

In the News...

MDS announces the recent **opening of a new office in Overland Park, Kansas.**

Lead by Vice President Ken Avery, CPA, the focus of the Midwest office will be to serve healthcare clients that need support from a team of professionals providing strategic and business planning, physician/hospital integration, valuation and compliance services. MDS President/CEO Phil Dalton said "the opening of this office represents the continued expansion of our capabilities to serve Midwest client hospitals, health systems, physician groups and attorneys."

Recent MDS projects

- Troubled hospital turn-around
- Development of a 1206(L) medical foundation model
- Physician needs assessments/medical staff development plans
- Hospital sale health impact review on behalf of the California Attorney General
- Physician practice valuations
- Assistance with the sale of a general acute care hospital
- Strategic plans for a general acute care hospital
- Board retreat facilitation
- Interim management
- Feasibility study for the potential merger of two acute care hospitals

Register now to attend the **MDS Annual Fall Healthcare Conference** on September 8-9, 2008 in Las Vegas, with a Pre-conference workshop on September 7. See page 5 for details.

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Phil Dalton speaking to attendees at the HASC annual meeting in April.

The repercussions of hospital distress include being unable to keep up to date facilities and equipment, maintain an adequate workforce and sustain competitive position. In turn, this can cause losses in market share, declines in service and quality, reduced profitability and potentially bankruptcy or sale.

II. RECOGNIZING SIGNS OF DISTRESS

Often distressed hospitals have experienced similar histories and common warning signals as described below.

■ **The Usual Indicators:** Flat net revenue, declining or negative net income, reduced cash on hand, high days in accounts receivable, large increases in operating expenses, high FTE's per AOB (Adjusted occupied bed), etc.

Boards and senior level management often accept reduced financial performance as a "fact of life" and become passive about creeping deterioration. In order to gauge the true circumstances of "stress" hospitals should look deeper in order to diagnose the situation and identify corrective actions before "distress" sets in.

■ **Deeper Level Indicators:**

- Managed care contract rates are lower than market
- Imbalanced payer mix relative to the competition
- Medicare ALOS higher than best practices
- Use of registry higher than competitors

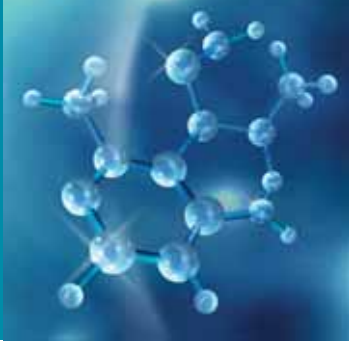
Hospital Stress and Distress

I. INTRODUCTION

Hospitals, nationally, are losing money on direct patient care. When other operating revenues are included they still average less than a 4% margin⁽¹⁾. Over 25% of hospitals have negative total margins and 40% of the hospitals across the nation are in states of insolvency⁽²⁾. "Hospitals are suffering for many reasons including declining reimbursement, the need to make expensive capital improvements, increasing competition, changing payer mix, poor geographic location, increasing labor costs, falling donations and investment income, and unfunded government mandates" says Phil Dalton, President and CEO of Medical Development Specialists (MDS). Medicare and Medicaid payments have declined relative to hospital costs resulting in overall underpayments that have grown from \$4 billion in 2000 to \$25 billion in 2005. In 2005, 65% of hospitals received payments less than their cost from Medicare and 77% of hospitals received payments less than cost from Medicaid. Surprisingly, more for-profit hospitals are insolvent than nonprofit facilities. Nonprofits have benefited from tax breaks, philanthropic donations, and investment income that for-profits are not able to realize. However, even those nonprofits with current success are in danger of becoming distressed during this period of economic turmoil.

(1) American Hospital Association for 2006.
 (2) American College of Healthcare Executives

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Physician Employment: DÉJÀ VU, ALL OVER AGAIN!

After the implosion of hospital owned physician practices in the late 1990s and early 2000s, a new wave of market pressures are emerging, causing a reconsideration of physician employment by hospitals. However, hospitals are being extremely cautious due to profound legal and political challenges in employing and managing physician practices. Market dynamics today are different than ten years ago and hospitals embarking on this strategy can learn from those that have endured and successfully integrated physician owned practices.

