El Camino Health

AGENDA
EXECUTIVE COMPENSATION COMMITTEE OF THE EL CAMINO HOSPITAL BOARD OF DIRECTORS

Thursday, May 30, 2019 – 4:00pm
El Camino Hospital | Conference Room A (ground floor)
2500 Grant Road Mountain View, CA 94040

PURPOSE: To assist the El Camino Hospital (ECH) Board of Directors ("Board") in its responsibilities related to the Hospital's executive compensation philosophy and policies. The Executive Compensation Committee shall advise the Board to meet all applicable legal and regulatory requirements as it relates to executive compensation.

	AGENDA ITEM	PRESENTED BY		ESTIMATED TIMES
1.	**CALL TO ORDER/ROLL CALL**	Bob Miller, Chair		**4:00-4:01pm**
2.	**POTENTIAL CONFLICT OF INTEREST DISCLOSURES**	Bob Miller, Chair		**4:01 – 4:02**
3.	**PUBLIC COMMUNICATION** a. Oral Comments *This opportunity is provided for persons in the audience to make a brief statement, not to exceed three (3) minutes on issues or concerns not covered by the agenda.* b. Written Correspondence	Bob Miller, Chair		**information** **4:02 – 4:05**
4.	**CONSENT CALENDAR** *Any Committee Member or member of the public may remove an item for discussion before a motion is made.* ***Approval*** a. Minutes of the Open Session of the Executive Compensation Committee Meeting (April 2, 2019) ***Information*** b. Progress Against FY19 ECC Goals c. Article of Interest	Bob Miller, Chair	*public comment*	**motion required** **4:05 – 4:06**
5.	**REPORT ON BOARD ACTIONS** **ATTACHMENT 5**	Bob Miller, Chair		**information** **4:06 – 4:15**
6.	**FY20 ORGANIZATIONAL GOALS** **ATTACHMENT 6**	Dan Woods, CEO	*public comment*	**possible motion** **4:15 – 4:35**
7.	**ADJOURN TO CLOSED SESSION**	Bob Miller, Chair		**motion required** **4:35 – 4:36**
8.	**POTENTIAL CONFLICT OF INTEREST DISCLOSURES**	Bob Miller, Chair		**4:36 – 4:37**
9.	**CONSENT CALENDAR** *Any Committee Member or member of the public may remove an item for discussion before a motion is made.* ***Approval*** *Gov't Code Section 54957.2:* a. Minutes of the Closed Session of the Executive Compensation Committee Meeting (April 2, 2019)	Bob Miller, Chair		**motion required** **4:37 – 4:38**

A copy of the agenda for the Regular Committee Meeting will be posted and distributed at least seventy-two (72) hours prior to the meeting.
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	AGENDA ITEM	PRESENTED BY		ESTIMATED TIMES
10.	*Gov't Code Sections 54957* and *54957.6* for report and discussion on personnel matters: - Market Review	Lisa Stella, Mercer		**information** **4:38 – 4:53**
11.	*Gov't Code Section 54957.6* for a conference with labor negotiator Dan Woods: - Proposed FY20 Executive Salary Ranges	Dan Woods, CEO		**discussion** **4:53 – 4:58**
12.	*Gov't Code Section 54957.6* for a conference with labor negotiator Dan Woods: - Proposed FY20 Executive Base Salaries	Dan Woods, CEO		**discussion** **4:58 – 5:08**
13.	*Health & Safety Code 32016(b)* for a report and discussion involving health care facility trade secrets; *Gov't Code Section 54957.6* for a conference with labor negotiator Dan Woods: - Proposed FY20 Individual Executive Incentive Goals	Dan Woods, CEO		**possible motion** **5:08 – 5:28**
14.	*Gov't Code Section 54957.6* for a conference with labor negotiator Dan Woods: - Proposed FY20 CHRO Salary Range and Base Salary	Dan Woods, CEO		**discussion** **5:28 – 5:33**
15.	*Health & Safety Code 32016(b)* for a report and discussion involving health care facility trade secrets; *Gov't Code Section 54957.6* for a conference with labor negotiator Dan Woods: - Proposed FY20 CHRO Incentive Goals	Dan Woods, CEO		**possible motion** **5:33 – 5:38**
16.	*Gov't Code Section 54957.6* for a conference with labor negotiator Bob Miller: - Proposed FY20 CEO Salary Range and Base Salary	Lisa Stella, Mercer		**discussion** **5:38 – 5:43**
17.	**ADJOURN TO OPEN SESSION**	Bob Miller, Chair		**motion required** **5:43 – 5:44**
18.	**RECONVENE OPEN SESSION/ REPORT OUT**	Bob Miller, Chair		**information** **5:44 – 5:45**
	To report any required disclosures regarding permissible actions taken during Closed Session.			
19.	**PROPOSED FY20 EXECUTIVE SALARY RANGES**	Dan Woods, CEO	*public comment*	**possible motion** **5:45 – 5:47**
20.	**PROPOSED FY20 EXECUTIVE BASE SALARIES**	Dan Woods, CEO	*public comment*	**possible motion** **5:47 – 5:49**
21.	**PROPOSED FY20 CHRO SALARY RANGE AND BASE SALARY**	Dan Woods, CEO	*public comment*	**possible motion** **5:49 – 5:51**
22.	**PROPOSED FY20 CEO SALARY RANGE AND BASE SALARY**	Bob Miller, Chair	*public comment*	**possible motion** **5:51 – 5:53**
23.	**FY20 PACING PLAN** **ATTACHMENT 23**	Bob Miller, Chair	*public comment*	**possible motion** **5:53 – 5:58**

	AGENDA ITEM	PRESENTED BY		ESTIMATED TIMES
24.	**6-MONTH EXECUTIVE COMPENSATION CONSULTANT REVIEW** **ATTACHMENT 24**	Bob Miller, Chair		**discussion** **5:58 – 6:18**
25.	**CLOSING COMMENTS**	Bob Miller, Chair		**discussion** **6:18 – 6:19**
26.	**ADJOURNMENT**	Bob Miller, Chair	*public comment*	**motion required** **6:19 – 6:20pm**

Upcoming Meetings (pending Board approval)**:** September 19, 2019; November 7, 2019; April 2, 2020; May 28, 2020 || **Board/Committee Educational Sessions** (pending Board approval)**:** October 23, 2019; April 22, 2020

El Camino Hospital
THE HOSPITAL OF SILICON VALLEY

Minutes of the Open Session of the
Executive Compensation Committee
Tuesday, April 2, 2019
El Camino Hospital | Conference Room B (ground floor)
2500 Grant Road, Mountain View, CA 94040

Members Present	**Members Absent**
Teri Eyre	None
Julie Kliger, Vice Chair**	
Jaison Layney	
Bob Miller, Chair	**via teleconference
Pat Wadors	
John Zoglin	

Agenda Item	Comments/Discussion	Approvals/ Action
1. CALL TO ORDER/ ROLL CALL	The open session meeting of the Executive Compensation Committee of El Camino Hospital (the "Committee") was called to order at 4:00pm by Chair Bob Miller. A verbal roll call was taken. Ms. Wadors joined the meeting at 4:04pm during Agenda Item 5: Report on Board Actions. Ms. Julie Kliger joined the meeting at 4:14pm during Agenda Item 8: Progress Against FY19 Organizational Goals and participated via teleconference. All other Committee members were present at roll call.	
2. POTENTIAL CONFLICT OF INTEREST DISCLOSURES	Chair Miller asked if any Committee members had a conflict of interest with any of the items on the agenda. No conflicts were noted.	
3. PUBLIC COMMUNICATION	None.	
4. CONSENT CALENDAR	Chair Miller asked if any member of the Committee or the public wished to remove an item from the consent calendar. No items were removed. **Motion:** To approve the consent calendar: Minutes of the Open Session of the Executive Compensation Committee Meeting (January 29, 2019); Proposed FY20 Meeting Dates; and for information: Progress Against FY19 ECC Goals; Article of Interest. **Movant:** Layney **Second:** Eyre **Ayes:** Eyre, Layney, Miller, Wadors, Zoglin **Noes:** None **Abstentions:** None **Absent:** Kliger **Recused:** None	***Consent calendar approved***
5. APPOINTMENT OF VICE CHAIR	Chair Miller announced that he has appointed Julie Kliger as Vice Chair of the Committee and that she has accepted.	
6. REPORT ON BOARD ACTIONS	Chair Miller referred to the recent Board approvals as further detailed in the packet. In response to Committee questions, Dan Woods, CEO, reported that the transaction between Silicon Valley Medical Development (SVMD) and San Jose Medical Group closed April 1, 2019. He explained that currently the President of SVMD is the only SVMD executive, and that position falls under the Committee's purview. Mr. Woods and Ms. Fisk described 1) bankruptcy court proceedings related to the transaction, 2) the SVMD VP of Human Resources who is managing	

