



# The Governance Institute's E-Briefings



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## Welcome to The Governance Institute's E-Briefings!

This newsletter is designed to inform you about new research and expert opinions in the area of hospital and health system governance, as well as to update you on services and events at The Governance Institute. Please note that you are receiving this newsletter because you are a Governance Institute member or expressed interest at one of our conferences.

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### News, Articles, and Updates

## The Strategic Alignment Committee: A Ready Response to Reform

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*This article is the first in a series discussing the role of board committees in the current environment.*

Hospital boards are encouraged to form a “strategic alignment” or similar committee to facilitate the governing board’s ability to evaluate the many business opportunities that will arise for provider organizations in the wake of seismic health reform legislation. The expectation is that the entire spectrum of healthcare organizations—not just hospitals and health systems, but also insurers, specialty facilities, medical groups, and physician networks—are actively considering both vertical and horizontal relationships of varied sorts in order to better position themselves to respond to health reform-prompted economic opportunities. In such a unique environment, it is incumbent upon the hospital board to shed its reputation for inertia and assert a proactive response to such unique opportunities. The purpose of the strategic alignment committee is to evaluate, on behalf of the board, business proposals and risks early in the opportunity cycle—as opposed to condemning them to the queue of the normal board agenda. The expectation is that the work of this committee will favorably position the full board to respond quickly and in an informed manner to meaningful alignment opportunities.

### **What’s At Stake**

It should be no surprise to the hospital board that reform legislation has dramatically accelerated thoughts of consolidation across all aspects of the healthcare sector. As the healthcare financing system shifts from traditional fee-for-service arrangements to “bundled” or “value-based” payment models, market participants are scrambling for proper positioning, identifying those structures most likely to enhance financial viability. Competing institutions are now evaluating the benefits of consolidation. Stand-alone hospitals are considering linkage with larger systems. Regional systems are reviewing potential synergies with national systems. Fiercely independent physician groups are revisiting employment or other forms of affiliation with local healthcare systems. Parties that heretofore would never have spoken to each other are now actively engaged in alignment discussions.

In all of this “scene-shifting,” there is an element of urgency. For example, the hospital’s ability to provide “accountable care” and ultimately be classified as an “accountable care organization” (ACO) may well depend upon the performance of

basic assessment, planning, and implementation steps in the very near term. In addition, many hospitals, health systems, and academic medical centers are actively considering merger/acquisition/affiliation opportunities of varying degrees of integration, both with other providers and with practitioner groups as well. Many healthcare markets are becoming highly fluid, as individual market participants position themselves to pursue opportunities or confront threats. The pursuit of certain opportunities by a hospital's competitors may foreclose similar opportunities for the hospital itself. Things are happening fast; there are many moving (corporate) pieces. In this context, the non-profit hospital's traditional governance style of slow, careful, and sometimes ponderous consideration of strategic matters becomes more of a burden than a virtue. The competitive marketplace is actively being reshaped in "real time," placing a premium on a streamlined board-level deliberative process. Enter the strategic alignment committee.

### **The Committee Concept**

**The Scope.** The purpose of the strategic alignment committee is relatively simple—to conduct the "spade work" on alignment opportunities for the board. This means that the committee's responsibility is to "roll up its (collective) sleeves" and perform core-level market monitoring, the parsing of speculative developments and the evaluation and prioritization of legitimate opportunities. Executive staff would direct market information and incipient-level opportunity development to the committee for consideration. While it would periodically report to the board on its activities and on its perceptions/observations, the committee would refrain from coming before the board in any significant way until a major opportunity presents itself. At that point, the committee would present an evaluation of the opportunity based upon the due diligence and goals analysis it has been conducting on a regular basis. In this way, the committee operates in a contemporaneous yet supplemental position to the regular board process, allowing critical market evaluation and alignment-focused strategic planning to proceed, independent of the normal board agenda.

**The Tasks.** The duties of the strategic alignment committee generally include the development of protocols and processes that will enable the board to aggressively address legitimate business opportunities as they are deemed to arise. This

may logically include tasks such as: (a) developing specific mission-based goals and objectives for strategic alignment; (b) crafting business development screens; (c) preparing marketing presentations to various potential alignment partners; (d) establishing opportunity evaluation tools, e.g., operational, financial, reimbursement, mission, and legal; (e) considering multiple, alternative acquisition/merger/joint venture/affiliation models; (f) formalizing and standardizing board approval processes and procedures to facilitate prompt decision making; (g) constructing frameworks for due diligence processes depending upon the type of opportunity presented; (h) conducting critical "market intelligence" with the help of professional advisors; (i) periodically interfacing with bond insurers, lenders, external auditors, and other interested third parties/hospital constituents as may be necessary; (j) anticipate specific enterprise risks arising from alignment activities; and (k) monitoring legal, regulatory, and legislative developments affecting health reform in general and alignment opportunities in particular. On a more targeted basis, it could serve as the principal board-level interface with the multiple levels of planning and activity necessary to position the hospital to implement an "accountable care organization."