In California, a medical foundation is a legal vehicle to employ physicians affiliated with hospitals. Foundations have become a vital instrument for healthcare systems, providing opportunities to recruit new physicians, implement quality initiatives, improve care coordination, rescue beleaguered independent physician practices and grow market share. Moreover, most physicians in a successful foundation are fairly satisfied and indicate that the sacrifice of independence was worthwhile compared to the reduction of financial and administrative pressures in a traditional practice environment.

In other states physician employment is not legally constrained by the corporate practice of medicine. An increasing number of physicians are being employed by hospitals across the nation as recently reported by Merritt Hawkins and Associates (MHA), "2007 Review of Physicians and CRNA Recruiting Incentives." MHA indicated that 43% of the overall searches for 2007 were for hospital settings which was up from 19% in 2005.

Why Employ Now?

KEEP ESTABLISHED PHYSICIANS

Many established physicians are throwing in the towel due to administrative issues, such as health plan contracting, personnel management, billing and collection and inadequate reimbursement.

Physicians who are retiring are unable to add partners and their practice has little financial value that can be purchased by a new recruit. Hospitals often times lose patients if they don't assist in succession planning before the physician retires.

ENCOURAGE NEW PHYSICIANS AND MANAGE MEDICAL STAFF

New physicians out of residency want to minimize financial risks and administrative burdens and maintain a desirable lifestyle. This leads them to join a well capitalized organization that can provide such a practice environment. Many hospitals are finding that their own medical staff does not offer the optimum opportunities for recruitment based on the expectations of new physicians.

Worst of all, hospitals that have provided income guarantees to recruit surgeons or other specialists often find that after termination of the income support, the physician will divert insured patients to competing outpatient surgery centers, while performing surgeries for uninsured patients at the hospital.

AVOID HOSPITAL INCOME GUARANTEE PITFALLS

Some hospitals are finding physicians are leaving because they are unable to maintain the same level of income after termination of the hospital guarantee. Such failure is expensive due to the recruitment and start up costs borne by the hospital.

CURB THE EFFECT OF PHYSICIAN SHORTAGES

Physician shortages have reached a crisis in many markets. This crisis is projected to worsen and will impact many hospitals' ability to sustain their medical staff. In many communities it has become difficult for patients to find primary care physicians that will accept new patients. Specialists are very concerned that care will be negatively impacted due to the shortages of primary care.

INTEGRATE ALIGNED MEDICAL GROUPS

There are numerous integrated systems that have shown that an aligned medical group is important to the success of the organization. Studies have shown that integrated delivery systems are more financially successful than non-integrated organizations. The best practices include joint health plan contracting, clinical integration of processes and systems, joint planning and marketing, new programs



and services and development of management infrastructure systems.

What to do?

Hospitals need to analyze the status and dynamics of its provider community and formulate a medical development plan. The plan should consider physician employment as an option. In some markets hospitals may not have a choice.

The key medical staff should be engaged in the medical development plan and have "skin in the game" if possible. This will minimize any perceived competition coming from the hospital.

Hospitals should use an outside firm to assist in establishing an aligned physician strategy and minimize political fallout.

Conclusion

Physician employment will become more prevalent and will be the cornerstone of many integrated delivery systems. Moreover, future transformations of healthcare are likely to demand that hospitals form an integrated delivery system to meet the needs of payers, consumers and other stakeholders.



Hospital Stress and Distress (continued from page 1)

- Under utilization of profitable services
 - Declining market share in a growth market
 - Stagnant and aging medical staff
 - Stagnant or declining ratio of outpatient net revenue to inpatient
 - Declining results in patient satisfaction surveys
 - Capital expenditures are routinely delayed
 - Interest on debt is higher than market
- Additionally, most distressed hospitals have experienced other common intangible, yet recognizable, symptoms.
- The board and senior management frequently discuss, but are resigned to long term financial under performance
 - Medical staff dissatisfaction has become an accepted fact
 - Talented, mid level managers are leaving and replacements are difficult to recruit
 - Vendors are unhappy and complain about lagging payments

The best way to avoid the risks of financial failure is to perform frequent and unbiased organizational "checkups" to identify corrective actions and strategies before irreversible deterioration sets in. Once the need to take action and a timeframe has been established, a number of actions could be necessary for a significant financial turnaround.