	HR for SVMD and is overseeing the staffing of the newly acquired clinics. Chair Miller reported that the CEO evaluation process was approved by the Board.	
7. DRAFT REVISED EXECUTIVE PERFORMANCE INCENTIVE PLAN	Ms. Fisk provided an overview of the revisions to the Plan, which removed outdated references, incorporated feedback from the Committee's last meeting, and included an exception clause (any exceptions require Board approval). **Motion:** To recommend that the Board approve the Draft Revised Executive Performance Incentive Plan. **Movant:** Eyre **Second:** Wadors **Ayes:** Eyre, Layney, Miller, Wadors, Zoglin **Noes:** None **Abstentions:** None **Absent:** Kliger **Recused:** None	***Draft Revised EPIP recommended for approval***
8. PROGRESS AGAINST FY19 ORGANIZATIONAL GOALS	Dan Woods, CEO, provided an update on the progress against the FY19 organizational goals: - Patient Throughput (door to floor): staff identified 64 opportunities and have focused on 18. He described constraints on the process improvements (e.g., a patient is ready to be admitted, but a bed may not available) and the development of a command center to better identify and triage available resources. - HCAHPS: Mr. Woods explained that cleanliness is a surrogate for satisfaction. He described the performance and employee engagement of the Environment Services department and lessons learned from newly introduced executive rounding regarding the nurse call system and accountability structures. - People Management: Ms. Fisk described some of the drivers of the increase in employee engagement scores including: 1) creating a line-of-sight for employees to ECH's organizational goals where they receive a recognition bonus for their contributions toward the organization's overall success and 2) regularly-scheduled CEO town halls.	
9. ADJOURN TO CLOSED SESSION	**Motion:** To adjourn to closed session at 4:25pm. **Movant:** Wadors **Second:** Eyre **Ayes:** Eyre, Kliger, Layney, Miller, Wadors, Zoglin **Noes:** None **Abstentions:** None **Absent:** None **Recused:** None	***Adjourned to closed session at 4:25pm***
10. AGENDA ITEM 15: RECONVENE OPEN SESSION/ REPORT OUT	Open session was reconvened at 5:28pm. Agenda items 10-14 were addressed in closed session. During the closed session, the Committee approved the Minutes of the Closed Session of the Executive Compensation Committee Meeting (January 29, 2019) by a unanimous vote in favor of all members present (Eyre, Kliger (via teleconference), Layney, Miller, Wadors, Zoglin).	
11. AGENDA ITEM 16:	Chair Miller requested that the goal related to the CEO Review process say	***Proposed FY20***

PROPOSED FY20 COMMITTEE GOALS	"review" rather than "support." Mr. Zoglin suggested that the goals should push the Committee to do more than what has been done in previous years. The Committee discussed other potential areas of focus including Board Director compensation and optimizing the Joint Board and Committee education sessions. Ms. Wadors cautioned that the Committee should not over operationalize its work; for example, the executive team and Ms. Fisk should choose the particular tools/template for succession planning, and staff and the Committee should discuss what success looks like. The Committee also discussed whether or not physician compensation and a scorecard of overall organizational health should be reviewed by the Committee. Ms. Eyre noted that the governance oversight of compensation committees is typically limited to executives. The Committee will conduct a self-evaluation in Q3 to review its effectiveness. **Motion:** To approve the Proposed FY20 Committee Goals with the edit as noted above. **Movant:** Wadors **Second:** Layney **Ayes:** Eyre, Kliger, Layney, Miller, Wadors, Zoglin **Noes:** None **Abstentions:** None **Absent:** None **Recused:** None	***Committee Goals approved; to be reviewed by the Governance Committee and the Hospital Board***
12. AGENDA ITEM 17: FY19 PACING PLAN	There were no questions or comments from the Committee.	
13. AGENDA ITEM 18: CLOSING COMMENTS	In response to Ms. Wadors' question, Ms. Fisk described ECH's diversity reporting, including the EEO-1 survey required by the Equal Employment Opportunity Commission (EEOC). Ms. Fisk noted the importance of the employee population mirroring the diversity of the patient population.	
14. AGENDA ITEM 19: ADJOURNMENT	**Motion**: To adjourn at 5:43pm. **Movant:** Wadors **Second:** Eyre **Ayes:** Eyre, Kliger, Layney, Miller, Wadors, Zoglin **Noes:** None **Abstentions:** None **Absent:** None **Recused:** None	***Meeting adjourned at 5:43pm***

Attest as to the approval of the foregoing minutes by the Executive Compensation Committee and the Board of Directors of El Camino Hospital.

______________________________ ______________________________

Bob Miller
Chair, Executive Compensation Committee

Julia E. Miller
Secretary, ECH Board of Directors

Prepared by: Sarah Rosenberg, Contracts Administrator/Governance Services EA

FY19 COMMITTEE GOALS (Progress as of 5/15/2019)

Executive Compensation Committee

PURPOSE

The purpose of the Executive Compensation Committee (the "Committee") is to assist the El Camino Hospital (ECH) Hospital Board of Directors ("Board") in its responsibilities related to the Hospital's executive compensation philosophy and policies. The Committee will advise the Board to meet all legal and regulatory requirements as it relates to executive compensation.

STAFF: **Kathryn Fisk**, Chief Human Resources Officer (Executive Sponsor); **Julie Johnston**, Director, Total Rewards; **Cindy Murphy**; Director of Governance Services

The CHRO shall serve as the primary staff to support the Committee and is responsible for drafting the Committee meeting agenda for the Committee Chair's consideration. The CEO, and other staff members as appropriate, may serve as a non-voting liaison to the Committee and may participate at the discretion of the Committee Chair. These individuals shall be recused when the Committee is reviewing their individual compensation.

GOALS	TIMELINE	METRICS
1. Advise the Board ensuring strategic alignment and proper oversight of compensation-related decisions including performance incentive goal-setting and plan design	- Review FY18 Org Scores (Q1) - Review and approve (or recommend) FY18 Individual Scores and Payout amounts (Q1) - Receive status update on FY19 progress toward goals and overview of FY20 strategic priorities (Q3) - Receive FY20 market analysis report - Receive FY20 market analysis and review and approve (or recommend) CEO's base salary recommendations (Q4) - Review proposed FY20 org and individual goals (Q4)	- Committee (or Board) approves FY18 Executive Performance Incentive Scores and Payouts (October 2018) COMPLETED - Board approves FY18 Executive Performance Incentive Scores and Payouts (October 2018) COMPLETED - Board approves Letters of Reasonableness (January 2019) COMPLETED - Committee (or Board) approves FY20 Executive Base Salaries (May/June 2019) ON TRACK - Board approves FY20 CEO Base Salary (June 2019) ON TRACK - Committee (or Board) approves FY20 Individual Executive Incentive Goals (May/June 2019) ON TRACK - Board approves FY20 Org Goals (June 2019) ON TRACK
2. Support successful implementation of changes in Board's delegation of authority to the Committee	- Evaluate effectiveness of changes in process (Q4) - Discuss impact of the delegation change on the effectiveness of the Committee and Committee meetings (Q4)	- Report to the Board regarding effectiveness of changes and proposed changes or process improvements (June 2019) ON TRACK
3. Evaluate the effectiveness of the independent compensation consultant	- Survey Committee members and administrative staff on performance of current consultant and determine whether or not to conduct an RFP (Q1) - If conducting an RFP, complete selection process (Q2)	- Determine whether or not to conduct an RFP (September 2018) COMPLETED - Renewal of Consulting Agreement or selection of another firm (no later than December 31, 2018) Extension COMPLETED - If new firm selected, select by December 31, 2018 and complete contracting by February 10, 2019 -- N/A

SUBMITTED BY:

Chair: Bob Miller
Executive Sponsor: Kathryn Fisk

Approved by the El Camino Hospital Board on June 13, 2018

EXECUTIVE BRIEFING

15 Things CEOs Need to Know in 2019

Insights that will drive health system success this year and beyond

PUBLISHED BY

Health Care Advisory Board

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BEST FOR

CEOs and senior executives

No hospital or health system leader can afford inaction amid **intensifying margin pressures** and a **rapidly restructuring market.**

Employers, retailers, and health plans are all searching for disruptive solutions to bend the health care spending curve. At the same time, mega-mergers and a new wave of vertical integration are creating different-in-kind delivery systems. In the public sector, states and the federal government are picking up cues as to what works—and embedding those mechanisms into provider reimbursement and regulation.

Beyond new threats of disruption, hospitals and health systems face unprecedented financial challenges. Purchasers increasingly seek to commodify the acute care business to drive down prices. At the same time, volumes are stagnating, further eroding the financial performance of hospitals and health systems. Expense growth continues to outpace revenue growth, and operating margins have hit a record low at not-for-profit hospitals.

As a result, developing a comprehensive margin management strategy—one that includes sustainable approaches to both cost control and revenue growth—must be the central priority for CEOs and their executive teams in 2019. This is the key to achieving financial viability and securing the strategic flexibility necessary to respond to new market entrants and disruptors.

> Read on to learn the **top 15 insights** that will drive health system success in 2019 and beyond.

15 things CEOs need to know in 2019

01 In a marked shift, the private sector is now the pace car for change.

02 With a divided Congress, CMS and state governments will drive health policy forward in the near term.

03 As Medicare not only grows but ages, case mix shifts will exacerbate payer mix challenges.

04 The private and public sectors are converging on outmigration—facilitated by physicians—as a key to cost savings.

05 Despite concerted focus on cost control, hospital margins continue to deteriorate—and there's no end in sight.

06 Leaders must simultaneously control expenses and grow revenue to attain sustainable margins.

07 While no expenses are immune to scrutiny, leaders should rebase external spending before confronting labor costs.

08 The ultimate step in slowing long-term expense growth is the rational expansion—and contraction—of acute care capacity.

09 Organizations cannot become truly cost disciplined without direct and active intervention from the C-suite.

10 With limited ability to increase prices, leaders must reduce avoidable revenue erosion through better revenue cycle management.

11 Meeting revenue goals will require winning increased market share, even in service lines with healthy organic growth.

12 Successfully growing market share necessitates a new approach to service line planning.

13 Most health systems will need to diversify revenue streams beyond traditional patient care.

14 A comprehensive pharmacy strategy can help providers realize both their cost-control and revenue-growth ambitions.

15 Achieving sustainable margins is ultimately a strategic and mission imperative.

In a marked shift, the private sector is now the pace car for change.

Since the passage of the Affordable Care Act (ACA) nearly a decade ago, hospitals and health systems have been laser focused on responding to health reforms driven by the federal government. But as the initial transition period has ended—and as the Trump administration takes steps to slow implementation in certain areas—other players have come to the forefront in attempts to transform the health care industry.