It will be important, though, to carefully craft the charter of the committee to clarify the distinctions between the tasks assigned to this body and other standing or special board committees with responsibility for strategic planning, physician relations, enterprise risk management, and/or transaction planning.

**Status.** The question is whether the strategic alignment committee should be "standing" (i.e., permanent) or "special" in status. There is no "hard-and-fast" rule here. The argument in favor of "special" status is that the committee is not expected to be permanent in nature; the potential alignments which the committee is likely to consider are probably going to arise within the next several years, as the various participants in the healthcare sector can be expected to complete their game of (corporate) musical chairs. The argument in favor of "standing" status is that the committee's activities, while limited, are nevertheless likely to last several years, and elevating the committee to the same status as that of more traditional bodies, such as the executive, finance, and audit committees, is likely to increase its governance-level prestige. The committee

should also be granted board-designated powers with respect to the limited scope of its charter, because a primary goal of the committee is to gain efficiencies by enabling the board to rely on its due diligence with respect to reform-prompted business opportunities. The board would not, however, be delegating to the committee the right to actually proceed to negotiate or commit the organization to specific opportunities; that, of course, would remain the province of the board.

**Membership.** The committee need not be exceptionally large in size, but must include independent board members with a particular affinity for strategic planning, and who have a strong grasp of healthcare reform and the challenges and opportunities it creates. Selecting members who may also serve on key committees like executive, finance, medical staff relations, and/or audit will help facilitate coordinated committee and board-level planning. Should state law allow it, the committee might logically include non-board members with strategic skills and medical staff representatives. That notwithstanding, the board should be very sensitive to the potential conflict-of-interest risks associated with involving physician leadership in a board committee that will have some jurisdiction for reviewing physician integration and similar types of transactions affecting physician practices and business investments. The committee must have heavy staff support, from both the executive leadership team (including the CEO, the CFO, and the general counsel) and outside advisors, including strategic consultants and investment bankers.

### **An Example**

The intended operation of the strategic alignment committee can be demonstrated through the following example. A regional, multi-hospital integrated health system (“Regional System”) has enjoyed steady growth over the last several years, and has successfully integrated a recent affiliation with a community hospital. Its area competitors include two other community hospitals (one of which is affiliated with a national, religious-sponsored system), an affiliate of a statewide non-profit system, and a division of a large proprietary hospital chain. Regional System management is closely watching developments in the marketplace, as the various participants begin to consider collaboration or similar strategic opportunities. In addition, Regional System is interested in structuring its controlled group practice

organization as an ACO. The status of the market is highly fluid, and aggressive action by one or more of its competitors may foreclose some opportunities to Regional System and re-prioritize others. Management’s concern is that the board, with its agenda full of major operational issues, may not be well-positioned to evaluate and react to emerging opportunities in a timely manner. In this context, the role of the strategic alignment committee would be twofold: (a) to assist management in taking the initial steps towards the establishment of an ACO; and (b) to work closely with executive leadership to establish strategic alignment goals for the board’s consideration, monitor market developments, and evaluate the core feasibility of multiple different business options that may arise. The expectation is that these efforts will greatly facilitate the ability of the board to make informed judgments concerning alignment opportunities in a competitive timeframe.

### **Advantages and Disadvantages**

**The Advantages.** The strategic alignment committee achieves critical efficiencies by allowing fundamental strategic alignment planning to proceed independent of the normal and customary agenda of the board and of its key committees. It establishes the necessary deliberative infrastructure critical to eventual board-level evaluation of legitimate strategic opportunities without the need to fit within the queue of the normal board process and structure. It conducts the “heavy lifting” that enables the board to move quickly to evaluate and consider only the most logical and feasible of business/integrations opportunities.

**The Disadvantages.** The strategic alignment committee will, by necessity, add to the workload of both executive leadership and the volunteer board members called to serve the committee. The administrative cost of the committee will be higher than most because of the likely need to seek the involvement of outside advisors on a regular basis. There is a potential that the duties of the committee will overlap, or conflict, with traditional standing committees of the board that have viewed their charter as including strategic and transactional planning and enterprise risk management. Further, there is a risk that, because of the important activities assigned to the committee, it may act as somewhat of a shadow board, potentially pushing the envelope of its assigned authority.

These advantages and disadvantages must be carefully considered by the board. Yet, the prudent decision may well be to create some committee-level function responsible for monitoring strategic alignment opportunities and vetting their initial feasibility. In the current fluid healthcare sector,

the hospital board and its decision-making process would benefit greatly from any committee support mechanism dedicated to conducting initial feasibility analyses of reform-prompted alignment opportunities.

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