The Role of Leadership in Planning Services to Meet Needs: Part B

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Embrace Change:
Building today's leaders

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Disclosure of Conflict of Interest

We do not have any financial relationships with any commercial interests relevant to this presentation.

Part B Learning Objectives

1. Describe the planning process for new clinical services to meet community and patient needs.
2. List financial considerations for sustainable clinical services.

Agenda

1. Planning Services in the Context of Strategy
2. The Business Plan: Writing Ideas Down
3. The Financial Pro-Forma: Looking for Sustainability

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SECTION 1 – PLANNING SERVICES IN THE CONTEXT OF STRATEGY

Scenario

» You are the chief executive officer of a private hospital in a large urban area, including government and private hospitals.

» Your medical director comes to you with an idea for a new service the hospital should offer: Renal hemodialysis.

» Intuitively, you agree with your medical director but you need evidence to get support from you board.

» What steps do you take to <u>objectively</u> evaluate this opportunity?

What is a service line?

» Business services organized around a group of similar customers, rather than similar processes or work.

~ Typical hospital service lines:

- Cancer services
- Orthopedics
- Mother and baby
- Cardiac services

Strategic Plans

» Strategic plans set the overall direction of an organization over a longer period of time, typically 3-5 years.

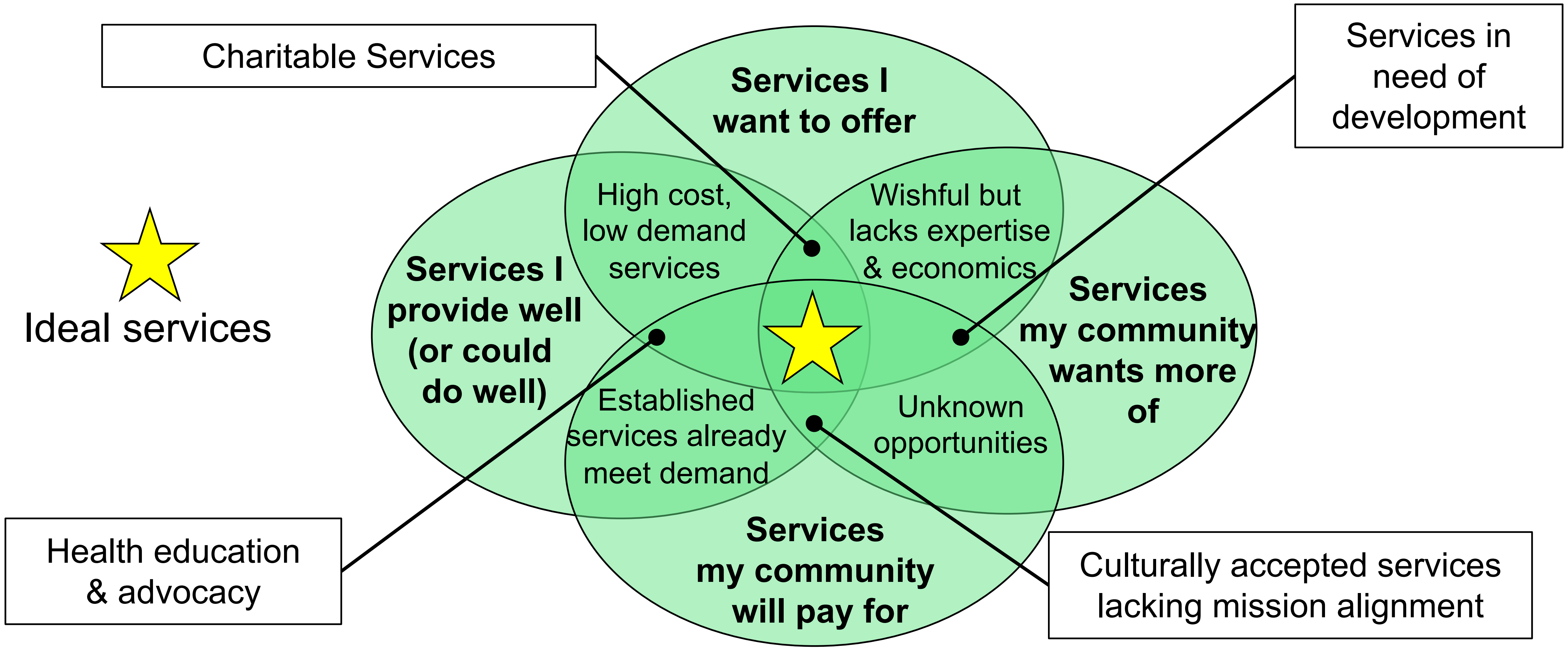
- ~Affirms the mission and values of the organization.
- ~Reviews the current state of the organization and the market.
- ~Sets the vision for the organization.
- ~Establishes the goals to realize the vision.