Sheer size of health spending drawing new interest

Apple

- "Health Records" app allows iPhone users to manage their own medical records
- Launching employee on-site clinics focused on population health

Alphabet Inc.

- Cityblock Health provides care to low-income, urban patients
- Verily exploring move into Medicaid managed care space

Uber and Lyft

- Offering non-emergency medical transportation for patients
- Providers can book and reimburse rides on behalf of patients

"Hearing Amazon's Footsteps, the Health Care Industry Shudders"

—*The New York Times*

"Be Afraid: Health Care Feels the Amazon Effect"

—*Forbes*

> Amazon's entry into the health care market, in particular, has generated both alarm and excitement across the industry.

Over the past year, the company has hired experienced health care leaders, acquired the direct-to-consumer pharmacy business PillPack, and launched a high-profile venture with JPMorgan Chase and Berkshire Hathaway—called Haven—to jointly manage the health of their employees. These moves have led many to speculate about the various ways Amazon might disrupt the health care industry.

Five visions of “Amazon Health Care” in five years

Near-term bet → *Long-term potential*

Employer aggregator	Next-generation retail pharmacy	Global health care logistics specialist	Consumer-focused technology platform	Primary care operator
Potential strategies				
• Improving wellness programs • Telemedicine	• PillPack growth, expansion • “Basic care”[1] expansion	• Supply chain platform operator • Wholesale medical supply, device distributor	• “Alexa” patient engagement platform • EHR; consumer-driven data sharing • Insurance broker	• On-site clinics for employees • Whole Foods retail clinics • Telemedicine
Problems addressed				
• Price variation	• PBM[2] cost inflation • High OOP[3] drug costs	• Inconsistent clinical products • Distributor cost inflation	• Fragmentation of care • Subpar financial experience	• Unnecessary hospital utilization • Inconsistent clinical experience
Industry impact				
Low	**Medium**	**Medium**	**High**	**High**

While these speculations often come alongside a healthy dose of well-warranted skepticism, the mere prospect of Amazon’s entry into the health care sector has already catalyzed action among incumbent players within the industry. For example, Amazon is frequently cited as one of the driving forces behind the current wave of vertically integrated mega-mergers sweeping the health care industry.

1. Amazon’s over-the-counter drug product line.
2. Pharmacy benefit manager.
3. Out-of-pocket.

In bringing together health plan assets and low-cost delivery sites, several of these new health care deals reflect the emergence of a very different type of integrated delivery network—one devoid of hospitals.

> In fact, these new networks appear designed to keep patients out of the hospital whenever possible.

Rebuilding the front door to the health system

Consumer loyalty platform — *Care management platform*

CVS-Aetna	Walgreens-Humana	OptumCare[1]
	Physical assets	
• 9,800+ retail and 68,000+ network pharmacies • ≈71% of population lives within 5 miles of a CVS	• 9,560 drugstores • ≈76% of population lives within 5 miles of a Walgreens or Duane Reade[2]	• Ambulatory provider networks in 12 states: AZ, CA, CO, CT, FL, IN, NV, NJ, NY, OH, TX, UT
	Clinical capabilities	
• 1,100+ CVS MinuteClinics; offer 40% of PCP services, with plan to expand to 90% • CVS owns home hemodialysis technology	• 400+ Walgreens clinics • 195 Humana-operated primary care clinics • Humana at Home; adding Kindred at Home	• Primary care • Pediatric care • Specialty and surgical care • Urgent care • Senior and advanced care
	Covered lives	
• **CVS:** 62M ExtraCare members • **Aetna:** 22.2M medical members	• **Walgreens:** 8M customers/day • **Humana:** 14M medical members	• 80 health plan clients covering more than 15M members
	Medical membership	
Aetna[3] • **81% Commercial** • 8% Medicaid • 8% Medicare Advantage • 3% Medicare Supplement	*Humana[4]* • **38% Medicare Advantage** • 35% Military services • 20% Commercial • 3% Medicare Supplement • 4% State-based and other	*Varies based on plan partner(s) in given market*

1. Advisory Board is a subsidiary of Optum. All Advisory Board research, expert perspectives, and recommendations remain independent.
2. Duane Reade is owned by Walgreens
3. As of March 31, 2018.
4. As of December 31, 2017.

With a divided Congress, CMS and state governments will drive health policy forward in the near term.

As private-sector players take increasingly bold steps to disrupt the status quo, the results of the 2018 midterm elections limit the prospect of major legislative reforms across the next two years, at least at the federal level.

While the debate around large-scale health care reforms will continue leading up to the 2020 presidential election, any substantive legislative reforms passed in the meantime will need to be bipartisan in nature. Despite the often divisive rhetoric heard on the campaign trail, policymakers on both sides of the aisle share common interest in a number of significant health care-related issues. For example, providers can expect continued collaboration around efforts to confront the opioid epidemic and potential steps to bolster the rural safety net.

Divided Congress limits prospect of major near-term legislative reforms

Democrats regain House, Republicans retain Senate

House results[1]

235 **Democrats** *(+40 seats)*

199 Republicans *(–40 seats)*

Senate results

47 Democrats *(–2 seats)*

53 **Republicans** *(+2 seats)*

- Eliminates Republicans' ability to repeal and replace the ACA in the immediate future
- Increases Democrats' ability to scrutinize Trump administration through newfound oversight and investigation powers
- Introduces potential for House to pass symbolic single payer bill as Democrats build 2020 platform

Bipartisan congressional priorities likely to continue

Confronting opioid epidemic

Scrutinizing industry consolidation

Advancing price transparency

Bolstering rural health facilities

1. As of March 2019.

Given the divided Congress, the most meaningful near-term health reforms are likely to occur outside of Congress. The results of several gubernatorial races and state-level ballot measures have put Medicaid expansion back on the table in at least five states (Idaho, Maine, Nebraska, Utah, and Kansas) and at risk in one other (Montana). Meanwhile, the success of the public insurance exchanges continues to vary widely state-by-state, even as enrollment on the federally facilitated exchanges declines moderately. In many issues regarding insurance market regulations—whether related to Medicaid or the commercial market—CMS is pushing more decision-making authority to the state level, enabling a new era of federalism to take hold.

Additional state insurance market flexibility arrives in 2019

Trump administration's 2018 actions:

- Cut open enrollment period in half
- Reduce navigator funding
- Scale back advertising
- Close website on Sundays for maintenance

New flexibilities for 2019:

Key elements of CMS' changes for 2019 enrollment period

- Allow states to set Essential Health Benefits benchmarks annually
- Return network adequacy oversight to states
- Allow states to request "reasonable adjustments" to Medical Loss Ratio

Expanded off-exchange coverage options:

Short-term health plans

Lengthens duration of plans with more coverage flexibility and eligibility barriers

Association health plans

Provides easier access to plans with more premium rating and coverage flexibility

As the federal government takes a step back from accelerating the ACA's coverage expansion efforts, it continues to double down on delivery system transformation. But the Trump administration hasn't held back from making substantive changes to the Obama-era payment reform programs. Between scaling back mandatory joint and cardiac bundles, overhauling Medicare's largest accountable care organization (ACO) program, and announcing plans to implement a new mandatory oncology bundle and a direct provider contracting model, CMS is poised to dramatically reshape Medicare's alternative payment landscape in 2019.

As Medicare not only grows but ages, case mix shifts will exacerbate payer mix challenges.

CMS' continued experimentation with alternative payment models reflects a growing sense of urgency regarding Medicare's financial outlook. While the Medicare ranks have swelled due to the aging of the baby boomers, the overall Medicare population has become younger and healthier in recent years, holding down growth in spending per enrollee. This "reverse aging" of the Medicare population has thus far shielded payers and providers from the full impact of population aging.

But as the Medicare population begins to age—the vanguard of the baby boom will turn 75 in 2021—accelerations in per-capita spending, hospitalization rates, and shifts from procedural to medical care will present new financial challenges to CMS and providers alike.

An "old-old" baby boomer generation will strain future provider economics

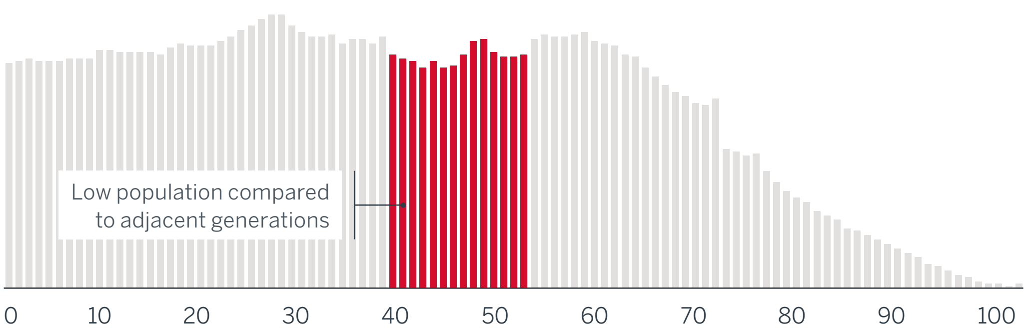
"Young-old" (65–74)	"Old" (75–84)	"Old-old" (85+)
Hospitalizations per 1,000 enrollees		
113.95	189.84	285.97
Surgical portion of MS-DRG volumes[1]		
34.1%	25.9%	15.8%
Highest volume inpatient conditions, 2017		
1. Major hip and knee joint replacement 2. Septicemia 3. Heart failure 4. COPD 5. Pulmonary edema and respiratory failure	1. Septicemia 2. Major hip and knee joint replacement 3. Heart failure 4. COPD 5. Pulmonary edema and respiratory failure	1. Septicemia 2. Heart failure 3. Kidney and urinary tract infection 4. Major hip and knee joint replacement 5. Simple pneumonia

1. Excludes MS-DRGs with fewer than 11 cases.

Furthermore, the relatively small size of generation X is unlikely to generate sufficient demand for procedural care to offset this impending case mix shift. And while the millennials are of a comparable size to the boomers, even the oldest millennials are nearly 15 years away from needing more intensive health care services. Provider organizations cannot bet on either an aging generation X or millennial population to sustain the core inpatient procedural business in the face of an aging Medicare population.

