

**Loudoun Healthcare Inc.
Loudoun Virginia**

This case study focuses on the development of Loudoun Healthcare system with special emphasis on the integration of community physicians, and later the dilemma of deciding whether or not to terminate its' relationship with the physicians.

LHI is a not-for-profit healthcare system that owns a 110-bed new community hospital, the original hospital campus, a 100 bed Long-Term-Care nursing facility, and a multispecialty physician group that is comprised of 70 integrated physicians.

In 1999, LHI suffered a significant operating loss and must make some difficult decisions that will impact employee relationships, management relationships, community relationships and physician relationships.

Loudoun Healthcare Marketplace

Since 1918, Loudoun Hospital Center (LHC) originally located in the heart of the historic town of Leesburg, Virginia has been the source of pride and has enjoyed strong support from the community of over 150,000 residents. In 1993, LHI's vision was to develop its' own integrated delivery system to secure its marketshare in the County.

During the early 1990s, Loudoun County experienced an aggressive growth of managed care penetration, and immense population growth that influenced LHI to integrate 70 community physicians over a four year period. LHI wanted to be well positioned for the future by building a strong primary care base. Their goal was to attract and retain these physicians.

LHI was surrounded by two healthcare giants Columbia HCA in Reston, VA and INOVA Healthcare System in Fairfax County, VA, that are known for aggressively increasing their market share. LHI's senior management was concerned that these organizations would establish relationships with Loudoun's local physicians. Therefore, they felt compelled to make a strong strategic move to secure their position for the short and long-term survivability of its' organization.

The Formation of Loudoun Health Services

LHI offered several advantages as a partner to physicians: size, capital, technology, political influence, organizational and managerial depth. From LHI's perspective, the integration was primarily needed to enhance the system's bargaining power with managed care contractors. Having the physicians as a part of the system would avoid unnecessary conflicts with one another, thus the systems' objectives were aimed at focusing on winning contracts. Management also supported this strategy to deter penetration from other healthcare systems within the region such as Columbia HCA and INOVA Healthcare system. Furthermore, this relationship was established to enhance their position with bond insurers and the banks if the practices were financially viable.

Many of the physicians also viewed the relationship as an increase in power to negotiate and leverage managed care contracts, with the assumption that a larger system is better equipped for contracting and managing broad patient populations by diffusing risk, particularly for capitated contracts. They had hoped to avoid undercutting of contracts, and gain assistance with the development of clinical protocols and guidelines, centers of excellence and coordinate research efforts. Physicians expected to lose some of their autonomy, but the tradeoff, however, was the benefit of economy of scale, access to more or better technology services and no overhead burdens.

At the same time, solo practitioners and small physician groups were concerned that they would not be able to make it in a very capitated environment. When the physicians decided to proceed with the notion of a medical group, the major motivating factors were positioning for managed care contracting, improving physician income.

LHI and the physicians were soon recognized as a vertically integrated system linking community physicians with the local hospital and Long-Term-Care-Center. LHI developed a strong primary care physician base. The inclusion of specialists were later, primarily to help share the overhead and economic viability. This new entity was named Loudoun Health Services (LHS).

Dunlop Ecker, Chief Executive Officer noted that the problems of integrating the practices were complex and required extreme patience to work out. He did experience some difficulty in finding the right person to fully integrate the practices. After one year he found an experienced Executive Director, Mr. Jim Lapsley. According to Mr.

Lapsley, melding together 12 different practices, 41 physicians and 11 nurse practitioners is a major challenge that would require capital investment, leadership, physician cooperation and time. They did everything differently, different patient forms, different billing, different policies on collections and different pay scales. They had different pension plans, and this posed some of the most difficult problems. Some of the physicians wanted to retain the assets in their plans, others did not.

Board and Leadership Challenges

Like many newly integrated systems LHI had limited experience in the management of expanded resources, physician practice management and financial assessment. Most of management's experience were in the management of hospitals and the Long-Term-Care-Center. The organization also had difficulty in finding the right person to lead the medical group in a timely period. This posed significant challenges for management and the entire organization.

Additionally, management was challenged with managing change, changing the way managers manage and establishing and building a corporate culture among all entities. The organization lacked a consolidated vision and a organizational culture to support the vision and mission. Both LHI and LHS faced tremendous difficulties in leading the physicians and staff to embrace and tie customer service, quality and place heavy emphasis and focus on efficiency in areas such as coding, reimbursement and all business aspects in general. In short, efficiency and effectiveness did not become part of the platform for the organizations goals for both the short and the long-term.

