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How Should Health Systems' Reconsider Their Business Portfolios?

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With declining inpatient revenues, many hospitals have acquired or developed ancillary health businesses to round out their portfolios in the past 10-15 years. The rationale for these acquisitions varied by the type of business but has typically been to diversify income, drive inpatient referrals, and raise brand awareness with patients. Examples of these ancillary service lines include diagnostic services (e.g., lab, imaging, speech and hearing testing), retail pharmacy, post-acute care, and health plans.

With business models shifting to embrace value-based rather than volume-based reimbursement, Marwood believes health systems must assess and potentially reconfigure their business portfolios to focus on the greatest strategic value. This may require discontinuing, selling, or outsourcing service lines that may be delivered in a more cost-efficient manner to focus resources on acquiring, developing, and integrating services that create the greatest value.

With margin pressure in the fee-for-service environment and the ongoing shift to value-based models with shared savings or even upside and downside risk, health systems are looking more closely at the costs of providing care. Major health systems, including academic medical centers, are working to cut costs by as much as 25-30%. Some, including Cleveland Clinic and Intermountain, are looking at variations in costs of care at the procedure level, and even by physician, to identify efficiency improvements. Other systems are looking at structural approaches to cost management, including insourcing, outsourcing, and even significant automation of ancillary service lines and support services.

Lab operations, for example, are expensive and yet may not bring significant margin. Inpatient labs are included in the episodic payment under the MS-DRG (IPPS) payment system and therefore operate as a cost center rather than revenue center. Medicare outpatient reimbursement rates have been cut dramatically under the recently released Clinical Lab Fee Schedule. Commercial payers are also pressuring hospitals to keep their laboratory costs in line with those of standalone laboratory service providers. Health systems are increasingly outsourcing labs to Quest or LabCorp, who may be able to operate at lower costs due to volume and other efficiencies. Montefiore, Peace Health, Health One, Barnabas Health, Hartford HealthCare, MemorialCare, and Henry Mayo New-hall Hospital have chosen to outsource or divest at least some components of lab operations to cut costs, while preserving quality. When evaluating their laboratory services, hospitals should consider the near and long-term value of their outreach lab businesses, including volume trends, cost structure relative to competitors, the longevity of commercial reimbursement rates (especially if they are higher than standalone competitors), and/ or the role in utilizing excess capacity. If the value of the outreach business is under pressure, then hospitals should consider divestiture to an independent lab.

Marwood believes health systems and hospitals should focus their portfolios on assets that offer, or likely will offer, strategic value in their portfolio. To preserve as many strategic options as possible, health systems must continually evaluate all business lines, including ones that are currently profitable, and determine how those lines will perform in the future.

Marwood worked with a 40-hospital system that had built a physician outreach lab operation. The operation was profitable, but growth had been slowing and the system was concerned about its ability to compete over the long-term against large competitors such as Quest and LabCorp. Marwood worked with the client in evaluating various strategic options, including growing the business, forming a joint venture, and divestiture. Ultimately, the system decided to sell the business, and Marwood was able to secure an attractive price from a large lab company. Achieving such an attractive valuation would likely not have been possible had the system waited until the business started to decline more significantly.

Such was the situation of another health system client that Marwood advised. This health system owned a government programs managed care plan, and like other Marwood Group clients, the plan had been growing membership, but it was also underperforming expectations and losing money. Marwood performed an analysis demonstrating that although the plan could likely be brought back to profitability over time, the continuing losses incurred during such a restructuring would not be worth the ultimate gains. The health system's delay in identifying and addressing the health plan problems restricted the potential strategic alternatives available to it.

Conversely, Marwood has worked with systems that opted to expand their business lines in the face of the current environment. One geographically diverse system wished to significantly bolster its presence in several ancillary provider practices. After Marwood conducted a careful analysis of both the national and local environment surrounding these businesses, the system opted to expand in selected geographies. Similarly, Marwood helped a regional health system structure a joint venture with an existing in-market health plan to establish a new commercial managed care plan. The health system did not believe it had the capabilities to enter into the health insurance market on its own, and a joint venture provided it with another alternative.

About Marwood Group

Marwood provides strategic, financial, and regulatory advisory services to healthcare clients. Strategic advisory services include analysis of market demand, competition, and capabilities to inform growth strategies. Financial advisory includes evaluation of business options and transaction services through our affiliate Marwood Group LLC, a FINRA-registered broker-dealer and state-registered investment adviser. Marwood's legislative and regulatory advisory provides an outlook for federal and state legislative and regulatory catalysts across all sectors of healthcare. The firm has offices in New York, Washington, D.C., and London.

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