

Planning the Right Facility: Seven Steps for Strategic Financial Success

The right facility is one that supports your organization's strategic objectives and its financial goals. Follow the seven steps below to get there.

Competing demands for limited capital make it imperative for hospital and health system leaders to plan inpatient and outpatient facilities that will best support the organization's strategic and financial goals. Whether a replacement hospital, a new imaging center, or a renovated patient tower, a major facility project can deliver significant growth, but it may also carry considerable risk if it does not achieve the level of performance required for a positive financial return. Taking the following seven steps will help reduce the risk of new facility investment.

Step 1. Integrate Strategic, Financial, and Facility Planning

A best-practice approach integrates strategic, financial, and facility planning. The end product is a strategic master facility plan that supports the organization's mission, vision, and long-range strategic objectives. A good plan provides for the needed capacity or expandability to accommodate anticipated growth, is flexible enough to respond to changing conditions, and is affordable within the organization's financial capabilities.

A team approach with participation of executive-level representatives of the strategy/business development, finance, and facility departments ensures that the facility "solution set" that emerges is consistent with the organization's competitive direction and has solid financial underpinnings. The planning process should be concurrent as well as integrated, thereby avoiding the traditional linear sequence in which a strategic plan is developed, followed by an architectural master plan, followed by a financial feasibility analysis. This linear process often results in a plan that cannot be implemented.

Step 2. Ensure a Strong Credit Position

Because most major facility projects require organizations to access the capital markets, building and enhancing the organization's credit position should be an early focus of the planning effort. Organizations with strong credit can borrow at lower cost, have access to increased capital market opportunities (including variable-rate debt, credit enhancement, and derivative options), and enjoy less-restrictive bond covenants.

An organization's credit profile provides the capital markets with an indication of the organization's ability to repay debt. Key elements of the credit profile include financial performance ratios and performance trends, such as operating margin, operating EBIDA (earnings before interest, depreciation, and amortization), and excess margin; leverage ratios (debt to capitalization, debt service coverage); and liquidity ratios (days cash on hand, cash to debt). Although many factors contribute to an organization's credit rating—including market position, strategic plans, governance, physician relationships, and financial position—operating performance and track record are the key components.

A demonstrated ability to achieve consistent profitability is critical when approaching the capital markets. If a healthcare credit looks risky, investors will put their dollars elsewhere. Management must know early in the strategic master facility planning process what operating and financial performance will be required and what is attainable. Organizations frequently need to improve financial performance to support the debt required for a major facility project within an appropriate credit and risk context.

Step 3. Establish Current Market Position

Facilities that meet an organization's growth objectives are built on a "fact base" that reliably assesses current market and strategic positions. Components of this fact base include clearly defined market boundaries and an understanding of patient origin and trends, demographic trends, utilization and market share trends, business/program/service mix, competitor actions, physician dynamics, key area payers and employers, and consumer preferences within that market.

In considering a new outpatient facility, Organization A, a small health system in a competitive market, will need to assess, among other factors, ambulatory competitors in the relevant geographic region by zip code; physician office locations by specialty; current demographics; and current market size and volume for selected ambulatory services (for example, urgent care visits and diagnostic services by imaging modality).

Step 4. Forecast Demand

Reliable demand projections are the cornerstone of a strategic master facility plan. High-quality demand projections take into account population growth and aging, utilization patterns, and realistic geography- and service-specific market share targets that reflect strategic plans and initiatives. A high-quality software tool that can process and integrate data from many sources adds considerable value to the planning process. Such a tool can help quantify the sensitivity of projections to changes in key variables (for example, population growth, use rates, market share estimates, and reimbursement rates) and the level of financial risk associated with the overall strategy.

Organization A in our example used an approach based on population use rates to develop market demand projections for the targeted geography. This approach quantified the new outpatient facility's likely cannibalization of current ambulatory volumes and the downstream impact on inpatient market share growth at the main campus. Growth in use rates over the projection period was identified using available benchmark sources. Volumes were projected for each diagnostic imaging modality, with scenarios 33 percent higher and lower than the baseline assumptions (Table 1).

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Step 5. Project Bed and Ancillary Capacity Needs

With demand projections in hand, including sensitivities for utilization and market share scenarios, organizations can forecast bed and ancillary capacity needs. Organization B, a two-hospital system considering options for facility consolidation, took a detailed look at the number of existing inpatient beds and the types of beds and rooms that would be needed in the future.

For ancillary services, capacity needs should be based on reasonable targets for equipment or room utilization. Identification of where that capacity is required—in the hospital or at an ambulatory site in the area—is extremely important, as discussed in the following step.

Step 6. Evaluate Facility Requirements

Integrated planning involves thorough identification, exploration, and quantification of facility options that will support strategic delivery capacity needs. Key questions that should be answered include:

- What is the optimal delivery system for the organization, given its market?
- What is the condition of current sites and facilities?
- What operating model for support services and patient care might be used in a new or enhanced facility?
- What facility development alternatives exist relative to sites, scope of services, and scale?

Typically, multiple facility alternatives could suit an organization's capacity needs. For example, to develop an ambulatory capability, Organization A may wish to consider developing its own facility, partnering with another organization to build a facility, or joint-venturing with physicians to buy and operate an existing facility.

Step 7. Identify Capital Requirements and Financial Feasibility

Costs and risks associated with facility investments are substantial and should be evaluated carefully. Key questions include:

- What are the capital costs and incremental income estimates associated with various options?
- What capital sources are available to fund the project?
- How much additional debt can the organization support?
- What facility development alternatives might be accomplished with the available funds?