Community Value and Economic Value

» Implicit in the Joint Commission International standards is the importance of making decisions that are sound from an economic perspective as well as a community need perspective.

- ~ **What services does the community find value in <u>and</u> are willing to pay for?**

Selecting Service Lines



Common Pitfall

» "Can't you see? It's obviously part of our mission, therefore we should do it. Do not question this…It is the right thing to do!"

~ Rigorous processes to evaluate business decisions will help your organization to avoid these traps and be good stewards of your limited resources.

Growth Rates-Market Share Matrix

	High Market Share	Low Market Share
High Growth	**★ Star ★** Very cash intensive, High cash flow	**? Question Mark ?** Very cash intensive, Inadequate cash flow
Low Growth	**$ Cash Cow $** Limited investment opportunities High cash flow	**X Pet X** Limited investment opportunities Inadequate cash flow

Agility and Market-responsiveness

» Highly volatile and turbulent market conditions will destroy those with rigid business strategies.

» Long-term success will depend on the agility and the quick responsiveness towards market and environmental conditions.

» Know your market!

Importance of a Business Plan

- Gives direction so that everyone in the organization works together to accomplish the same goal.
- Outlines specific tactics planned to make progress.
- Useful in gathering support and consensus.
- Helps to hold stakeholders accountable.

Business Plans: Plans for Growth

» Business plans help the organization pursue its goals to realize the strategic vision.

- ~Articulates the growth opportunity to stakeholders:
  - Describes how it supports realizing the vision.
  - Fit of the strategy in overall mission.
  - Describes how and when it will be achieved.
  - Describes the resources necessary.
  - Describes who will be accountable to steward the opportunity.
- ~Business plan is not something to complete and put on a shelf!

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SECTION 2 – THE BUSINESS PLAN: WRITING IDEAS DOWN

Six Steps

1. Assessment of Market Need (What is market need?)
2. Business Plan objectives (How to address market need?)
3. Resources Needed (How to make it a reality?)
4. Funding Sources (How are you going to pay for it?)
5. Financial Projection (Will it be sustainable?)
6. Decision and Action Steps (Move forward, yes or no?)

How to Assess Market Need

» Go beyond intuitive or anecdotal evidence.

» Focus on data driven decision-making:

- Focus groups
- Voice of the community (press, gov't, chamber/community groups, religious entities)
- Physicians and other healthcare workers
- Health insurance plans
- Other 3rd party data collection companies (if available)

Market Needs Assessment

» **Comprehensive External Analysis**

~ Political, Economic, Social, Technological, Legal, Environmental components (PESTLE rubric).

~ Informs the Opportunities and Threats in a SWOT Analysis.

» **Competition Profile**

~ Who are they and where are they located?

~ What are their capabilities, strengths, and weaknesses?

~ What are their reputation and market share?

Setting Service Line Objectives

» **Identify your goals for <u>Service Line Growth</u>**

- ~Building around your competitive advantage.
  - Draw on your strengths that align with your opportunities
- ~Market strategy: Who is(are) your target market(s)?
- ~Sources of income
- ~Pricing strategy

Scenario Application: Market Assessment

Strengths	**Weaknesses**
(part of internal analysis)	*(part of internal analysis)*
Opportunities	**Threats**
Diabetes rates (social) Income growth (social) Insurance coverage (economic) Desire for comfortable access (social) No private services locally (economic) Public hospital wait times (political) Local physician support (social)	Quick-reacting competition (economic) Competition's access to capital (economic) Public hospital offers free care (political) 200% tariff on imported equipment and supplies (political)

Scenario Application: Competitive Advantage – What Sets You Apart?

- Build on your strengths that align with your opportunities.
  - Will you rely on compassionate customer service?
  - Will you be known for cutting edge technology?
  - Will you be known for the best clinical care and outcomes?
  - Your business will need to identify the niche area that makes it competitive in the market.
  - Articulate whether there is a limited window of opportunity to take advantage of an opening in a market (if applicable).