Generation X unlike to boost demand for inpatient care

Generation Z	Millennials	Generation X	Baby boomers	Silent generation	Greatest generation
Born					
1997 and later	1981–1996	1965–1980	1946–1964	1928–1945	1901–1927
Ages					
22 and under	23–38	39–54	55–73	74–91	92–118
Size					
90.7M	71.9M	67.5M	71.4M	23.8M	2.0M



US Population by age, 2017

The private and public sectors are converging on outmigration—facilitated by physicians—as a key to cost savings.

Across both the private and public sectors, a set of common themes have emerged in efforts to transform the industry and bend the health care spending curve.

While there continues to be overarching focus on the cost of care, there is also renewed scrutiny on the underlying drivers of that spending—pharmaceuticals and hospitals, in particular. To target variation in prices, there is growing effort to use data and transparency to influence utilization patterns. And increasingly, payers are aiming to put price information in front of not only consumers, but also independent physicians, who may be even more powerful influencers.

Private and public sectors converging on common solutions

Private sector

1. **The rise of the hospital-less IDN**

   Vertical mega-mergers focusing on lower-cost delivery networks

2. **The resurgence of the activist employer**

   Recognizing the limits of cost-shifting, employers actively pursuing levers to inflect health care prices

Public sector

3. **The new performance standard**

   New administration raising the bar on delivery system reform, while delegating coverage reform to states

Major themes from the new era of outmigration

- Heightened focus on input costs
- The primacy of the independent physician
- Data-driven utilization management
- Active steerage over hands-off delegation

For example, CareFirst BlueCross BlueShield, a 3.4 million member health plan in Maryland, Washington, D.C., and Northern Virginia, focuses on referral management as one of the most crucial components of its robust patient centered medical home program. Participating primary care physicians submit a list of their preferred specialists to CareFirst, which then color-codes and ranks the list on the basis of episode cost. The program has seen a noticeable increase in referrals to lower-cost specialists, particularly independent physicians. As a result, one of the program's aims is to help physicians maintain their independence from hospitals and large multispecialty groups.

Similarly, Medicare has identified physician independence as a crucial component of its cost-control strategy. As part of CMS' revamp of the Medicare Shared Savings Program, the new rules specifically ease participation requirements for physician-led ACOs. In fact, CMS emphasized physician independence as one of the guiding principles behind the program's redesign.

Betting on a more physician-centric approach

> "Our program helps [physicians] stay independent, and we have found that independence has led to greater freedom in judgment about when and where to refer, and that in turn drives [down] a lot of healthcare costs."
>
> Chet Burrell—CEO, CareFirst

> "...we are proposing to redesign the Shared Savings Program to...promote free-market principles by encouraging the development of physician-only and rural ACOs in order to provide a pathway for physicians to stay independent..."
>
> CMS Proposed Rule—August 9, 2018

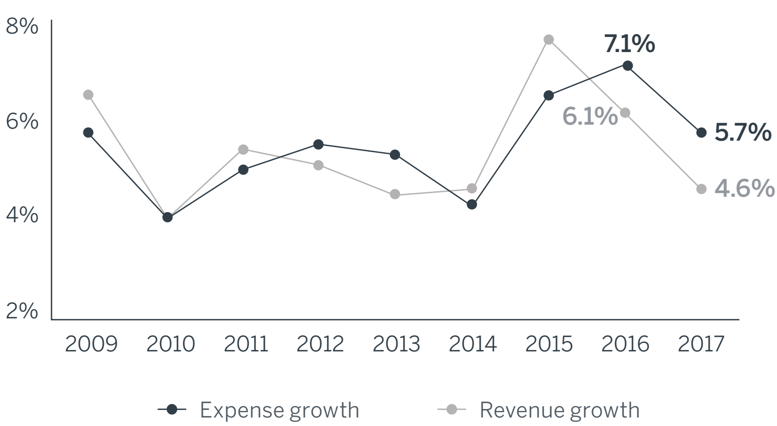
Despite concerted focus on cost control, hospital margins continue to deteriorate—and there's no end in sight.

The way hospitals and health systems respond to accelerations in disruption, outmigration, and active referral steerage will be complicated by the financial realities facing most provider organizations today. In 2017, median operating margins at not-for-profit hospitals hit an all-time low of 1.6% after operating expense growth outpaced operating revenue growth for the second consecutive year. Initial estimates for 2018 and expectations for 2019 show no relief to this imbalance between cost and revenue growth.

This ongoing margin deterioration is especially concerning because it occurred despite hospitals' success in slowing the rate of expense growth in recent years. Organizations' cost savings haven't been sufficient to keep up with the rapid slowdown in revenue growth. And unlike previous periods of margin pressure, current revenue challenges are being driven by structural shifts within the industry rather than a cyclical decline in the overall economy.

Cost growth continues to exceed revenue growth

Median revenue and cost growth



1.6%

Median operating margins among not-for-profit hospitals in 2017; all-time low

Health Care Advisory Board's financial projections demonstrate that as a result of these financial pressures, a model $1 billion health system with a 3% operating margin in 2017 would begin to see negative margins by 2021 and reach a −4.2% operating margin in 2025. This model—called **Antares Health System**—assumes that growth in operating expenses slows to match the industry's best performance since the passage of the ACA and that operating revenue decelerates gradually based on pressures to volumes and pricing. Across the remainder of this research report, the Antares Health System model will help illustrate the impact of various margin management strategies.

Introducing Antares Health System[1]

Organizational profile in 2017

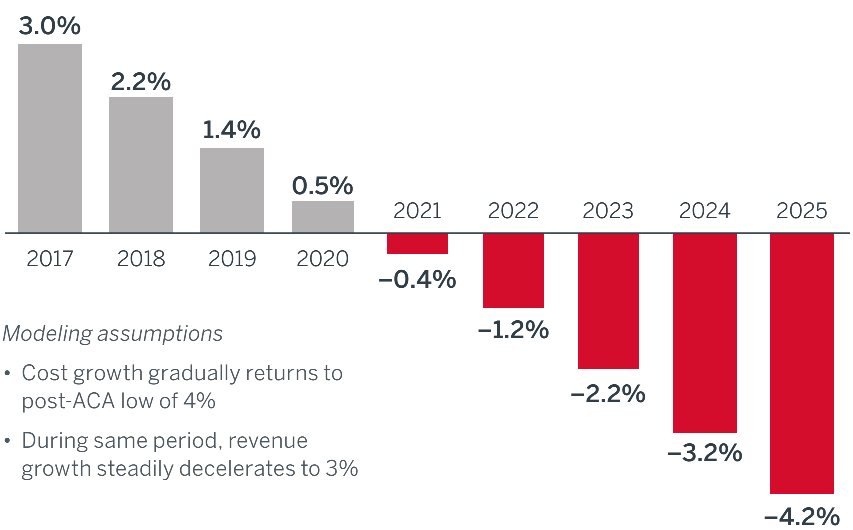
- **$1B** in operating revenue
- **$970M** in operating expenses
- Operating at a **3%** margin
- Eastern U.S., **suburban** location
- **Five** hospitals
- **820** beds
- **6,400** employees

390 employed physicians

3,320 non-physician clinical staff

2,690 non-clinical employees

Antares's margin absent intervention



Modeling assumptions

- Cost growth gradually returns to post-ACA low of 4%
- During same period, revenue growth steadily decelerates to 3%

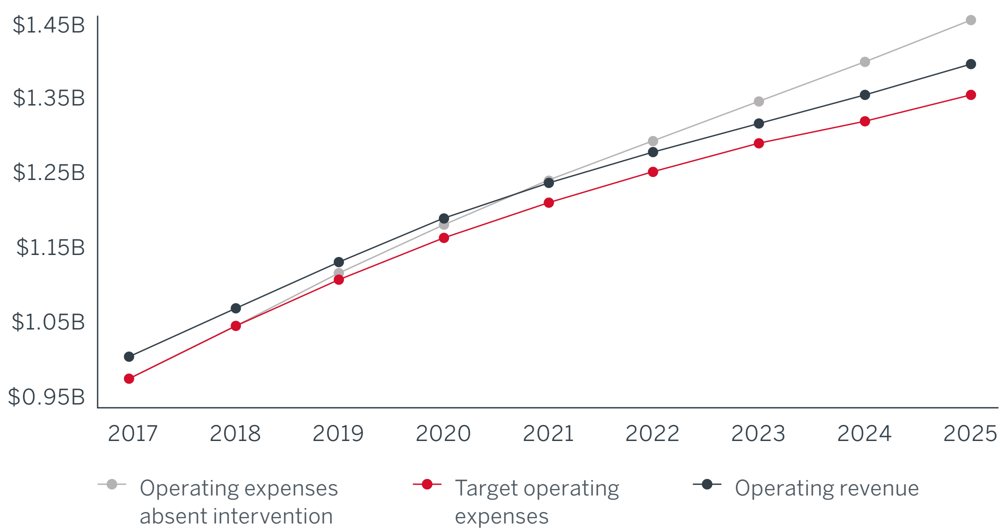
1. Advisory Board-created, model health system.

Leaders must simultaneously control expenses and grow revenue to attain sustainable margins.

