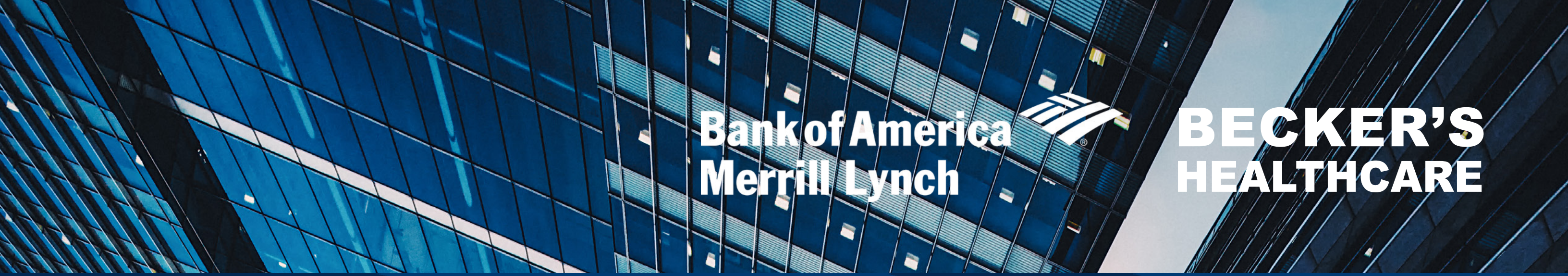

The Quest for Sustainability and the Evolution of the CFO

Expert Insights into Achieving Fiscal Health in an Era of Shrinking Revenue

Participants Include:

Kari Cornicelli
President and Chief Financial Officer, Sharp Metropolitan Memorial Campus (San Diego)

Tim Heinrich
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The Quest for Sustainability and the Evolution of the CFO

Expert Insights into Achieving Fiscal Health in an Era of Shrinking Revenue

By Brian Zimmerman, Senior Writer/Reporter, Becker's Healthcare

Even the nation's largest, most-established hospitals and health systems have experienced revenue declines in recent years. The financial squeeze is the result of numerous pressures, including the rise of value-based care and healthcare consumerism.

Fiscal years 2016 and 2017 marked periods of financial deterioration for many major hospitals and health systems. In a Becker's Healthcare and Bank of America Merrill Lynch survey of financial leaders conducted in May 2018, two-thirds of respondents said their organization had experienced a decline in revenue in recent years.

For healthcare organizations operating in markets highly affected by fiscal and regulatory changes, achieving financial sustainability is a crucial, top-of-mind priority. Financial sustainability may look different depending on the organization, but in general it denotes when an organization implements strategies to maintain or accrue adequate financial resources to meet the healthcare needs of its community over the long term.

Achieving financial sustainability is especially consequential in rural markets where hospitals' patient mix tend to consist of a higher number of low-income individuals and older adults with chronic health conditions. Financial distress has led 83 rural hospitals to close their doors since 2010, according to the North Carolina Rural Health Research and Policy Analysis Center at the University of North Carolina at Chapel Hill.

The nature of the hospital CFO role is evolving to meet these new challenges. This Becker's Healthcare e-book examines the pivotal positions these leaders play in the push for financial sustainability. The following content is based on the results of the Bank of America-Becker's survey and a roundtable discussion with three hospital and health system CFOs and one healthcare strategy expert.

Discussion participants included:

- Kari Cornicelli, Vice President and Chief Financial Officer, Sharp Metropolitan Memorial Campus (San Diego)
- Tim Heinrich, Senior Vice President and Chief Financial Officer, Thorek Memorial Hospital (Chicago)
- James J. Nelson, FHFMA, CPA, Senior Vice President of Finance and Strategic Development and Chief Financial Officer, Fort HealthCare (Fort Atkinson, Wis.)
- Charles Alston, Market Executive and Senior Vice President, Bank of America Merrill Lynch

Focus on operations and a culture of cohesion

Despite the financial challenges hospitals and health systems face in the current market, financial leaders expressed optimism and excitement regarding the evolving role of healthcare CFOs. Participants cited the growing influence of hospital CFOs on organizational operations as a particularly compelling development in the evolution of the CFO role, and one that is key to attaining financial sustainability.