Scenario Application: Target Market

PRIMARY TYPES OF CUSTOMER SEGMENTATION			
Geographic	Demographic	Behavioral	Psychological
• Distance • Urban or rural	• Age & Gender • Income level	• Frequency of use • Existing patterns	• Priorities • Attitude

» Develop a description of the profile of your target market using this type of segmentation.

~What is the forecasted market growth for this group?

~How much market share can you expect to gain?

Scenario Application: Sources of Income

- Will you bill insurance or operate exclusively on cash payments?
- Will you participate in managed care or related incentive programs?
- Are you expecting any subsidies from the government or elsewhere?
- Will you have a retail income component?
- What types of services or products will you sell?
- How much money do you expect each source of income (types of services or products sold) to provide to your business each year?

Scenario Application: Pricing Strategy

» Are you pricing lower or higher than prevailing market rates for the services and products you provide?

» Are you engaging in “loss-leader” pricing for any of your lines of business in order to attract customers other (profitable) services?

» Will you provide discounts or special pricing?

Identifying Clinical Space

» Location and accessibility

» Building, buying, or renting

» Appropriately sizing the clinic

» Availability of utilities and services

» Appropriate approvals

Scenario Application: Identifying Space

» Where will you be located, and how accessible is it to your target market?

» Are you planning to build a new building or use existing space?

» How close is your facility to transportation? Are basic utilities available and reliable?

» Does the government approve and/or support your facility development? Does your facility comply with regulations?

» Is the location big enough to handle the business you expect to see? Is there room for future growth in business volume?

Identifying Staff

» Management

» Clinical staff

» Support staff

» Professional services

» Roles and responsibilities

» Salaries and benefits strategy

Staffing Models in the Context of Growth

» Early reliance on generalists, then adapt to specialization.

» Begin with lower-cost staffing models, and it will be easier to add cost than to subtract later on.

Scenario Application: Identifying Staff

- Identify the type and quantity of the necessary staff
  - Create a job description with identified roles and responsibilities
- Identify the wages and benefits cost of each employee.
  - If they are difficult to recruit, how will you incentivize and recruit?
  - Are you going to pay wages different than the market? Why?
- Also account for any indirect support services such as information systems, accounting, or human resources?
- **How will my staff give us a clinical and market advantage?**

Identifying Equipment and Supplies

» Equipment

» Supplies

» Sourcing and procurement

» Maintenance and support

Scenario Application: Equipment and Supplies

- What equipment will you need and how much will it cost?
- How are you going to purchase your equipment?
- What supplies will you need and how much will it cost?
- How much will maintenance and support cost?
- **How will equipment give me a clinical and market advantage?**

How to Publicize Your Efforts

» Advertising strategy:
  - Branding
  - Traditional advertising
  - Social media and the Internet
» Advocacy and philanthropy:
  - Functions of the Board of Directors

Scenario Application: Marketing

- How are you going to brand your business?
- Will you spend money on marketing your business in traditional advertising (TV, billboards, newspapers, radio, etc.) or the Internet (or both)?
- Are you going to engage in social media marketing?
- Who are you going to engage to help you in marketing your business?

Financial Projections – Funding Sources

- Equity or Philanthropy
  - How much of your start-up capital will be equity or philanthropy?
  - Who will be your major investors or donors?
  - What are your investors' expectations for a return on investment?
- Debt
  - How much of your start-up capital will be debt-financed?
  - Where will you borrow the money?
  - What rate of interest do you expect to receive and what is the term of the debt?

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SECTION 3 – THE FINANCIAL PRO-FORMA: LOOKING FOR SUSTAINABILITY

The Importance of Financial Projections

» Standard part of a comprehensive business plan.

» Assess project feasibility and sustainability:

  ~ Sets expectation for financial performance.

  ~ Exit strategy in case performance is below expectation.

» Allows for quantitative comparison of different project opportunities simultaneously.

  ~ Prioritize with competing proposals.

  ~ Opportunity cost of inaction.

Elements of a Pro Forma Analysis

» Baseline scenario: What will likely happen if nothing changes?

» Pro forma scenario(s): What is the assumed incremental impact of making specified changes in the organization?