LHI's Board was comprised of volunteers some with business management experience and some with strong political community ties. None were familiar with healthcare challenges or had the experience to deal with these challenges. They were faced with the same challenges as other healthcare organizations across the country. External pressures of the market, third party payors and the integration of community physicians challenged this inexperienced governance. In many ways some members felt unprepared for the surge of internal and external challenges.

LHS Governance

LHS was governed by the Care Management Committee which was comprised of 5 physicians and the Executive Director. The Medical Director and the Executive Director represented the physicians on the LHI governing board of directors. This was needed to facilitate communication and an understanding of the physicians. Some of the physicians felt misrepresented. Many of the physician felt uninformed.

Community Concerns

As a not-for-profit healthcare system, LHI is accountable to the community. As the County's board learned about LHI's financial crisis they became concerned and requested public discussions on the matter. The County Administrator Kirby approached G.T. Dunlop Ecker, president and CEO about attending the Board of Supervisors meeting to explain LHI's financial crisis and the plan to turn things around. The District Supervisor also requested briefings. Ecker scheduled a series of meetings to talk about the situation. He understood that there was dire need for communication, but the question was how best for that to occur.

Information Systems

The system used for business operations was adequate for the managed care environment. The administration and the physicians needed to be better equipped to monitor the performance, and as a result take corrective actions when necessary. Mr. Lapsley the Executive Director noted that information systems in a capitated environment need to provide real time information so changes can be made quickly. Lapsley said that it is important to be able to constantly compare projected data against utilization. He also noted that physicians respond better to data than anecdotes. Shortly after his arrival, he developed reports for each practice and personally discussed trends, goals, benchmarks and strategies for improvement. This was well received, it had never occurred in the past. Jim's goal is to build an electronic data interchange to process claims, prepare reports, determine eligibility and integrate medical records for the physicians and the hospital.

Mr. Lapsley said that they needed to revamp the information system to fully integrate physicians and perform well in a managed care environment. He was concerned that the capital investment needed for this system would be difficult to achieve.

The Financial Crisis

Two years after acquiring these practices this not-for-profit healthcare system suffered a \$20 million dollar operating loss. As of 1999, LHI had over \$91M in revenues and more than 1079 employees. LHI's losses were attributed to the *financial impact of managed care penetration, the expense of operating two campuses, and the aggressive integration of physician practices. LHI's financial situation was critical and a quick infusion of cash was needed. INOVA health system, its' neighboring competitor provided a loan to the institution, but it was only sufficient for immediate needs.*

In FY 1999, LHS experienced an operating loss of approximately \$10 million. During this period practices were integrated at a very fast pace and little time was spent building the operational infrastructure. Budgeted overhead figures as of 8/12/98 were approximately \$2.2M or \$30,701 per provider. The total overhead of \$2.2m compares favorably with the FY 98 overhead expenses of \$3.1M. Overhead expenses were significantly higher than expected due to the growth of LHS being several years ahead of schedule. These budgeted overhead figures cover both direct and allocated management and clerical support, Central Business Operations, physician directorship, additional group development, legal and consulting fees.

Although a substantial portion of the issues faced by LHS were related to growing pains, many of the problems LHS faced were similar to problems faced by Loudoun Hospital Center. Specifically, LHI's losses were attributed to misalignment of physician compensation with productivity, excess staff compensation, excess professional fees, excess rent, etc. (Tab 1). Overall, the financial costs for operating the physician practices increased while operating efficiencies have decreased. Tab 1 is a summary of key indicators for LHS. The data on this exhibit show that total revenues for 1999 and 2000.

	LHS FY 99	LHS 2000	Program Transfers – Eliminations	2000 Projected
Gross Patient Revenue	\$31.3	\$37.5	\$7.9	\$29.6
Less Contractual Allowances & Bad Debt	\$13.8	\$15.4	\$4.2	\$11.2
Net Patient Revenue	\$17.5	\$22.1	\$3.7	\$18.4
Operating Expenses	\$26.6	\$27.9	\$4.7	\$23.2
Income from Operations	(\$9.1)	(\$5.8)	(\$1.0)	(\$4.8)
Non-operating Revenue	----	.1	----	.1
Net Income	(\$9.1)	(\$5.7)	(\$1.0)	(\$4.7)