To achieve a 3% margin in 2025, Antares must improve financial performance by $595 million to $635 million between 2017 and 2025.

If Antares is able continue growing its top-line revenue, it can meet margin goals by slowing cost growth rather than resorting to budget cuts in absolute terms. Based on its projected revenue growth, Antares needs to avoid a total of $320 million to $350 million across eight years, or $40 million to $44 million annually. These cost savings represent roughly 55% of Antares's total margin improvement goal.

Setting Antares's cost control ambition



$320M–$350M

Cumulative cost avoidance necessary between 2017 and 2025 to achieve a **3% margin** in 2025

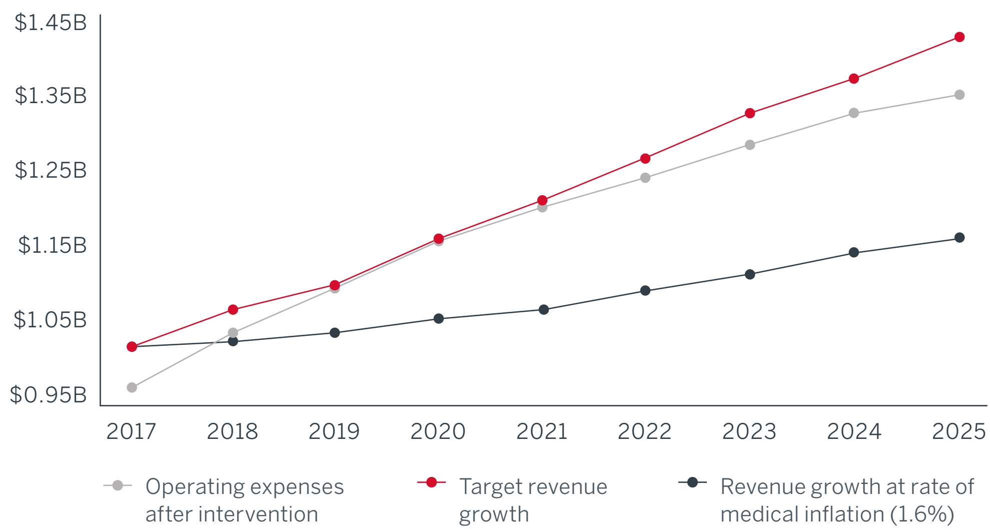
$40M–$44M

Annualized cost avoidance necessary to achieve a **3% margin** in 2025

But crafting a margin management strategy around cost avoidance is possible only if hospitals and health systems maintain sufficient revenue growth. Otherwise, absolute spending cuts would be necessary.

To achieve a 3% margin in 2025, Antares thus needs to complement its annual cost savings with $35 million to $45 million in additional revenue per year. That revenue target is above and beyond what Antares is currently projected to achieve as a baseline and represents about $275 million to $285 million in additional revenue growth across the next eight years. This growth target represents about 45% of Antares's total margin improvement goal.

Solving the revenue side of the equation



$275M–$285M

Cumulative new revenue necessary between 2017 and 2025 to achieve a **3% margin** in 2025

$35M–$45M

Annualized new revenue necessary to achieve a **3% margin** in 2025

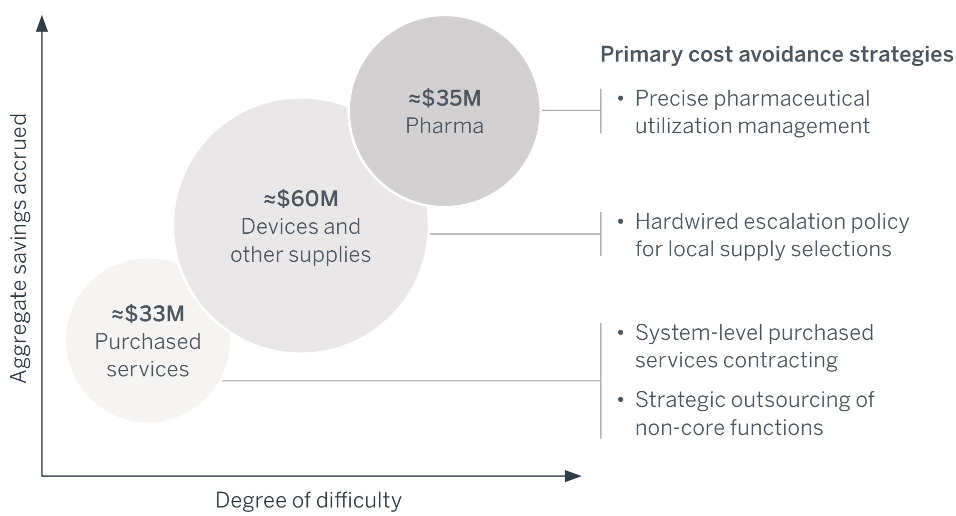
While no expenses are immune to scrutiny, leaders should rebase external spending before confronting labor costs.

Hospitals and health systems, including Antares, will need to find savings across nearly all expense categories to meet their substantial cost-avoidance goals. However, leaders should front-load strategies that rebase costs to yield increasing dividends over time.

As the single largest source of operating expense, labor may seem like an obvious place to start. However, it is also one of the most difficult expense categories to inflect. Conversely, external spending—on supplies, pharmaceuticals, and purchased services—accounts for a smaller but still significant portion of total spending and is a prime target for rebasing. Most organizations already manage these costs, but given the compounding effect of rebasing external spending, it's worthwhile to accelerate these efforts.

Meeting the mandate in external spending

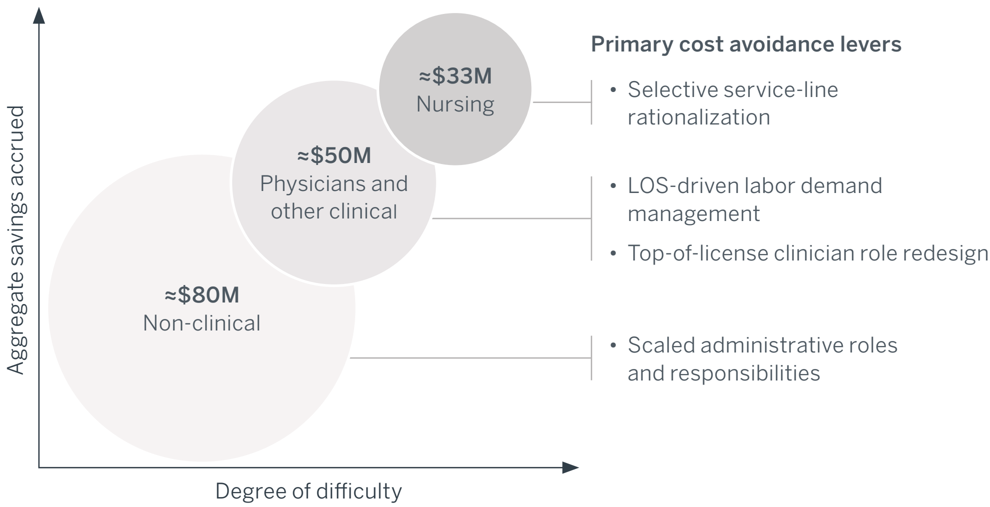
Antares's eight-year cost avoidance targets in purchased services, supplies, and pharmaceuticals



In contrast, savings in labor should primarily come from slowing workforce growth rather than decreasing it in absolute terms. Hospitals and health systems should avoid undesirable tactics such as mass reductions in force and instead ground efforts in labor market realities. For example, employers cannot—and should not—push away talented employees by reducing compensation or cutting benefits. Protecting employee engagement throughout margin management efforts is paramount.

Sizing Antares's labor cost avoidance targets

Antares's labor opportunity assessment

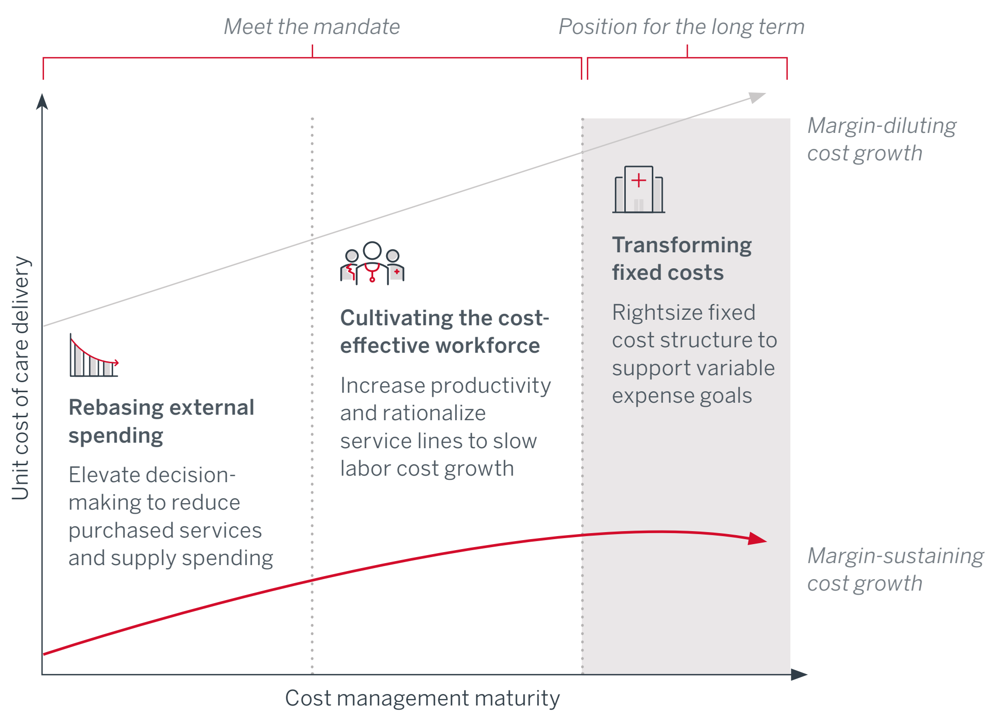


For more research on this topic, download *The New Cost Mandate* at advisory.com

The ultimate step in slowing long-term expense growth is the rational expansion—and contraction—of acute care capacity.

