

Financial Operations: Developing and Implementing a Strategic Capital Acquisition Plan

Overview of a Corporate Finance-Based Integrated Decision Making Process

Dan Majka, Kaufman Hall

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The essential and most important proposition is that the hospital industry is entering a new business model

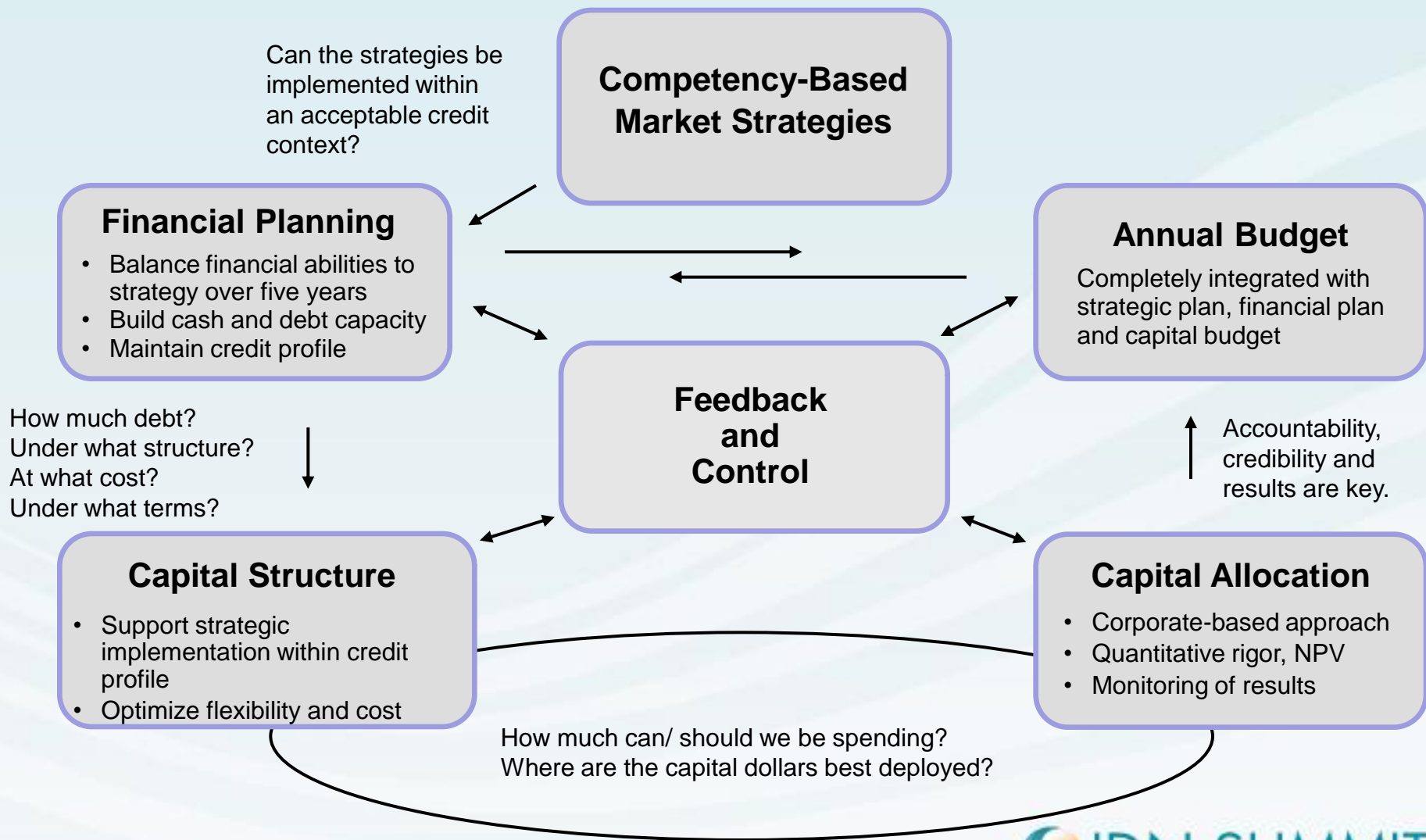
Lingering effects of the economic crisis in tandem with reform legislation and societal awareness of a broken delivery system are accelerating the pace of this new business model transition