In an era of diminishing margins, operations are especially important to the financial health of hospitals and health systems. Health systems that comfortably recorded a 7 percent or greater profit margin five years ago may struggle today to simply stay in the black. It's crucial for hospitals to have the right operational strategies in place to maximize efficiency and value across departments to remain sustainable and continue meeting the needs of their communities. To improve financial health and performance, CFOs are increasingly involved in both high-level financial strategy as well as improving day-to-day operations.

As a result, at many organizations, the CFO role is seeing more overlap with the COO role. When asked which C-suite executive their organization's CFO works most closely with, a majority of participants in the Becker's-Bank of America survey said the CEO. However, the second-most selected C-suite executive chosen by survey participants was the COO.

"I think it's an exciting time to be a CFO and to be able to work so collaboratively with [COOs]," Ms.

Cornicelli said. "I think that the two roles definitely should be … joined at the hip. … It just makes for a much stronger approach to the type of problem solving that we'll need to have in the future."

Amid increasing financial pressures, healthcare organizations are implementing cost-cutting initiatives in areas of operations that have traditionally resided outside the CFO's purview, such as labor management and supply chain. Such changes are making more collaborative relationships between the CFO and COO a near necessity for hospitals and health systems. This evolution in organizational dynamics demands CFOs be capable of not only providing strategic financial guidance at an enterprise level, but also identifying cost-saving opportunities and participating in efficiency improvement initiatives.

Mr. Nelson also described the line between the CFO and COO at Fort HealthCare as "fairly blurred." While the CFO has traditionally spent a substantial portion of his or her energy reviewing historical financial data, Mr. Nelson and his organization place greater focus on what's to come. It used to be the only forward-looking aspect of the CFO's job was to set budgets and make sure no one went over. Developing a vision of the health system's future — rather than solely analyzing the past — has been personally gratifying for Mr. Nelson.

This added emphasis on future strategies is crucial to achieving financial sustainability as the healthcare appears poised for even more substantial changes in the future. The CFO's primary concerns are no longer relegated to tabulations of past fiscal performance.

Mr. Nelson also characterized the CFO role as the "conscience" of an organization, suggesting financial leaders are generally a bit more disciplined in the development of long-term strategies. Mr. Nelson described the CFO's tendency toward accountability as a likely asset for organizations looking to improve operations long-term.

Building on the idea of the CFO as an organization's conscience, Mr. Heinrich emphasized the importance of asking the hard questions when considering long-term operational strategies, especially amid changing payment and delivery models.

As an independent hospital in Illinois, Thorek Memorial has had to ask some particularly difficult questions regarding operational strategies after Illinois lawmakers battled for two years over a state budget. While legislators brought the historic

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budgetary impasse to a close in July 2017, the crisis left the state with years of unpaid bills — including reimbursements to medical providers, according to a July 2017 article published by the *Chicago Tribune.*

Amid these unique statewide circumstances and the national trend of declining reimbursements, Illinois hospitals have had to make difficult decisions, including job reductions. For example, Downers Grove-based Advocate Health Care laid off 75 workers in the fall of 2017 and Naperville-based Edward-Elmhurst Health laid off 84 employees, eliminating 234 positions in total, according to December 2017 report from the *Chicago Tribune*. When discussing his organization's approach to operations, Mr. Heinrich highlighted the challenges presented by changing reimbursements, even among Medicaid Managed Care Organizations.

"In the state of Illinois there's a lot of uncertainty, even for the various Medicaid MCO plans," Mr. Heinrich said. "In theory, [the plans] all follow Medicaid guidelines, but they each have different authorization alerts, approvals [and] different ways to measure whether [a procedure] is valid or medically necessary."

The Chicago-based CFO added that his hospital has to "step back and make some of the big picture strategic decisions."

From the perspective of an outside partner, Mr. Alston said his organization can feel a cultural difference between organizations where collaboration between the CFO and COO is the norm versus entities that don't prize cooperative relationships between these two C-suite executives. Hospitals where CFOs and COOs work closely tend to have a more cohesive culture, which can help create an environment where sustainability becomes more deeply entrenched in the cultural DNA of an organization. However, to fully achieve this atmosphere of cohesion, these collaborative relationships need to place an emphasis on the real-time exchange of financial and operations data between leaders instead of retroactively looking at this data at the end of every month.

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"The more real-time cohesion of strategy between the CFO and the COO is just creating a better culture," Mr. Alston said. "We work with so many hospitals where we see that cultural element working really well."