In the long term, health systems will need to rightsize their capacity to better match future demand and support operating margin goals. Successful rightsizing will involve a combination of strategies to redistribute services across existing sites to reduce duplication, improve efficiency, remove excess capacity, and refocus planning and capital spending efforts on lower-cost care sites.

Fixed cost restructuring necessary for long-term success



In fact, perhaps the ultimate test of an organization's commitment to cost control comes in its approach to future expansion. Truly disciplined organizations carefully evaluate the need to add acute care capacity and consider the most appropriate means for such expansion.

> "The real savings will come from avoiding the next $100 million building."
>
> CFO, Health System in the West

Above all, leaders must instill in any newly built or acquired asset the same level of discipline they expect of the current enterprise. Effective operational integration requires detailed planning and execution under circumstances that are specific to each organization and every deal. However, organizations that have successfully achieved cost-focused integration exhibit certain commonalities. These organizations have found that rigorous strategic planning, robust integration leadership, detailed functional implementation, and responsive accountability mechanisms are all crucial to yielding the greatest cost-savings results from complex transactions.

Key principles for full operational integration

Incorporate cost reduction into target selection and acquisition strategy

Tactics

1. Conduct thorough cost opportunity due diligence
2. Commit to actionable, attainable cost-reduction targets
3. Ensure cultural compatibility required to execute

Empower functional experts to integrate core operations

Tactics

6. Focus initial scope on core business functions
7. Integrate vendors, people, and processes strategically
8. Build momentum toward reducing care and cost variation

Create a tiered leadership structure

Tactics

4. Assemble a representative executive steering committee
5. Leverage functional workgroups for day-to-day integration

Ensure accountability and appropriate adaptability

Tactics

9. Assign accountability for cost goals to steering committee
10. Keep integration moving forward with principled adjustments

For more research on this topic, download *Unlocking Cost Reduction Through Effective Integration* at advisory.com

INSIGHT 09

Organizations cannot become truly cost disciplined without direct and active intervention from the C-suite.

Successfully executing against cost-control ambitions requires a level of discipline that few organizations have demonstrated to date. But as downward revenue pressures intensify, the need to maintain tight control over expense growth will be increasingly important. Truly cost-disciplined organizations will demonstrate low cost growth relative to revenue growth over a prolonged period and manage closely to their budgets. They will also avoid spikes in spending and dramatic cuts, and have the ability to precisely inflect categories of excess spending without unintended consequences.

Adopt cost discipline as currency of success

Cost discipline

- Low cost growth relative to revenue growth over time
- Managing closely to desired budget or cost target
- Avoids large swings in expense growth
- Able to inflect desired expenses with precision

Few health systems see revenue growth substantially outpace expense growth

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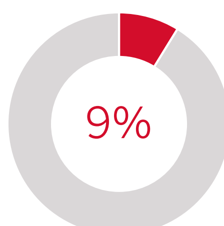


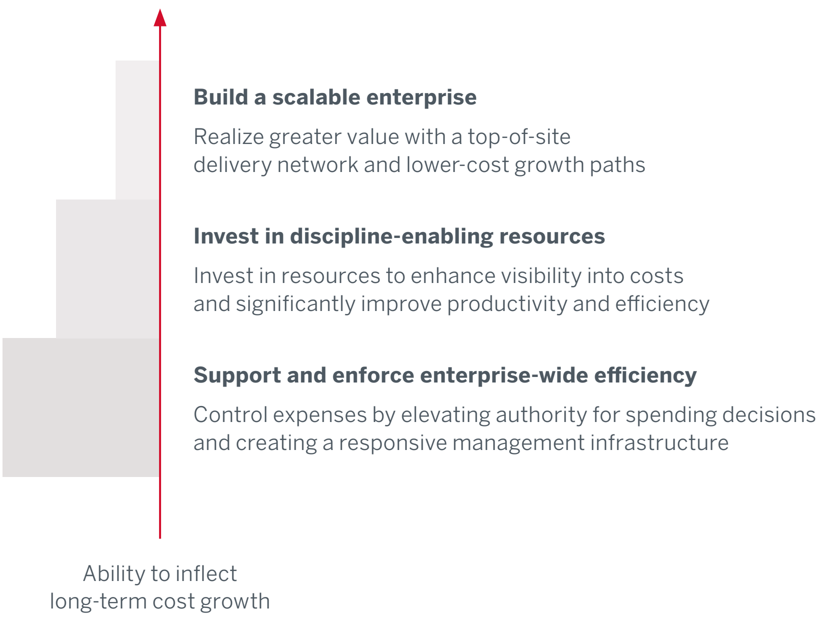
Health systems whose average annual revenue growth exceeded average annual expense growth by more than one percentage point between 2011 and 2016[1]

1. Analysis includes only health systems reporting for all years.

While many of the tactical steps to implement an effective cost-control strategy will occur at the front lines, embedding cost discipline is ultimately the responsibility of the executive leadership team, requiring direct intervention from CEOs and their teams across three key areas.

First, senior leaders must establish the right balance between centralizing control over spending decisions and remaining responsive to frontline needs. Second, leaders will need to evaluate strategic investments in technology and expertise to control expense growth in the long term. Finally, the senior leadership team must ensure that the organization not only maintains its focus on cost control but ideally accelerates progress as the organization grows and achieves greater levels of scale.

Three-part approach to long-term sustainability



For more research on this topic, download *Toward True Sustainability* at advisory.com

With limited ability to increase prices, leaders must reduce avoidable revenue erosion through better revenue cycle management.

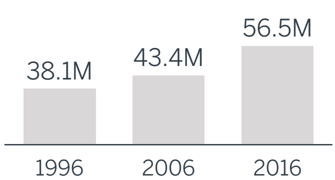
Achieving sustainable cost control is a necessary component of margin management, but it's insufficient on its own given how rapidly revenue growth is decelerating. Leaders must supplement a renewed and more rigorous focus on cost control with strategies designed to reignite revenue growth.

Pricing has always played—and will continue to play—a role in health systems' growth strategy. But that role has rapidly changed as market dynamics limit organizations' ability to increase their market-facing prices. As a result, leaders should instead pivot to reducing avoidable revenue erosion—ensuring the organization gets paid appropriately for every patient encounter.

Several factors reducing effectiveness of increasing the price of care

1 Demographics shifting toward public payers

Annual Medicare enrollees



2 Consumer financial exposure generating public scrutiny

"Blame Emergency Rooms for the Out-of-Control Cost of Health Care"

—*The New York Times*

"Hospital ER fees: They've been secret. We're uncovering them."

—*Vox*

3 Commercial insurers refusing reimbursement

Anthem no longer paying for hospital outpatient MRIs, CTs

BCBS denying ED visits that don't meet discrete guidelines

If Antares performs at the 50th percentile in revenue cycle performance, it would collect 87¢ on every billed dollar. But if the model health system could improve performance to the 70th percentile or 90th percentile, it would collect 91¢ or even 95¢ for every billed dollar—a 4.6% to 9.2% increase in effective price. This represents considerable revenue capture without increasing volumes and ultimately improves the efficiency of future growth.

Revenue cycle optimization is hardly a new ambition for hospitals and health systems. Organizations have devoted significant time and resources in this area for many years and have achieved some success. For example, the average hospital has significantly increased its speed to collect across the past decade. But the work remains far from complete, particularly as payers have transitioned from delaying payments to outright denying claims.

Health Care Advisory Board research has identified four strategies to achieve best-in-class revenue capture. First, organizations must establish a solid foundation by elevating the role of revenue cycle to a strategic priority. Next, hospitals and health systems must strengthen their relationships with three major stakeholders: physicians, patients, and payers.

Four strategies for achieving best-in-class revenue capture

Elevate stature

1 **Elevate revenue cycle's strategic value**

- Quantify immediate and accretive revenue optimization opportunity
- Articulate strategic benefits of improved revenue cycle performance
- Elevate role of revenue cycle as a broader system-wide strategic priority

Strengthen relationships

2 **Invest in dedicated support to engage physicians as revenue cycle partners**

- Reduce midcycle-driven denials
- Reduce physician administrative burdens
- Improve physician alignment and overall financial stewardship

3 **Build robust patient financial navigation platform**

- Understand patient financial needs and preferences at the market level
- Provide broad suite of education, navigation, and financing capabilities

4 **Restructure payer-provider relationship around shared objectives**

- Transcend false perception of zero-sum relationship with payers
- Identify discrete areas where payers share common goals
- Renegotiate payer contracts in a way that reflects alignment

For more research on this topic, download *Re-igniting the Growth Engine Part 1: Reducing Avoidable Revenue Erosion* at advisory.com

Meeting revenue goals will require winning increased market share, even in service lines with healthy organic growth.

After reducing avoidable revenue erosion, Antares's next growth ambition must be to increase its share of lucrative patient volumes in both the inpatient and outpatient settings. If Antares simply maintains its current market share—even with organic growth on the outpatient side—it will fall well short of meeting its total revenue goal.

While hospital and health system leaders will ultimately need to pursue specific (and potentially distinct) tactics to grow inpatient versus outpatient share, they must first address a set of overarching strategic questions about how they will effectively grow net share of consumer wallet, agnostic of setting.

Prepare to win market share holistically

Grow net share of wallet

- Why should consumers choose to seek care with us?
- How can we get consumers to return for a second visit?
- How do we keep our physicians consistently loyal?
- What do our payers need from us?