Regardless of what happens to reform legislation in 2011 and beyond, the business model changes are already well underway – only the rate of change could be affected

The Kaufman Hall Point of View

1. Healthcare is rapidly moving from a post-Medicare business model to a post-reform business model
2. Reimbursement will decline over time either on a “relative” or a “real” basis
3. The hospital sector will consolidate significantly, and size and scale will increasingly matter
4. The basic relationships and care model between payers, hospitals, doctors, and patients will change dramatically
5. Technology will become a major disruptive change agent in healthcare as it has been in other industries

Informed Decision Making Around Your Organization's Point of View Is Achieved by Navigating the Capital Management Cycle



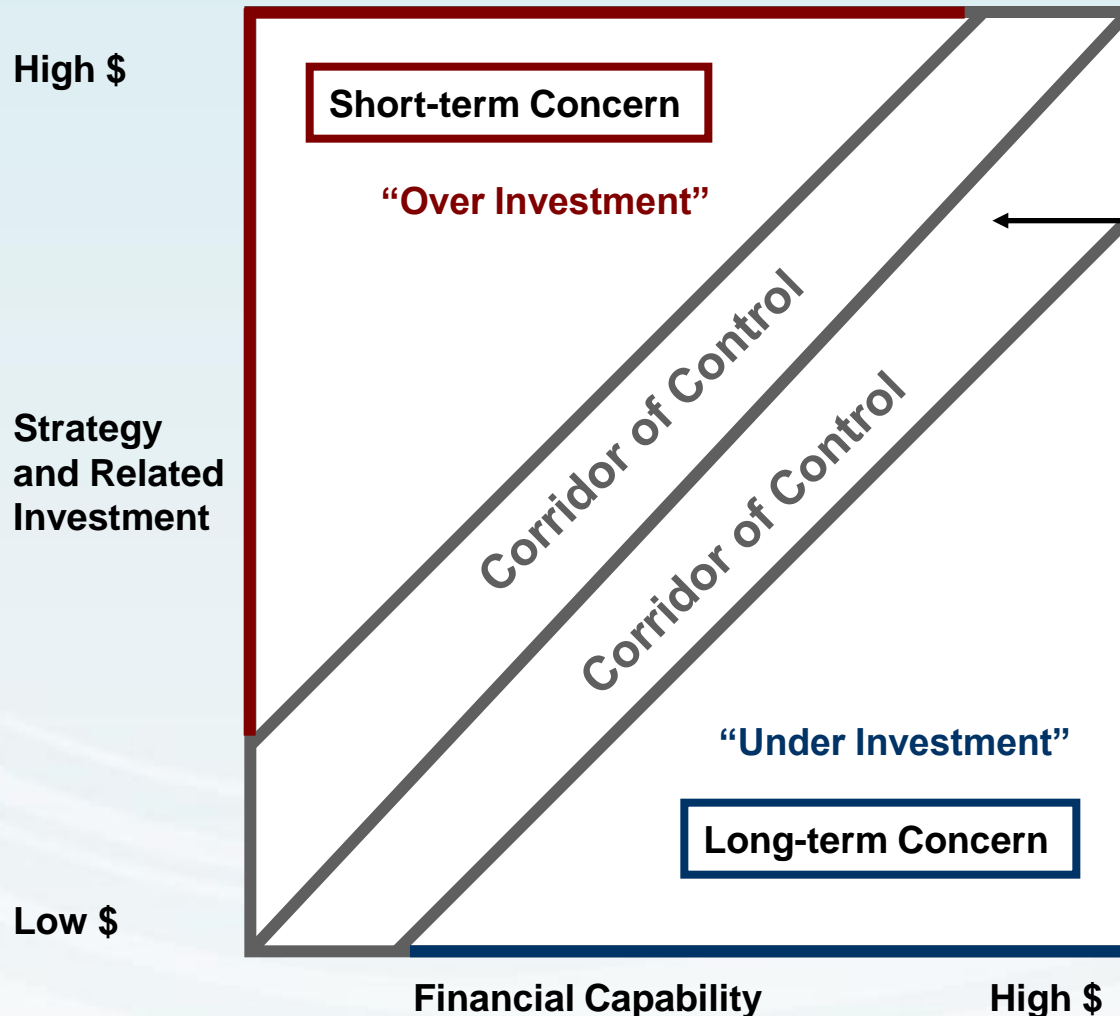
Strategic Planning Framework in the “New Era”

