4sight HEALTH
expect better healthcare

Dynamic Tension:
Rethinking Health System Governance

Market Corner Commentary
April 18, 2017

By John Koster, M.D. and
David W. Johnson

The winds of post-reform transformation are blowing through healthcare. Long-established health systems confront existential questions: do we buy or sell? what businesses are we in? can our company remain competitive? is our business model sustainable? what is our value proposition to customers?

Transformation is particularly hard for nonprofit systems. Community-oriented governance models can be ill-suited for today's more competitive, consolidating, value-driven, consumer-oriented marketplace. Traditional nonprofit boards often lack the strength, composition and information to shape strategy and provide meaningful oversight.

It's time to rethink health system governance. Enlightened governance achieves appropriate balance between board and management. Dynamic tension between board and management defines organizational purpose, fuels strategic growth and identifies hidden dangers. Winning health systems are restructuring governance to optimize performance in the post-reform healthcare marketplace.

THE IMPERATIVE FOR IMPROVED GOVERNANCE

Nonprofit health system boards can be large and philanthropically focused. They may lack critical expertise, suffer from uneven attendance, distribute governance responsibilities broadly and some even cede responsibility for organizational strategy to management.

Relative to other industries, healthcare has not experienced significant disruption and operates largely as it did fifty years ago. Doctors administer care in centralized settings and third-party payors, notably governments and insurance companies, reimburse providers for the care they deliver. Very few large hospitals have closed. Community-based governance models have supported organizational success during this prolonged period of stable operations. Health systems thrive without high-performing boards.

Historically, resources have flowed disproportionately into the healthcare sector. Healthcare's share of GDP has tripled since the mid-1960s. Regulation, deep political support and activity-based fee-for-service payment have shielded incumbent health systems from marketplace demands for better outcomes, greater transparency and more efficient operations. These industry defenses are beginning to crumble.

A host of factors now challenges entrenched business practices.

- Technological advances support lower-cost delivery alternatives; increase cost, quality and outcomes transparency; and empower employers/consumers to make value-based healthcare purchases.
- New payment methodologies shift financial risk to providers for the quality and cost of the care they deliver and to individuals to be prudent consumers.
- New competitors are everywhere. These include global retailers, like Walgreens and Walmart, as well as hundreds of venture-funded enterprises seeking to exploit the delivery system's inefficiencies and serve consumers' unmet healthcare needs.

- There's less societal willingness to support healthcare's ever-increasing costs. For example, Congress recently passed a new balanced-budget bill with overwhelming bipartisan support (despite fierce AHA opposition) that limits facility charges for care provided in non-hospital settings.

Enlightened health systems understand that current business models are unsustainable, but wrestle with transforming business cultures that emphasize revenue optimization, resist accountability and have limited understanding of consumerism. For the first time, health systems confront real uncertainty regarding strategic positioning. Moreover, risks associated with strategic "bets" (e.g. entering the health insurance business) are extremely high.

In *n=1: How the Uniqueness of Each Individual is Transforming Healthcare*, John and his coauthors discuss how the term transformation can be overused, but that it's not in this instance. Transformation refers to the fundamental changes that occur in business operating environments. Sometimes, leaders see the disrupting shifts and adjust easily. Other times, the shifts are so profound and fundamental that leaders fail to appreciate their potential catastrophic impact. Witness Kodak.

More than ever before, organizational leadership will determine which health systems develop the expertise and capabilities necessary to maintain organizational competitiveness. To win, health systems must pair managerial talent with effective board governance to ensure superior performance, appropriate resource utilization and proper strategic positioning. The risks associated with not upgrading organizational governance are dangerously high.

GOVERNANCE FOR TRANSFORMATIONAL TIMES

Unlike their for-profit counterparts, nonprofit boards must satisfy many constituencies in defining their purpose and operating orientation. Lacking the clarity of "advancing shareholders' interests," nonprofit boards instead strive to advance "community benefit" which has multiple and sometimes conflicting interpretations. In seeking to exercise their governance responsibilities, nonprofit boards sometimes overemphasize organizational interests and/or tolerate underperformance.