III. TURNAROUND STRATEGIES

An organizational assessment could lead to different intervention strategies based upon the urgency of the circumstances:

1. Situation A:

A turnaround is believed to be achievable utilizing practical steps that may include:

- More attention to efficient use of personnel, supplies, materials, and equipment resulting in expense reductions

- Renegotiation/termination of selective managed care, physician, vendor, and other contacts
- More attention to physician relations, service line development, revenue enhancement, and geographic expansion strategies to boost volume, market share and profit

2. Situation B:

A turnaround may need more dramatic steps to accomplish a profit improvement plan more quickly. Steps may include:

- A reduction in workforce, including management
- Elimination of unprofitable services
- Cancellation of payer and vendor contracts
- Refinancing of debt

3. Situation C:

While short term steps can help, the hospital will not survive without quick action (within 1-2 years). In this circumstance, additional actions may need to include:

- Enlisting support from all relevant stakeholders (physicians, vendors, payers, bond holders and insurers, and other obligors) for dramatic change
- Strategic partnership or sale to a more financially stable organization
- Bankruptcy

Unfortunately, many hospital boards and management teams will be actively discussing survival issues. Stressed hospitals that want to avoid distress, bankruptcy or sale should have a process in place today for a thorough organizational "check up" that considers the deeper level indicators and results in a detailed "diagnostic and treatment plan." Hospital Boards and management that ignore the symptoms may find out too late for successful treatment and recovery and the community may end up being the eventual loser.

ABOUT MDS

Medical Development Specialists (MDS) is a healthcare planning, policy, consulting and business development firm. We have strategic partnerships with other firms specializing in facility design and development, health law, operational performance improvement and capital access and financing. Our team brings both operational and consulting experience to our clients' projects, which translates into insightful, yet pragmatic solutions for the challenges in the healthcare marketplace.

OUR PHILOSOPHY

- Effective and honest communication is critical
- Organizations need a solid understanding of their current position in order to plan for the future
- Clear objectives, priorities and accountabilities are necessary for successful implementation
- Trust is essential for good working relationships
- A strong value proposition must include considerations for improved healthcare quality, ethics and financial performance to be successful

OUR SERVICES

- Strategic Planning and Business Development
- Service Line Development and Feasibility Studies
- Medical Staff Development Planning
- Joint Venture Formation
- Valuation Studies and Fairness Opinions
- Financial Analysis and Due Diligence
- Managed Care Advisory Services
- Facility Planning
- Performance Improvement
- Interim Management
- Marketing Strategy and Implementation
- Conference Services

OUR CLIENTS

- Non-profit and for-profit healthcare systems and hospitals
- Urban and rural hospitals
- Government organizations (e.g. Attorney General's Office, County health departments)
- Academic medical centers and teaching hospitals
- IPAs, medical groups, surgical centers and individual physicians
- Foundations and grantmaking organizations
- Health plans
- Health related businesses serving the industry

NEW TEAM MEMBERS



Michael Manansala – Senior Manager

Mr. Manansala has over 25 years of successful healthcare strategic management experience. He has served in various executive management positions and consulted with large hospital systems and medical groups across the country. His consulting engagements include interim turn-around management of hospital/physician delivery systems, outpatient revenue diversification, development of hospital/physician strategy and implementation i.e. Medical Foundation, physician employment and other models.

Mr. Manansala previously served as the Executive Director of one of Sutter Health Medical Foundations and as a senior manager for a healthcare consulting firm.

He received his MBA and MPH from the University of Hawaii Graduate School of Business and Public Health, respectively.



Jon Yipp – Senior Manager

Jon Yipp is a senior manager with over 15 years of healthcare planning, consulting and hospital operational experiences. He has led and participated in many complex consulting engagements in hospital re-engineering, turnaround, service line delivery, operational improvement, joint-venture negotiations, facility construction and space planning, as well as strategic and business planning.

Prior to joining MDS, Mr. Yipp was an assistant hospital administrator at Kaiser Permanente where he successfully led the planning, license preparation and transition of services into a new inpatient tower. In this role he also reduced non-payroll supply chain expenses and increased revenue and sales.

Mr. Yipp previously held positions as the director of planning and analytical services at a service area in Kaiser Permanente as well as senior consultant in operations improvement and strategy consulting for the company's corporate office.

He received his MPH, with a concentration in Health Services Policy and Management, as well as a bachelor's degree from UCLA.