» All scenarios should include:

- ~Key assumptions
- ~All start-up costs & any financing costs
- ~Annual income statement and cash flows for 3-5 years
- ~Metrics on profitability and return on investment
- ~Risk and sensitivity analysis

Financial Projections – Key Assumptions

» Patient volumes (daily visits, annual visits, unique patients, etc.)
  ~ Include conservative ramp up periods, and also consider capacity.
» Payor mix (government, cash, commercial insurance, etc.)
  ~ Use a conservative price for each payor, multiplied by volume
» Estimate expenses by category (also estimate annual cost growth)
  ~ Wages and benefits, supplies, maintenance, rent, utilities, depreciation, interest and taxes.
» Use historical data whenever possible.
» **Be conservative in each and every estimate!**

Financial Projections – Start-up Expenditures

» Start-up capital expenditures:
  ~ Purchasing or leasing land, buildings, and equipment.
  ~ Use actual quotes for equipment, including taxes.

» Can include pre-operating expenses:
  ~ Wages and benefits before revenue begins.

» For multi-year capital projects, use a cash flow schedule.

Example	Year -2	Year -1	Year 1	Year 2	Year 3	Year 4	Total
Capital Expenditure	($100k)	($500k)	($50k)				($650k)
Net from Operations			$150k	$250k	$300k	$350k	$700k

Financial Projections – Income Statement

» Forecasted income statement
  ~ Revenues & expenses
  ~ Incremental approach: For each pro forma scenario, only show the incremental difference between the baseline and scenario

» Create a cash flow statement
  ~ Adjust financing, capital purchases, and depreciation into the year of cash flow, rather than revenue/expense recognition.

Financial Projections – Profitability Metrics

- »Determine your net income and cash flow, year by year.
- »Profitability ratios and methods of assessment:
  - ~Payback period
  - ~Discounted payback period
  - ~Net present value
  - ~Profitability index

Payback Period

» Payback period is used to identify your break even point.
  - Using your net cash flows, how long does it take to recover the cost of your startup costs?
  - Calculate cumulative cash flows
  - Example: Cumulative cash flows become positive in year 3
  - Calculation: 2 + (250k / 300k) = 2.83 years

Example	**Year -2**	**Year -1**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Total**
Net project cash flows	($100k)	($500k)	$100k	$250k	$300k	$350k	**$400k**
cumulative	*($100k)*	*($600k)*	*($500k)*	*($250k)*	*$50k*	*$400k*	

Discounted Payback Period

» Discounted payback period incorporates the time value of money.

~ Stated in today's dollars.

~ Based on a discount rate

- Use 2-6%, based on your organization's cost of capital.

~ Calculation: 3 + ($27k / $244k) = 3.10 years

Example	Year -2	Year -1	Year 1	Year 2	Year 3	Year 4	Total
Net project cash flows	($100k)	($500k)	$100k	$250k	$300k	$350k	**$400k**
cumulative	*($100k)*	*($600k)*	*($500k)*	*($250k)*	*$50k*	*$400k*	
Discount Factor (5%)	1.000	0.9500	0.9025	0.8574	0.8145	0.7738	
Discounted net cash flows	($100k)	($475k)	$90k	$214k	$244k	$271k	**$244k**
cumulative	*($100k)*	*($575k)*	*($485k)*	*($271k)*	*($27k)*	*$244k*	

Net Present Value

» **Net present value (NPV)** is the present value of a project's future cash inflows less the amount of investment needed to achieve it.

» Calculation: Sum of discounted cash flows.

Example	Year -2	Year -1	Year 1	Year 2	Year 3	Year 4	Total
Net project cash flows	($100k)	($500k)	$100k	$250k	$300k	$350k	**$400k**
cumulative	*($100k)*	*($600k)*	*($500k)*	*($250k)*	*$50k*	*$400k*	
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Profitability Index

» **Profitability index** is a way to compare various potential projects when you can't afford to accomplish them all.

~ Calculation: NPV of Operating Cash Flows / NPV of Investment Required

» Example: ($90k+$214k+$244k+$271k) / ($100k + $475k) = **<u>1.42</u>**

Example	**Year -2**	**Year -1**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Total**
Net project cash flows	($100k)	($500k)	$100k	$250k	$300k	$350k	**$400k**
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Financial Projections – Risks & Sensitivity

» Understand which assumptions are most sensitive to profitability and net present value.

» After scenarios are finalized, identify the 1-3 assumptions that have the greatest impact to the financial outcome.
  - ~ Replace the existing estimate with one that is even more conservative and one that is more aggressive.
  - ~ Measure the positive and negative impact to the Net Present Value calculation, and show this as part of your sensitivity analysis

Common Financial Analysis Pitfalls

- »Volume, pricing, or costs far too optimistic.
- »Tendency to identify breakeven point, and stagger scenarios around a preconceived conclusion.
  - ~Develop scenarios before calculating profitability metrics.

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Questions