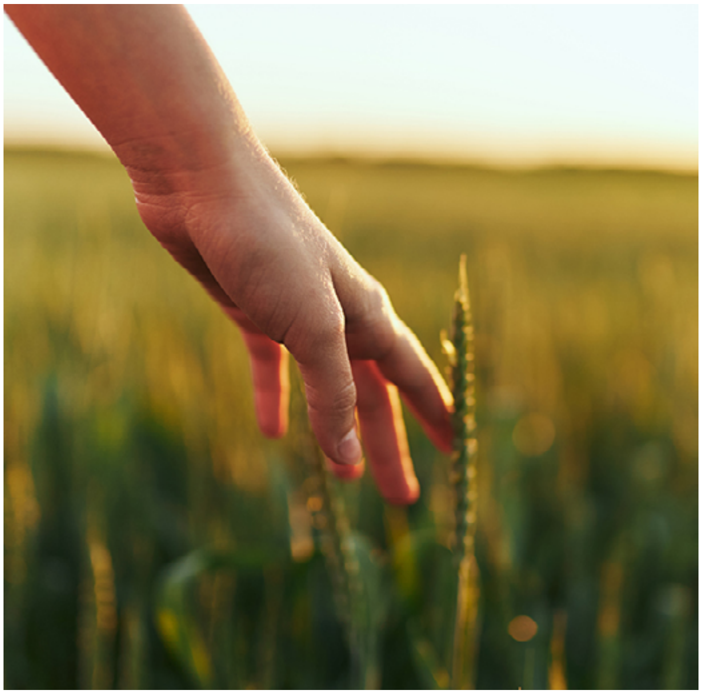
This mission ambiguity argues for greater rigor in defining organizational vision, performance standards and strategic imperatives. The best strategies often require organizations to stop providing long-offered services. These "cancelling" decisions almost always generate opposition and can become difficult for community-based nonprofit boards to execute.

Modernizing health system governance requires clarity and commitment in the following five areas: 1. Board Character; 2. Board Composition; 3. Board Orientation; 4. Board-CEO Dynamics; and 5. Board Management.

Board Character: Boards govern, they don't manage. Their responsibilities require profound respect, loyalty and care for the organization. Board members must have enough distance from operations to see "the bigger picture" and provide insightful strategic guidance. With rare exceptions, board members should attend all meetings. They should come prepared and participate actively. Boards exercise enterprise-wide responsibility. They should operate as a unified body with no "representational" seats, conflicts of interest or reserve powers. Board members must trust one another and the governance process. Individual members must be able to speak freely and openly share concerns. Interactions must be honest, deliberative and respectful. Increasingly, health systems compensate board members to recognize their time commitment and increase accountability.

Board Composition: Smaller boards are better. According to a 2014 survey by Spencer Stuart, the average board size for S&P 500 companies is 11. Only 17% of S&P 500 companies have more than thirteen members. Smaller boards enable members to know one another well and engage fully in the governance process. It is essential to recruit board members with relevant competencies. Which competencies health system boards require should be a topic of frequent debate. For example, health systems may consider having members with expertise in consumerism and technology. Board members with career experience in "disrupted" industries can offer valuable insights into strategic repositioning, new business development and competitive pressures.

Board Orientation: Importantly, boards own organizational strategy. Boards should devote at least fifty percent of their time to understanding, discussing and guiding both short-term



(the next year) and longer-term (five-ten years) strategy. It is essential for boards to regularly examine the three to five biggest threats confronting the organization. Beyond strategy, boards should develop meaningful "information architecture" with metrics that summarize organizational performance and highlight troublesome issues. There should be only necessary subcommittees (e.g. audit, compensation, human resources). Content experts from the board should chair subcommittees staffed with other board members. In-depth oversight occurs in committees with results reported to the full board by committee chairs.