<u>Loudoun Health Services</u>	
<u>FY June 30, 1998</u>	
<u>Loss Factors</u>	
<u>Misalignment of Physician Compensation</u>	<u>(\$2,725,000)</u>
<u>Realization Deficit</u>	<u>(\$3,176,000)</u>
<u>Excess Staff Compensation</u>	<u>(\$1,068,000)</u>
<u>Excess Professional Fees</u>	<u>(\$1,978,000)</u>
<u>Salary Allocation</u>	<u>(\$518,000)</u>
<u>Excess Rent</u>	<u>(\$342,000)</u>
<u>Miscellaneous</u>	<u>(\$438,000)</u>
<u>Total</u>	<u>(\$10,245,000)</u>

Tab 1

LHS
Budget for FY 2000

	MHS	Ratio to Net Revenue
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Revenue

Fee for Service Revenue	\$34,114,377
Adjustments	(12,982,477)
Provision for Bad Debt	(2,403,728)
Capitation	3,400,951
Net Patient Revenue	22,129,123
Other Revenue	74,041
Total Revenue	\$22,203,164

Expenses

Physician Salaries & Benefits	\$12,457,452	56.11%
Staff Salaries & Benefits	8,875,379	39.97%
Facility Rental	1,811,493	8.16%
Other Operating Expenses	4,026,030	18.13%
Depreciation	673,235	3.03%
Interest	210,000	0.95%
Total Operating Expenses	\$28,053,589	126.35%
Operating Income/(Loss)	(5,850,425)	
Non-Operating Revenue	72,000	
Net Income/(Loss)	(\$5,778,425)	

Tab 2

The Cost Reduction Plan

In an attempt to stop the hemorrhage, LHI's Board and senior management considered a number of cost reduction consultants. They made the decision to retain "The Rindler Group" in 1999, to develop a strategic cost reduction plan with the organization's senior management team.

The Rindler Group conducted an extensive series of meetings with 60 senior management, middle management, and physician leaders to learn about the LHI and to build support for the development of a major cost reduction initiative.

During the interview process three main questions were asked:

- 1. *What are the organization's strengths?***
- 2. *What are the organization's weaknesses?***
- 3. *What are the suggestions for the future?***

Michael Rindler, the consultant reported that there was a great deal of anger and frustration expressed during some of these interviews and meetings. The majority of this anger and frustration was directed at the Board of Directors and CEO. The pervasive view of the middle management and physician leaders was that the Board and CEO had been untruthful about the hospital's dire and deteriorating financial situation. There was also pervasive distrust of the senior management staff due to the widely held perception that they did not work as a team and that they were more oriented to political goals vs operations goals.

In addition, political dislike and distrust of consultants was expressed during these initial interviews. The consultant combined the feedback from all these sessions to design the cost reduction Task Force process. Recommendations by the Task Forces were evaluated by senior management. A total of \$13.4 million in cost reduction initiatives were selected for approval.

In addition, Michael Rindler offered recommendations to restructure senior management and senior management offered recommendations on restructuring middle management structure. As a result some key

management positions were eliminated to include the CEO, Vice President for Business Operations and Vice President for Managed Care.

To implement the cost-reduction plan and lead the organization, the board hired Pitts Consulting firm. They provided an interim CEO and two support staff members with significant experience in turning around trouble organizations to assist with the turnaround. Along with senior management, the firm examined additional areas within the organization for cuts and realignment.

At the same time, LHS and the physicians began to look for cost reduction opportunities. The Care Management Committee and LHS management planned and projected improved performances for FY 99 estimated at \$5million. Improvements would be as result of improved managed care contracts, more effective billing and collections efforts, heightened awareness of and compliance with group purchasing opportunities for both clinical and non-clinical supplies, provider productivity and closing of specified entities.

Termination of Relationship with the physicians

With the recommendation of the interim CEO, the board voted to terminate its' relationship with the physicians. Lapsley stated that the physicians were dissatisfied that the integration strategy did not reach its full potential, but they were not surprised. Interim CEO, Joseph Ruffolo said the disengagement of the practices represents a significant change in strategy, but an appropriate one given the current healthcare landscape. Ruffolo said that buying the practices was a sound business decision five years ago, but that radical, rapid and continuing change requires adaptation. Buying the practices was very expensive, and there were hidden costs – such as billing and collections that can eat into an organization's reserves.

Several weeks prior to the decision the physicians were told that the board was considering terminating its integration strategy. As a result, Jim Lapsley lead the physician on a comprehensive review of all the practices and business operations to discuss how they might organize the practices. However, the immediate concern for the physicians was negotiating an exit strategy with LHI, including financial compensation. They retained a lawyer to help negotiate a deal.