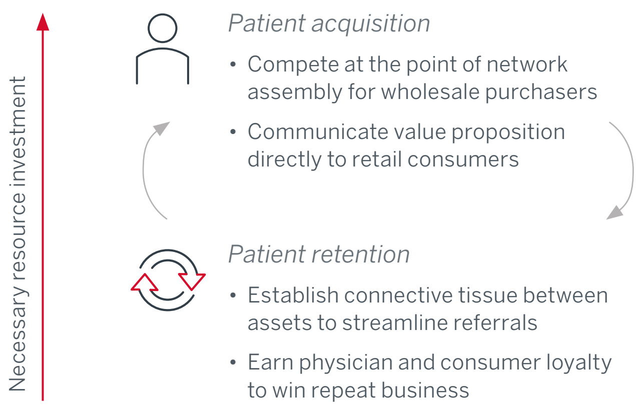
Grow inpatient vs. outpatient volumes

- What physical care delivery assets do we need?
- Where should we build our delivery network?
- What is our inpatient and outpatient capacity?

In answering these questions, hospital and health system leaders must think intentionally about their strategies for both patient retention and patient acquisition. Fortunately, tactics for retention and acquisition are mutually reinforcing.

While beginning with a focus on new patient acquisition may seem natural, health systems should instead prioritize refining their patient retention strategy, which is less expensive and accretive since every new patient will be more valuable. By improving patient retention at the outset, leaders create the conditions to realize outsized gains in the long term—especially when coupled with a principled approach to new patient acquisition.

Two mutually reinforcing approaches to sustainably grow share



For more research on this topic, download *Re-igniting the Growth Engine Part 2: Winning Increased Share of Lucrative Patient Volumes* at advisory.com

INSIGHT 12

Successfully growing market share necessitates a new approach to service line planning.

Successfully executing on a plan to better retain and acquire patients will require a new approach to service line planning. Traditional service line planning and strategy have been relatively passive in nature, assuming patients will appear if providers have the right infrastructure, technology, and physicians in place. But following major changes in service line economics—including new competition, downward pricing pressure, continued outmigration of care, and the rise of consumer self-referrals—this strategy is no longer sufficient. Hospitals and health systems must actively compete upstream to drive downstream business.

Four new imperatives for service line growth

Best-in-class service line strategy

1. PRIORITIZATION

Filter for achievable growth opportunities

Use new market opportunity analytics to make the best bets

2. PLANNING

Redesign service lines around patient needs

Build programs around key entry points and patient preferences

3. ACQUISITION

Showcase access points to attract self-referrers

Compete upstream for specific patient populations and segments

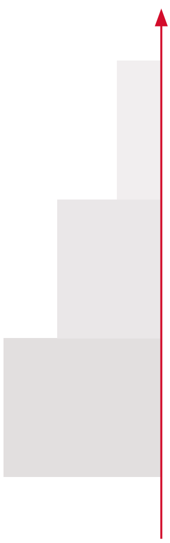
4. RETENTION

Cultivate system-wide loyalty

Create ongoing connections to remain top-of-mind and win future business

Competition is particularly intense in the ambulatory surgery center (ASC) market, which has become highly attractive to outside entities due to healthy growth projections. In fact, outpatient surgery currently represents one of the few opportunities for organic volume growth. To be successful in this setting, hospitals and health systems will need to strike a balance to harness that growth opportunity without cannibalizing the inpatient surgical business altogether. Leaders can improve their competitive posture in the ASC market in three key steps: refining their strategy, assembling the facility footprint, and competing to win.

Three steps to building a winning ASC strategy



Compete to win

- How will you become the workshop of choice to attract proceduralists?
- How will you generate referrals in a competitive market?

Assemble facility footprint

- Will you need an external management company to operate your ASCs efficiently?
- What is your distinct value proposition to engage potential physician partners?

Refine strategy

- What specific goals are you trying to accomplish with your ASCs?
- How should ASCs fit into your broader procedural care strategy?

Ambulatory procedural growth

For more research on this topic, download *The New Rules of Ambulatory Surgery Competition* at advisory.com

Most health systems will need to diversify revenue streams beyond traditional patient care.

Hospital and health system leaders need to start meeting their new revenue mandate by reducing avoidable revenue erosion and increasing their share of lucrative patient volumes. For many organizations, however, these two approaches alone will be insufficient to meet long-term revenue goals. As a result, they will need to diversify revenue streams beyond traditional patient care.

Despite clear interest in diversifying revenue streams, the process of finding and selecting the right opportunities is far from straightforward, given the vast array of potential ventures beyond the traditional scope of providing patient care. Leaders need a framework to narrow down the options, ultimately prioritizing opportunities that align with mission and capitalize on strategic advantages.

Four filters to identify top opportunities for revenue diversification

1. **Substantial revenue opportunity**
   Organizations should prioritize investments that can significantly inflect year-over-year operating margin performance.

2. **Capitalizes on existing capabilities**
   Providers should not invest in wholly unfamiliar terrain. They should instead focus on hospital-centric products that capitalize on existing skill sets.

3. **Aligned with broader mission**
   Diversified investments should advance broader system goals to create high-quality, cost-efficient organization.

4. **Replicable across markets**
   For systems operating in multiple geographic areas, investments should be prioritized according to their scalability across regions.

The most natural place for many hospitals and health systems to begin diversifying revenue streams is to elevate the effectiveness of their development efforts. Many leaders undervalue the considerable opportunity that philanthropy presents. For example, if Antares's development office were able to improve performance from 50th to 70th percentile, it would generate $33.7 million in new revenue, leading to a $26.3 million bottom line contribution. This success would increase Antares's margin by 2.4 percentage points through development alone.

Beyond philanthropy, there at least four new revenue streams that meet the criteria listed on the previous page. Those opportunities are shown below. Leaders must, however, exercise caution before jumping into a new venture. The goal is to close the revenue gap through a variety of revenue streams, not to become even more vulnerable through a reliance on a new business that is unsustainable or overly competitive.

Primary opportunities to generate diversified revenue

While five main opportunities rise to the forefront—philanthropy, health plans, pharmacy, venture investment, and the commercialization of intellectual property—organizations may need to pursue only one or two to meet their revenue goals. The key is to make these diversification decisions as part of comprehensive margin management efforts, not in isolation.

For more research on this topic, download *Re-igniting the Growth Engine Part 3: Diversifying Through New Revenue Streams* at advisory.com

A comprehensive pharmacy strategy can help providers realize both their cost-control and revenue-growth ambitions.

Pharmaceutical spending has risen at a rate higher than any other component of health care spending. Like all other purchasers—the government, health plans, employers, and consumers—hospitals and health systems face a major financial challenge when it comes to pharmaceutical spending.

Providers face an especially complex challenge, however, in that rising pharmaceutical spending presents both cost-management and revenue-growth opportunities. Depending on the site-of-service and reimbursement mechanism, a pharmaceutical is either a source of cost or potential revenue. While providers theoretically have natural advantages in both controlling cost and capturing pharmacy revenue, most have struggled to fully realize that potential.

For example, large health systems could use their scale to exert downward pressure on prices, but a general lack of standardized prescribing patterns has prevented them from bringing maximum volume to the negotiating table.

Real-world obstacles preventing providers from capturing full value of pharmacy

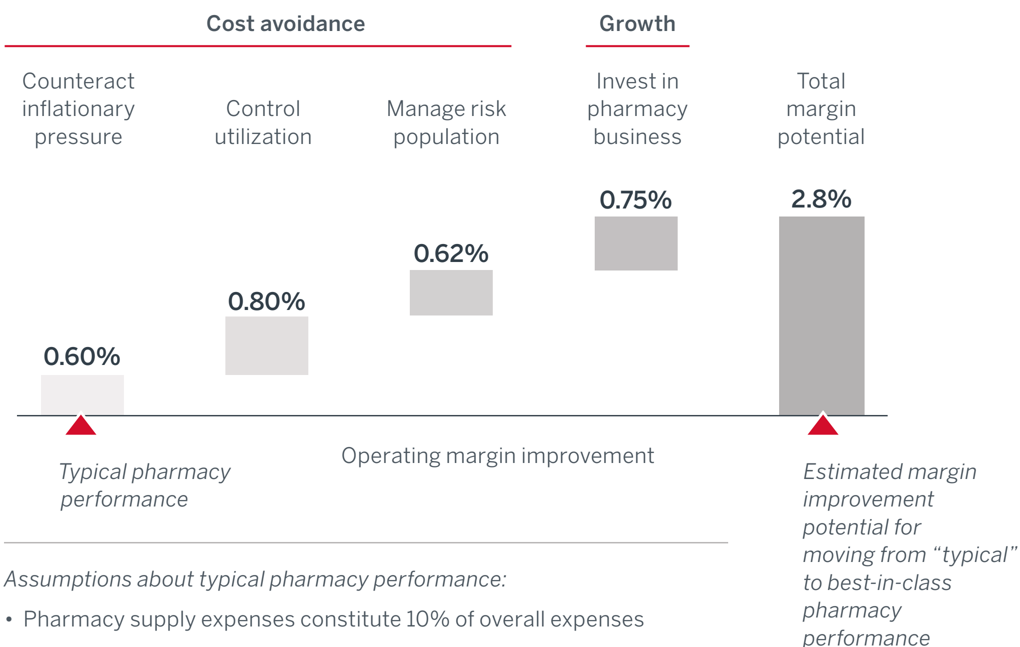
UNCAPTURED VALUE BROUGHT BY PROVIDERS

Theoretical provider advantage	*Real-world obstacles*	
Control over "demand" of supply chain: Use purchasing power to put downward price pressure on suppliers	Lack of purchasing standardization inhibits efforts to use scale	Volatility in price and supply places practical limits to efforts
Alignment with prescribing physicians: Shift prescribing patterns to highest-value drugs	New drugs flood market—prescribers want to use them	Care standards are often overlooked or ignored
Access to pharmacists, pharmacies, and medical record: Make optimal use of pharmacy assets; improve health outcomes through integration of care	Medical and pharmacy teams often disconnected	Hard ROI on care management resources isn't easily achieved given reimbursement dynamics
Proximity to patient, provider, and pharmacist: Retain script volume from pharmacy-adjacent services	Immature pharmacy footprint	Not meeting service bar set by much larger industry players

Across hospitals and health systems, pharmacy performance varies dramatically. Health Care Advisory Board's financial modeling suggests that if the average organization could achieve best-in-class pharmacy performance, it would improve total operating margins by nearly 3 percentage points. Most of the improvement opportunity—slightly more than 2 percentage points—comes from cost avoidance, with 0.75 percentage points attributed to the growth potential of investing in a pharmacy business.