Board-CEO Dynamics: The board's most important responsibilities are hiring, evaluating and guiding the organization's CEO. The CEO selection process should incorporate strategy, capabilities assessment, organizational culture and succession planning to identify candidates that fit. Once selected, the board must work with new CEOs to ensure their success. The old expression "It's lonely at the top" rings true. CEOs often cannot share their deepest concerns with their leadership teams. For this reason, it makes sense to have board members provide perspective and give both personal and professional advice. The best boards provide a safe outlet for CEOs to unburden themselves and debate sensitive topics. They also hold executive sessions at each meeting, so members can discuss topics, observations and concerns without the CEO in attendance. Typically, board chairs share insights from executive sessions with CEOs to preserve trust and guide decision-making.

Beyond the CEO, board members should develop relationships with the organization's senior management team. As part of professional development and evaluation, CEOs should provide opportunities for senior leaders to interact with the board. This is particularly important when undertaking succession planning.

Board Management: Effective board chairs are essential for successful board operations. In addition to setting meeting agendas, board chairs police deliberations (no wild goose chases), keep the dialogue moving, encourage participation and bring issues to resolution. To optimize the board's contributions, board chairs should develop a feel for the board's calendar and work plan. Once a year, the board chair should canvas all board members individually to learn their assessment of the board's performance, solicit suggestions for improving board deliberations and discover any hidden concerns. Annual board surveys can aid in the review process. Finally, boards must have guidelines and mechanisms for replacing board members at appropriate times. Year-end conversations create opportunities for these dialogues.

IF NOT NOW…

Reconfiguring board governance is a daunting endeavor. It could involve moving long-time supporters off the board. CEOs may resist more rigorous oversight and perceived loss of control. Orthodox thinking clouds awareness and obscures realistic market assessments. Honest discussion regarding organizational capabilities and competitiveness can be excruciating. It may seem both easier and safer to maintain the status quo and muddle through.

And yet… The threat posed by value-based service demands is existential for many, perhaps most, health systems. They lack the culture, capacity and capabilities to transform in ways that meet customer demands for better healthcare and accommodate substantial financial risk. Health systems cannot dodge the approaching tornado. Better to address industry disruption with wide-open eyes and strong leadership supported by equally strong governance.

Huron Healthcare commissioned this article.

AUTHORS

David Johnson is the CEO of 4sight Health, a thought leadership and advisory company working at the intersection of strategy, economics, innovation and capital formation. Dave wakes up every morning trying to fix America's broken healthcare system. Prior to founding 4sight Health in 2014, Dave had a long and successful career in healthcare investment banking. He is a graduate of Colgate University and earned a Masters in Public Policy from Harvard Kennedy School. Employing his knowledge and experience in health policy, economics, statistics, behavioral finance, disruptive innovation, organizational change and complexity theory, Dave writes and speaks on pro-market healthcare reform. His first book ***Market vs. Medicine: America's Epic Fight for Better, Affordable Healthcare***, and his second book, ***The Customer Revolution in Healthcare: Delivering Kinder, Smarter, Affordable Care for All*** (McGraw-Hill 2019), are available for purchase on www.4sighthealth.com. His third book, ***Less Healthcare, More Health: The Prescription for a Happier, More Equitable and Productive America***, will publish in 2024.

John Koster, MD A healthcare author and consultant, Dr. Koster is also on the boards of Sutter Healthcare and Banner Healthcare. He is an advisor to hospital systems, health insurers, boards, and early-stage healthcare technology companies. He also serves as an executive in residence of the Health Management Academy. John served for ten years as the CEO of Providence Health & Services, one of the largest US health systems, until 2014. Prior to Providence, John served in senior leadership in health insurance plans, hospital systems, medical groups, and consulting practices. He is an internist and emergency medicine physician.