- Ambulance/Life Flight
- Laboratory Services
- Imaging
- Radiation Therapy
- Infusion Services
- Behavioral Health
- Orthopedics
- Pediatrics
- Inpatient Rehab

- Do we provide the service better than others can?
- Do we enhance patient care and viability by retaining control?
- Is there a viable partner that can meet our service expectations?
Financial Projections: Then vs. Now

**Then**
- Derived from “same store” plus “new projects” approach
- Provides guidance for the annual budgeting process
- Often a finance process, versus management decision-making framework

**Now**
- Models fundamental shifts in business models—integrates future strategic resource requirements, operating model changes, and potential partnerships
- Uses initiative-based and environmental scenario planning
- Can form the basis to transition from guidance for the annual budget approach, to real-time monitoring and management of performance through a rolling forecast
- Integrates planning at various levels:
  - Corporate: Provides overall inflationary guidance
  - “Implied Covered Lives”: Evaluates overall relevance in healthcare ecosystem beyond IP and OP services
  - Physician Enterprise and Departmental: Quantifies impact of cost structure transformation
  - Service line: Creates volume budgets (that then are translated into department volumes)
Risk Analysis: Then vs. Now

**Then**
- Emphasized traditional P&L drivers and capital expenditure/debt assumptions
- Measured impact on profitability and liquidity

**Now**
- Focuses on both inpatient and outpatient—with keen attention to disruptive competitive risks to outpatient
- Identifies service line level risks, including physician retirement and turnover
- Requires ongoing risk and sensitivity analyses as conditions change, including integration of operational risks from normal variation (e.g. flu season) with capital risks (e.g. events and portfolio structure) and strategic risks (e.g. disintermediation of key business segments like imaging volume)
- Integrates with Enterprise Resource Allocation assessment to determine potential calls on and reserves against liquidity
Process: Creating an Enterprise Net Liquidity/Risk Profile

1. Risk Identification and Cataloging

- Establishing and maintaining a Risk Map represents the foundation of an effective resource allocation framework
- **Quantify** risks/claims over a defined measurement period
- Establish a “**Risk Horizon**” that defines the ability to adapt to new reality, thereby establishing measurement period for risk
- Assess “**Dedicated Offsets**” to identified risks sourcing from insurance, hedges, proactive management processes, etc.
- **Assess the residual or net risk pool** and determine whether to carry as unhedged or to deploy cash and unrestricted assets as the hedge of last resort

2. Risk Mitigation Strategy

- **Addressing Risk Horizon:**
  - a. Hedge / Dedicated Offsets
  - b. Managed Response
  - c. Net Cash Reserves
Concluding Thoughts
The ISFP Process Identifies the Balance and Tradeoffs Between Strategy and Financial Capability

The Corridor of Control is the balancing point between two opposing goals:

1. Compete as effectively as you can, which requires aggressive investment of capital and commitment of operating dollars, BUT
2. Respect the fiduciary role of management and the Board to maintain the long-term financial integrity of a community asset
Healthcare disruption requires legacy healthcare providers to make all-new levels of investment.

An integrated approach to strategic financial planning effectively balances strategic direction/investment with an organization’s financial capabilities, and provides a Blueprint for Future Growth that enables effective organizational and financial management.
Questions
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