

## ***ASSET PORTFOLIO MANAGEMENT***

*The following summarizes a keynote address presented to healthcare Board Directors and Chief Executive Officers at The Governance Institute in San Francisco, California.*

Healthcare executives have just completed the most extensive accumulation of assets in the history of our industry. In anticipation of a managed care future which has not fully arrived in many markets – and will likely never arrive -- healthcare executives have been building a “continuum of care” to prepare for managing populations on a prepaid basis. Asset accumulation examples include the development of provider-sponsored health plans, physician acquisitions and joint ventures, ambulatory care initiatives, hospital acquisitions, long-term care facility acquisitions, home health company formation, and countless other initiatives.

Investments in vertical and horizontal integration have not produced expected results in many instances. Horizontal integration has achieved neither scale to improve contracting leverage, nor sufficient cost reduction based on economies of scale. While affording stability in the supply chain, vertical integration into physician practice or health plan management has introduced new challenges and largely unprofitable outcomes.

As a result, healthcare delivery system profitability continues to fall. Two out of every three health systems have experienced a decline in profitability since 1995 according to Modern Healthcare. Many of those systems that remain profitable may be living off of investment income. Declining financial performance reduces health systems’ ability to access capital to invest in short and long-term strategic initiatives.

### **Healthcare delivery systems can address these organizational and financial challenges through effective asset portfolio management.**

Asset portfolio management represents how a healthcare organization makes decisions related to the acquisition, growth, and divestiture of core business assets. Business strategy should drive asset management decisions. Products should be managed as a portfolio. Adding, maintaining, or shedding assets should be balanced with the need to preserve mission commitments, create opportunities to differentiate existing services, and fund new strategic initiatives.

Given the recent accumulation of assets coupled with declining financial health, healthcare executives should conduct ongoing monitoring. Healthcare delivery systems are already acting to prune their holdings. According to HCIA, 36% of healthcare delivery system survey respondents indicated that they had divested some portion of their assets in 1998. Of the divestitures, 39% involved health plans, 33% involved physician groups, 28% home health, 15% hospitals, 11% skilled nursing facilities, and 24% other assets.

## ***ASSET PORTFOLIO MANAGEMENT FRAMEWORK***

Asset management decisions should be made along three dimensions: strategic value of an asset, financial performance of an asset, and management resources required to manage an asset.

**Strategic Value**

Strategic value measures the extent to which an asset supports and advances a care delivery system’s overall strategic intent. There appear to be two overall business strategies for physicians and hospitals in healthcare today: service delivery or population management. A number of dimensions help to distinguish these strategies as follows:

<u>Dimension</u>	<u>Service Delivery</u>	<u>Population Management</u>
Revenue:	Per unit of service	Per covered life
Efficiency:	Cost management	Cost avoidance
Scope:	Hospital services	Continuum of care
Clinical focus:	Event management	Disease management
Risk:	Intensity	Actuarial
Triage competency:	Referral management	Demand management

Because of the clear differences in each strategy and according to a study performed by BDC Advisors, LLC, care delivery systems that attempt to fulfill both often experience lower profitability than those that choose a primary strategy. Therefore, a care delivery system should first define its strategic intent – service delivery or population management – and then evaluate the contribution that each asset makes in fulfilling that business philosophy.

A healthcare delivery system should also identify its unique value proposition relative to its competition. There appear to be selected forms of differentiation that can be pursued by health care providers: lower cost, greater access, higher clinical quality, or better customer service. Assets should also be evaluated based on the extent to which they help fulfill that differentiation. Based on these assessments, assets should be designated as providing a “strong fit” or “loose fit” relative to strategic value.

***Financial Performance***

Financial performance is the next dimension against which to evaluate assets. As organizations struggle to develop access to more cost effective capital or generate capital internally through increased profitability, appropriate criteria for assessing financial performance are those used by bond rating agencies and capital advisors.

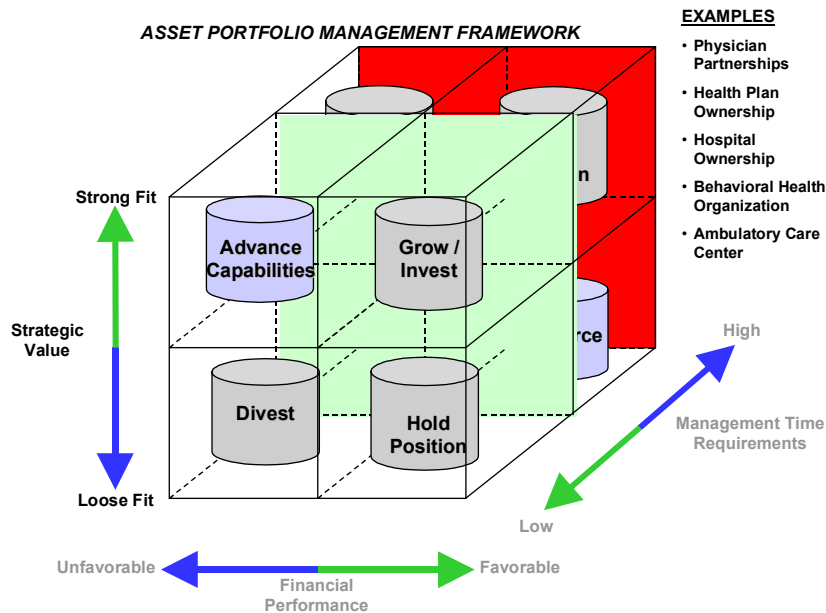
Three overarching metrics are used to determine bond ratings: liquidity, leverage, and profitability. The assessment of individual assets against their contribution to these bond rating criteria can be classified into “net contributors” (i.e., those that contribute to better financial performance) and “net consumers” (i.e., those that impair profitability, liquidity, and/or leverage). Net consumers should be evaluated to identify whether the source of poor performance is related to revenue (e.g., price, volume), cost (e.g., fixed costs, utilization), cash flow, debt, or other factors. These assets should also be evaluated to determine the extent to