'We can't be hospital-centric anymore' — considerations for going ambulatory

While CMS research suggests the utilization of outpatient healthcare services has been steadily rising for decades, this trend has picked up added momentum in recent years. An infographic with data of outpatient utilization published by Avanza Healthcare Strategies in May offers statistical context to the sharp rise in outpatient services. According to Avanza, the share of hospital revenue attributable to outpatient services increased significantly from 2010 to 2015. In 2010, the share of revenue generated by outpatient services was 21 percent — by 2015, this percentage had increased to 60 percent. The rise in outpatient services is poised to continue, meaning hospitals and health systems looking to remain sustainable have to find ways expand their delivery of these services to fully capitalize on market demand.

"Outpatient: It's obviously where it's at," Mr. Heinrich said. "The payment trends are trying to clearly get people out of the hospital, or not even in the hospital in the first place, and focus on outpatient."

Major health systems have taken note of the rise in outpatient and are investing accordingly. Dallas-based Tenet Healthcare is poised to spend $1.9 billion through 2020 in a buyout of ASC-operator United Surgical Partners International. Additionally, the 77-hospital health system said it planned to invest $100 million and $150 million on freestanding surgery centers, freestanding emergency departments and satellite facilities, according to a September 2017 report from *The Wall Street Journal.*

In the Becker's-Bank of America survey, 87 percent of respondents said they were pursuing some type of investment in the nonacute market.

However, while having a financial stake in outpatient services is an appealing investment strategy, willingness to invest is not enough to ensure organizations reap an anticipated return when expanding ambulatory services. The primary pitfall to investing in outpatient businesses, according to Mr. Heinrich, is that it can be quite difficult to achieve scalability in non-acute services. As a Chicago safety-net hospital, Thorek Memorial provides inpatient, emergency and outpatient services, and so Mr. Heinrich knows first-hand the difficulties of turning a profit on outpatient care.

"There's so much competition that there comes a point where there's almost diminishing returns," Mr. Heinrich said, adding that achieving the right patient volume is key to financial success in outpatient services. "It's very hard and it takes a lot of throughput in order to make the outpatient services work. … What we've found is we have to be very strategic and figure out what outpatient services and ambulatory spaces we want to compete in and becoming more specialized."

Investing strategically in non-acute specialties today is key to ensuring hospitals and health systems see a healthy return — and a more sustainable bottom line — in the future. When asked where their organizations were investing in non-acute care, 43 percent of participants in the Becker's-Bank of America survey selected primary care clinics, followed by freestanding emergency rooms at 20 percent and specialty care clinics at 10 percent. All other possible non-acute investment areas were selected by less than 10 percent of participants.

Mr. Nelson described Fort HealthCare's non-acute investment strategy as comparable to what Mr. Heinrich described at Thorek Memorial. Fort HealthCare leaders are doing a thoughtful analysis of the hospital's strengths, opportunities for growth and patient

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volumes per service line to determine its most financially sustainable options looking forward.

"Being a rural community, we struggle with the economies of scale and being able to be efficient in some of the service lines," Mr. Nelson said.

"We've got to be able to create partnerships and collaborate with different providers in ways that are transparent but achieve a lower cost of service. We can't be hospital-centric anymore. We've really got to be able to look at the entire delivery system and invest in the right places at the lowest cost."

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Vice President and Chief Financial Officer
Sharp Metropolitan Memorial Campus

Compared to Thorek Memorial and Fort HealthCare, Sharp Metropolitan Memorial is a large urban hospital with considerably greater resources than its safety-net and rural counterparts. As such, its nonacute and ambulatory investment strategy is more robust than Thorek and Fort, though certainly no less strategic and well-considered.

Currently, Sharp's outpatient revenue is growing and accounting for larger share of the organization's bottom line, according to Ms. Cornicelli. The San Diego-based CFO said understanding the various outpatient cost structures plays a key role in determining where and how to invest in outpatient services. Specifically, Ms. Cornicelli said identifying possible partnerships and determining what service lines can be provided outside the hospital at the lowest cost are among the most important strategic discussions hospital CFOs can have when it comes to achieving sustainability.