	Attributes	Key characteristics of the best prepared
New focus areas	Care coordination capability	Use of care coordination tools and processes by an empowered and integrated workforce that manages costs and meets performance goals that are regularly measured and reported
	Physician integration	A highly aligned medical staff characterized by outcome-based contractual arrangements, informed planning, and adequate representation in organizational governance
	Service distribution system	A rational service distribution system that has accessible primary care, easy access (both physically and through referrals) across the care continuum, and contemporary facilities and equipment
	Information systems sophistication	An IT platform that supports clinical decision making, information management, and access by all stakeholders (physicians, patients, administration) to proper treatment and strategic decision making
Traditional focus areas	Cost management	A right-sized organizational cost structure, characterized by appropriate levels of staffing, capital spending, and supply chain costs; constant review of costs based on comparative peer group studies and benchmarks
	Capital capacity	Strong appeal to capital markets through sustained operations, revenue growth, and balance sheet strength
	Brand, Scale and Essentiality	Sufficient brand and scale in the market to attract competitive clinical and administrative talent, realize economies, drive marketplace innovation, and be an essential provider to health plans and patients

With New Competencies Come New or Expanded Funding Needs

Attribute	Funding requirements
Care coordination capability	<ul style="list-style-type: none"> • Software acquisition • Staff resource expansion
Physician integration	<ul style="list-style-type: none"> • Practice acquisition • Practice subsidization • Joint ventures/ co-management
Service distribution system	<ul style="list-style-type: none"> • Ambulatory facility expansion • Comprehensive diagnostic capability • Primary care network development
Information systems sophistication	<ul style="list-style-type: none"> • Computerized physician order entry (CPOE) • Electronic health record (EHR) • Physician systems integration

Financial Planning Ensures the Critical Relationships 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 the Board and management to protect the long-term financial integrity of a community asset.

What Is Capital Allocation?