Daniel Juberg – Consultant

Daniel Juberg is a consultant with MDS specializing in planning and marketing for healthcare organizations and hospitals. He joins MDS from Echelon Partners, an investment banking and consulting firm based in Manhattan Beach. He has experience in a variety of areas including strategic and business planning, service line development, physician needs assessments and facility planning for acute care hospitals and ambulatory facilities.

Mr. Juberg holds a Bachelor of Science degree in Business Administration with an emphasis in Entrepreneurship from the University of Southern California.



Billy Lambon – Consultant

Billy Lambon is a consultant with MDS specializing in market research, planning and data analysis for hospitals and health systems. Billy has experience in a variety of areas including strategic planning, service line development, market feasibility, physician needs assessment, and facility planning and practice valuation and fairness opinions.

Mr. Lambon holds a bachelor's degree in marketing from Erskine College in South Carolina. Billy is a native of South Africa.

JOIN YOUR COLLEAGUES AND REGISTER NOW FOR OUR ANNUAL CONFERENCE!



Cutting Edge Strategies to Improve Operational & Financial Performance

Learn from industry leaders how to better position your healthcare organization for financial and operational performance improvement.



September 8-9, 2008

WYNN LAS VEGAS, LAS VEGAS, NEVADA

PRE-CONFERENCE WORKSHOP - SEPTEMBER 7
Performance Improvement for Troubled Hospitals
 1:00 pm - 4:00 pm

On a national basis, hospital patient margins are dwindling and operating margins have increased only slightly to about 3-4% in recent years. However, the median profitability is much lower with about half of all hospitals losing money on operations. While the prognosis for many hospitals is poor, some have been able to succeed despite the troubling environment. This conference explores definitive strategies for operational and financial improvement as presented by industry leaders who have achieved impressive results.

LEARN FROM THE EXPERTS ABOUT:

- What CEOs are doing to improve the financial and operational performance of their hospitals (case studies from industry leaders)
- Strategies for the successful turnaround of distressed hospitals
- Warning signs for troubled hospitals
- Best models and opportunities for financial improvement in perioperative, emergency, imaging and other service lines
- Financing opportunities and sources of capital in today's difficult market
- Winning examples for physician contracting and productivity improvement
- The benefits of strategic partnerships with physicians

WHO SHOULD ATTEND? CEOs, CFOs, COOs | Chiefs of Medical Staff and Chiefs of Nursing | Vice Presidents and Directors of Finance | Vice Presidents and Directors of Business Development | Physician Leaders | Healthcare Attorneys, Consultants and Developers

For registration information call (714) 754-5424 or email us at info@medicaldevelopmentspecialists.com.

TOPICS AND SPEAKERS

- **Identifying Strategies for Operational and Financial Performance Improvement**
 Phil Dalton, President and CEO - Medical Development Specialists, Inc.
- **The Roadmap to Performance Excellence**
 Tony Armada, President and CEO - Henry Ford Hospital & Health Network
- **Your Revenue Cycle is only as Strong as Your Weakest Process**
 Stephen Mooney, Senior Vice President Patient Financial Services - Tenet Healthcare Corporation
- **Improving Profitability: A Case Study of Recently Acquired Hospitals**
 Phil Cohen, Executive Vice President and Chief Operating Officer - AHMC Healthcare, Inc.
- **Service Line Optimization: Balancing Growth and Profitability**
 Eric Themm, Senior Vice President - Medical Development Specialists, Inc.
 Patricia Tyson, Vice President Clinical Specialty Services - VHA, Inc.
- **Riding the Wave: How to Get Healthcare Financing During Tough Times**
 Eric Weissman, President - London & Pacific Capital Advisors, LLP - MODERATOR
 Robert A. Hemker, Chief Financial Officer - Palomar Pomerado Health
 Shane Passarelli, Senior Vice President - Healthcare Finance Group, Inc.
- **Successful Approaches to Hospital Turnarounds, Case Study: Prime Healthcare**
 Lex Reddy, President and CEO - Prime Healthcare
- **Strategies for Cost Effectively Managing Physician Contracts and Joint Ventures**
 Paul DeMuro, Partner - Latham and Watkins, LLP
- **Designing Inpatient and Outpatient Services to Achieve Patient, Provider and Hospital Goals**
 Linda Bradley, Co-Director of Medical Ventures - March Healthcare Development
 Craig Beam, Senior Vice President - Hammes Company



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NEWSLETTER | Volume III | Summer 2008