"We've got to be able to create partnerships and collaborate with different providers in ways that are transparent but achieve a lower cost of service," Ms. Cornicelli said. "We can't be hospital-centric anymore. We've really got to be able to look at the entire delivery system and invest in the right places at the lowest cost."

Know your strengths and partner strategically

Healthcare affiliations and partnerships come in various forms and have been increasing in volume in recent years as organizations look for ways to improve their financial strength, market standing and ability to compete with other healthcare players. While these partnerships can be a great way to increase market share, they are not a sure-fire route to better financial and operational health. In fact, a 2013 report from PricewaterhouseCoopers found that just 41 percent of hospitals acquired between 1998 and 2008 outperformed their market peer groups.

Hospital partnerships can collapse or fall short of fiscal goals for a number of reasons, including issues with board synergy, ineffectively compelling medical staff buy-in and creating affiliations that are too loose. Mr. Alston highlighted the critical importance of partnering strategically and also emphasized that healthcare organizations should continue "to focus on what [they're] really good at and not stretch [they're] already strained resources financially into new areas of care delivery where [they] can't get critical mass or scale."

"When a hospital provider like us takes over [behavioral health] and we add our cost structure to it, we make it unaffordable. We just have to have the discipline to invest in the right places, recognize what we are and what we're not, what we do well and what we don't."

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At Bank of America, Mr. Alston has seen hospitals create a number of partnerships and alliances for the sake of expediency and solving cost problems. However, when these ventures aren't carefully considered and investigated, they can fall short of delivering anticipated results. In particular, he cautioned against the perils of cultural misalignment when considering financial and strategic transactions.

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"[Some of these partnerships] weren't investigated deeply enough to unearth that there was going to be a cultural disconnect between the two organizations that ultimately ends in that partnership being discontinued," Mr. Alston said. "Cultural misalignment ends up becoming one of the main reasons why partnerships that looked like they may be promising on the front end up getting dissolved."

"You need to draw the line and understand what you're good at, what your core competency is and then look for partnerships where they can help you shore up your strategic initiatives. Don't try to be all things to all people ... look for partners that can help you be successful in [your] core competencies or engage in a new strategy in an area where [they're] strong ... all of that is going to be absolutely critical to the future financial sustainability of an organization."

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Vice President and Chief Financial Officer
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Mr. Nelson echoed Mr. Alston's comments regarding hospitals remaining focused on their strengths. When looking to invest in services beyond hospital walls, Mr. Nelson suggests a strong dose of self-awareness, citing the expansion of behavioral health services as a prime example of when looking for an outside partnership may be warranted.

"When a hospital provider like us takes over [behavioral health] and we add our cost structure to it, we make it unaffordable," Mr. Nelson said. "We just have to have the discipline to invest in the right places, recognize what we are and what we're not, what we do well and what we don't."

Mr. Nelson added that finding trustworthy partners that excel in fields outside a typical hospital's wheelhouse, whether it be home health or assisted living, is essential.

Building on previous comments from Mr. Nelson and Mr. Alston, Ms. Corncelli said hospitals should look to improve upon strengths and leverage partnerships to bolster areas of weakness.

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While Mr. Heinrich acknowledged partnerships can play a strong role in sustainability, he said some hospitals seem to be rushing into these agreements without fully considering the long-term implications. The Chicago-based CFO added that it's also important for organizations to leave themselves a way out of partnerships should they become detrimental to achieving long-term sustainability. Organizations that jump right into partnerships can become overly intertwined, making necessary separations difficult.

"You've just got to be careful and just make sure that there's an out," Mr. Heinrich said. The CFO organizations should continuously monitor the viability of partnerships to determine whether the joint endeavor is moving both entities closer to their respective operational goals. If the partnership becomes non-beneficial in terms of the achievement of long-term sustainability, Mr. Heinrich said efforts to mend the partnership should be implemented or the agreement should end.

"Long-term sustainability is the goal," Mr. Heinrich said. "And I think people oftentimes are too myopic in looking at the short term. So it's a struggle. It's a balance."

Conclusion

The current healthcare environment creates a number of fiscal challenges for hospitals. However, these entities are not without recourse: a finance-centric approach to operations, strategic partnerships and the expansion of outpatient services are steps hospitals can take to achieve financial well-being. With a greater foothold in operations, the hospital CFO has perhaps more influence than ever to navigate their organizations through the turmoil of the moment and onto a path toward financial sustainability. ■

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