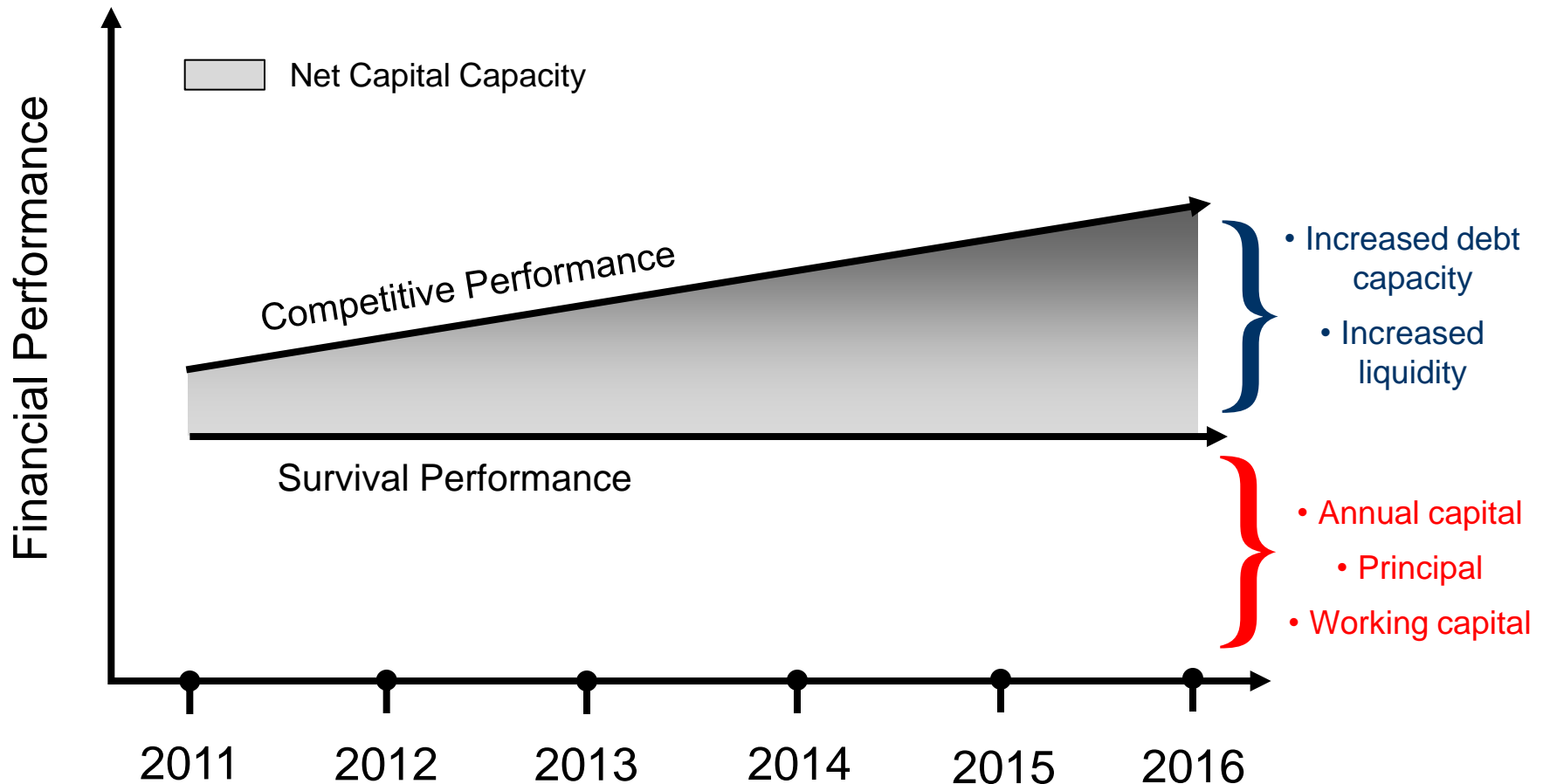
The process by which an organization deploys its scarce capital resources (cash and debt capacity) for investment in:

- Mission and community-based imperatives
- Existing service line growth and/or new businesses and ventures
- Routine infrastructure investments
- Reinvestment as cash reserves on the organization's balance sheet to fund a competitive liquidity position
- Information technology

How Is Capital Allocation Different than Capital Budgeting?

- **Capital allocation** is a strategic process by which an organization distributes scarce capital resources to assure appropriate reinvestment. Best practice capital allocation must assure increasing corporate value (capital capacity) and future financial success for the organization.
- **Capital budgeting** is only one component of the capital allocation process. Capital budgeting is focused on the detailed administration of the funding and tracking of allocated capital.

Effective Capital Allocation Drives Complete Performance



Capital Allocation Is an Inherently Complex and Visible Process

- Proposals emerge from multiple points of origin
 - Department initiatives
 - Service line planning
 - Physician initiatives
 - Clinical technology assessment
 - Information systems
 - Facilities/ infrastructure maintenance management
 - Strategic planning
 - External regulatory/ code requirements
 - Market-driven opportunities

Capital Allocation Is Often a Highly Political Process

- Multiple constituencies have a real or perceived stake in the success of various proposals
 - Board
 - Senior management
 - Physicians
 - Department management
 - Community
- The result is the real potential for politically driven chaos that can limit an organization's ability to make optimal investment decisions
 - In the current environment, suboptimal decision making has direct and material impacts on organizational sustainability
 - A comprehensive, structured process is the best means to bring order to this complexity

A “Best Practice” Capital Management Process Incorporates Various Perspectives and Issues



A Best Practice Approach to Capital Allocation Is Founded on the Following:

- Clearly articulated objectives and principles
- Bureaucratic process methodology
 - Standardized analysis format
 - Rational and consistent evaluative guidelines
 - Uniform decision criteria
 - Formal batch review process
- Corporate finance-based concepts
 - Net cash available for capital
 - Incremental project free cash flow
 - Weighted average cost of capital
 - Discounted cash flow (net present value) and risk analysis
- Qualitative criteria
- Known process timing
- Governance of the allocation process

Bringing It All Together Through Calendar Management