which performance can be improved. As a result, assets can be designated as providing “favorable” or “unfavorable” financial performance.

### Management Time Requirements

The least profitable initiatives often consume the greatest amount of management time. An overall asset portfolio management strategy can be optimized by assessing the return on “invested” management time and expense. A high-level time-in-motion study can be conducted to determine the relative amount of direct and indirect time spent by management on each of the organization’s assets. Management should be focusing as much if not more on those assets which contribute the most to profitability (e.g., in order to increase same store sales) as it does on under-performing assets.

Assets that maintain a strong fit with strategy, demonstrate favorable financial performance, and require low management time should be grown and attract investment. Likewise, assets with a poor strategic fit and unfavorable financial performance should be divested. The framework below outlines the different disposition recommended based on the evaluation of an asset against strategic, financial, and management dimensions.



The ultimate goal of an asset portfolio management strategy is to generate sufficient capital to advance an organization’s strategic position in the market.

***CASE STUDY: CALL CENTER***

An integrated delivery system in the Midwest evaluated its call center against strategic, financial, and management objectives and concluded that the focus of the call center should be changed to fulfill the overall strategic intent of the organization. Currently, Good Community Health System's call center is used to manage demand and promote wellness among patients.

Should Good Community Health System maintain its call center? Should the goal of the call center be to triage patients (i.e., cost management), to provide health information (i.e., cost avoidance), or to serve another purpose? Is the call center consistent with their value proposition? What direct and indirect impact will the call center have on their financial performance and capital capacity? What will the management time requirements be relative to the overall value of the call center to the organization?

With 22% HMO business of which 7% is capitation, and average PPO profitability at 8% compared to -12% for average HMO profitability, Good Community Health System's business strategy revolves around service delivery. With the second-most market share among four (4) major systems, their value proposition in the local market is access to services. The strategic value conclusion therefore is to de-emphasize the current use of the call center which minimizes care, market the call center to promote access, evaluate the collection of use fees, use the call center to augment centralized scheduling, and triage patients for appropriate placement within their system (i.e., cost management vs. cost avoidance).

In terms of financial performance, the call center has a poor impact on Good Community's bond rating as evidenced by very low profitability. Opportunities to increase productivity have been identified. The average time spent on the phone has been increased from 42% to over 80%. Calls per staff member per day have increased from 22 to 35. The error rate has been reduced from 7% to below 3%. The net patient capture is 12%. Financial and operating performance will continue to be measured in order to evaluate the ongoing return on investment through increased patient visits.

Management time requirements have been streamlined based on the integration of responsibilities for the call center director into the role of the marketing vice president.

Whereas the call center appeared to be a poor fit with strategy with poor financial performance, specific performance opportunities have been identified and implemented, making it a productive asset for the organization.

***Other Case Examples***

An integrated delivery system in Illinois involving 1,800 affiliated physicians and 8 hospitals comprising 2,400 beds developed a provider-sponsored HMO several years ago. The plan served approximately 22,000 commercial HMO and 8,000 Medicare HMO lives. Without sufficient scale, the HMO was unprofitable but fulfilled its objective of increasing the delivery

system's influence with health plans in their own contract negotiations. With the HMO being a loose fit with the organization's service delivery strategy and flagging financial performance, the organization decided to divest its provider-sponsored HMO. By selling the provider-sponsored HMO to another health plan in exchange for 170 PCPs in 8 clinics, the organization advanced its position as a market-leading physician-hospital delivery system in the service delivery business.

A health system in New York is growing its PPO network which was once believed to be a transitional product in anticipation of managed care business. With consumer backlash against HMOs, the consistency of the product with the health system's service delivery strategy, acceptable financial performance, and not much management time required to support the PPO, the New York health system will grow and invest in this product.

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An evaluation of all assets using an asset portfolio management framework helps to inform short-term and long-term opportunities to align business units with strategy, improve financial performance, and generate access to capital through the strategic management of assets.

If you should have any questions about BDC Advisors, LLC or our work in asset portfolio management, please contact Bob Dickinson at (415) 247-1013 or via electronic mail at [BDickinson@BDCAdvisors.com](mailto:BDickinson@BDCAdvisors.com).