A capital position analysis enables an organization to evaluate sources and uses of

Table 1. Procedure Projections, Organization A

Service	2016 Organization A Procedures		
	High	Moderate (Baseline)	Low
CT	3,914	2,943	1,972
MRI	1,885	1,417	949
General X-Ray	4,536	3,410	2,285
Mammography	4,368	3,284	2,201
Ultrasound	3,112	2,340	1,568
ED	14,179	10,661	7,143
Lab	22,359	16,811	11,264
Physician Office Visits	14,595	10,974	7,352

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funds over a 5-year to 10-year planning horizon. This type of analysis quantifies any capital surplus or shortfall and identifies the level of cash flow improvement required to bring the sources/uses equation into balance. Given the significant level of capital required by major facility initiatives, capital sources beyond operations and new debt, such as philanthropy, asset monetization, grants, and partnerships, are often required.

Figure 1 illustrates Organization B's capital position based on consolidation of the two hospitals into one hospital site. The nearly \$231 million, 5-year capital shortfall indicated that absent operating or other trade-offs, the consolidation scenario as defined could not be funded through operating cash flow alone. The organization responded by identifying specific operating and capital savings by department that would improve profitability and reduce overall capital expenditures. With some new debt

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Figure 1. Capital Position Analysis, Organization B

Uses of Cash, FY07-FY11		Sources of Cash	
Capital Expenditures		New Debt	
Baseline	\$456.1	Borrowing	\$100.0
Scenario	325.0	Less: Cost of Issuance (5%)	(5.0)
Capital Avoidance	(24.5)	Net Proceeds	\$95.0
Total Capital	\$756.6		
Funding of Minimum Cash Position (260 days cash)	655.5	Cash Flow from Operations (FY07-FY11 Net Income + Depr)	653.9
Principal Payments	36.6	Unrestricted Cash (2006)	498.9
Working Capital	29.9	Philanthropy and Other Sources	0.0
Total Capital Uses	\$1,478.6	Total Capital Sources	\$1,247.8
5-year Surplus (Shortfall): (\$230.8) or (\$46.2) per year			

Source: Kaufman, Hall & Associates, Inc. Used with permission

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tion is up without presenting past and present statistics is not compelling. Explain what you did to move those numbers in the right direction, and be as specific as possible. For example, stating that you increased net revenue by 2 percent is not as concrete an example of your accomplishment as reporting a 1 percent increase in market share and a 2 percent reduction in operating expenses, resulting in a 2 percent net revenue gain at a time when similar hospitals experienced an operating loss.

8. Be willing to take preemployment tests as an additional step in the recruitment process.

Many organizations engage firms to assess the “fit” of executive candidates through behavioral and psychological testing. These firms can serve a multitude of purposes. Some are used to help assess developmental needs of an incoming candidate. Other firms assess all the members of the existing team and examine a candidate’s ability to mesh with them. Behavioral or psychological testing can provide one more data point in the decision-making process. Given the cost of a bad hire, companies are more sophisticated and meticulous than ever about selecting a search firm and testing and interviewing candidates.

9. Select your references with care.


At some point in the search process, your references will be contacted. Talk to each of them ahead of time to confirm they are comfortable serving as a reference and are accessible during the timeframe needed. Make it easy for them to say no, so you only choose references who will speak glowingly of you.

References who do not return search consultant calls can work to your disadvantage. They are usually regarded as

people who have nothing positive to say. The same holds true for references who are ambivalent or who refer consultants to the human resources department.

10. Do not take it personally if you are not selected.

Without a doubt, the most difficult aspect of the search process is letting qualified people know they were not selected. With so many excellent executives, selecting the right candidate can be extremely difficult. In virtually every case, the choice comes down to chemistry. Regardless of the outcome, many candidates consider the experience of working with a consultant to be valuable for career growth. It allows them to clarify their goals, refine their resumes, and interview with potential employers.

Whether or not you are in the market for a career move, it makes sense to answer the phone when a search consultant calls. If you take the time and energy to build a relationship with a retained search consultant, you’ll be in a favorable position when the right opportunity presents itself. You’ll be comfortable working with the consultant, and the consultant will know the qualifications you have to offer. Everyone is a winner. 

Written by:

Janet Oppenheimer

Consultant

Witt/Kieffer, Oak Brook, IL

630.990.1370

e-mail: janeto@wittkieffer.com

www.wittkieffer.com

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borrowing, these and other capital avoidance measures enabled the organization to proceed with the consolidation plan.

Organizations frequently discover that the most desirable facility option is simply not feasible. The integrated planning process proves particularly helpful at this point in exploring options from strategic, operational, and facility design perspectives. Pursuing a practical and affordable option without every “bell and whistle” is better than pursuing no option, and certainly better than pursuing an option that places the organization in financial jeopardy.

Getting to the Right Facility

Developing a strategic master facility plan that is data- and analysis-driven requires discipline and multidisciplinary collaboration. It also requires time—from 6 to 12 months, depending on the complexity of the situation and the organization’s decision-making processes. As new market and internal data become available, analyses may need to be updated during plan development and implementation. Superior analytic tools enable organizations to complete the work accurately and efficiently.

As a May 2007 report from Moody’s Investors Service notes, “(Facility) projects...carry with them the greatest potential for long-term strategic benefits as well as the highest short-term operating and financial risks, especially given the rising costs of construction.” Spending the time necessary to get to the “right” facility is well justified given the consequences of missing the mark on a project with such significant potential impact on the organization. 

Written by:

David Ennis, Senior Vice President

Zachary Hafner, Assistant Vice President

Robert York, Assistant Vice President

Kaufman, Hall & Associates, Inc., Skokie, IL

847.441.8780

e-mail: dennis@kaufmanhall.com

zhafner@kaufmanhall.com

ryork@kaufmanhall.com

www.kaufmanhall.com