Big-dollar market means big margin potential

Operating margin impact by achieving best-in-class pharmacy performance



Assumptions about typical pharmacy performance:

- Pharmacy supply expenses constitute 10% of overall expenses
- Employee drug benefit expenses constitute 2% of overall expenses
- Baseline organization has minimal initial investment in pharmacy:
  - Minimal steerage of employee population to in-house pharmacies (≈10% scripts filled internally)
  - Pharmacy provides ≈5% of organization's contribution margin

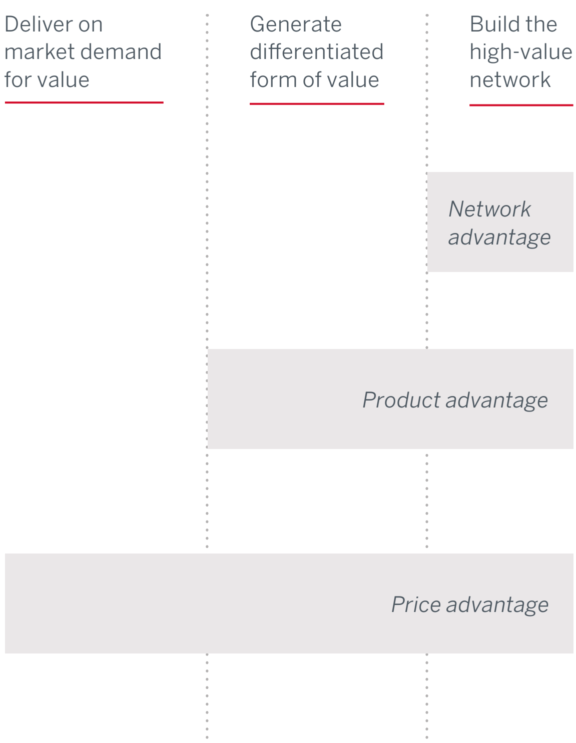
For more research on this topic, download *Realizing Pharmacy's Full Value* at advisory.com

Achieving sustainable margins is ultimately a strategic and mission imperative.

For many hospitals and health systems, maintaining financial viability will be the central organizational priority for the coming years. However, the need to right an increasingly challenging economic model is about much more than ensuring solvency or attaining financial success. Margin sustainability will also be key to achieving the strategic flexibility necessary to compete in a rapidly changing market—particularly one that is vulnerable to outside disruption.

The strategic paths outlined below are all feasible in the right circumstances and with the right leadership, but none are possible without a concerted and successful focus on margin management.

Three viable paths forward for delivering on value



Build comprehensive, integrated offering with **seamless patient access or cross-market system services.**

Develop unique, industry-leading clinical capabilities by investing in clinical innovation and focusing on **niche treatments and populations, or (consumer-obvious) superior quality.**

Compete on the basis of **unit or episodic price affordability** where necessary by instilling required level of cost discipline to control rate of inpatient and outpatient cost growth relative to revenue growth.

Most important, hospitals and health systems have a mission imperative to remain financially viable. Stakeholders in both the private and public sectors are turning to outside disruptors and independent physicians as the potential arbiters of change. But hospitals and health systems provide an undeniably critical service to their communities and stand alone in their ability to provide comprehensive acute care to all patients, regardless of ability to pay. Maintaining financial sustainability will ensure that hospitals continue to play that crucial role for many years to come.

Margin management is core to the mission

We could focus on services that pay us well...

Focusing on procedural care alone is one path to margin preservation.

...but that doesn't align with our mission.

Hospitals and health systems are pillars of their communities where essential activities of life take place.

It is our responsibility to remain sustainable.

Providing care to our communities as a thriving enterprise is at the core of our mission.

Learn more

Read our other recent publications, all available on **advisory.com/hcab**

The New Cost Mandate

Hospitals and health systems need new strategies to effectively and sustainably slow operating expense growth to protect future margins. This research report unpacks the drivers of the emerging margin management challenge and provides a road map of strategic cost-control solutions for hospital and health system leaders.

Toward True Sustainability

The enduring nature of today's revenue pressures—direct pricing threats, site-of-care shifts, new payment models, and more—means that cost containment is more important than ever to maintaining margins. This research report explores the characteristics of cost-disciplined organizations and examines the role of hospital and health system executives in achieving sustainable expense growth.

Re-igniting the Growth Engine: 3-Part Series

Achieving sustainable revenue growth will require organizations to focus on three primary goals: reducing avoidable revenue erosion, winning market share, and exploring diversification opportunities. This three-part series walks through 10 strategies to guide hospital and health system leaders on the road to effective long-term revenue growth.

The New Rules of Ambulatory Surgery Competition

In markets across the country, hospital and health system leaders are witnessing massive growth in the lucrative but highly competitive market for ambulatory surgery. This research report guides hospital and health system leaders in implementing a dedicated and winning ASC strategy to compete against new and traditional competitors alike.

Realizing Pharmacy's Full Value

For providers, a comprehensive pharmacy strategy must include both competencies: more effective control over expenses and inroads into pharmacy revenue. This research report covers the four steps needed to realize pharmacy's full value: counteracting inflationary price pressure, hardwiring high-value prescribing, leveraging pharmacy assets to reduce total cost of care, and creating a principled pharmacy business strategy.

Unlocking Cost Reduction Through Effective Integration

M&A presents a time-limited opportunity to improve cost performance, but only through full operational integration that captures the potential for efficiency gains and economies of scale. We've identified four principles for cost-focused integration that can help ensure newly acquired organizations become part of the solution, rather than part of a bigger cost problem.

About the Health Care Advisory Board

The Health Care Advisory Board is Advisory Board's flagship research program. We provide hospital CEOs and their executive teams the tools, insights, and guidance needed to set strategic direction and drive initiative implementation.

Advisory Board advantage

An unparalleled network

4,900+

Hospitals and health care organizations in our membership

In-depth analysis

200+

Customizable forecasting and decision-support tools available

Extensive expertise

300+

Industry experts on our staff to work with members

Your strategic thought and implementation partner

	Strategic guidance +	*Actionable data and analytics* +	*Implementation support*
Bringing you an industry-wide perspective	**Best practice studies** and national meeting presentations clarify cutting-edge ideas from across health care. **Blogs** and frequent **Insights** memos offer up-to-the-minute coverage of new developments.	**Benchmark Generators** compile nationwide performance standards for customizable industry cohorts.	**Onsite presentations** deliver actionable intelligence to the entire organization—from the board of directors to frontline staff.
Supporting your organization's own efforts	On-call **Expert Center** prepares custom responses to specific member questions. Unlimited access to phone conversations with leading **subject matter experts**.	**Customized Assessment Portal** presents dozens of organization-level performance indicators with no user input needed. **Market Estimators** reveal local trends and opportunities, from service lines to individual procedures.	**Intensive workshops** convene Advisory Board experts and member leaders for rubber-meets-the-road planning sessions. **Implementation guides, diagnostics, and ready-to-use templates** bridge the gap between idea and execution.

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Sources

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Health Care Advisory Board interviews and analysis.

WF1065033

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EL CAMINO HOSPITAL
COMMITTEE MEETING COVER MEMO

To: Executive Compensation Committee
From: Cindy Murphy, Director of Governance Services
Date: May 30, 2019
Subject: Report on Board Actions

Purpose:

To keep the Committee informed with regards to actions taken by the El Camino Hospital and El Camino Healthcare District Boards.

Summary:

1. Situation: It is important to keep the Committees informed about Board activity to provide context for Committee work. The list below is not meant to be exhaustive, but includes agenda items the Board voted on that are most likely to be of interest to or pertinent to the work of El Camino Hospital's Board Advisory Committees.

2. Authority: This is being brought to the Committees at the request of the Board and the Committees.

3. Background: Since the last Executive Compensation Committee Meeting the Hospital Board has met twice and the District Board has met twice. In addition, the Board has delegated certain authority to the Finance Committee and the Executive Compensation Committee. Going forward, those approvals will also be noted in this report.

A. ECH Board Actions

April 10, 2019

- Approved FY19 Period 7 and Period 8 Financial Reports.
- Approved the Annual Board Assessment Tool and Process to be Conducted by Via Healthcare Consulting

May 8, 2019

- Approved Resolution 2019-06 acknowledging the Stroke Team for receiving Thrombectomy Capable Stroke Center Designation from The Joint Commission
- Elected Board Officers for Two-Year Term effective July 1, 2019:
  - Lanhee Chen, Board Chair
  - John Zoglin, Vice Chair
  - Julia Miller Secretary/Treasurer
- Approved Revised Executive Incentive Plan Policy

B. <u>ECHD Board Actions</u>

May 20, 2019

- Added Jeffery Davis, MD to the list of candidates to be interviewed for open El Camino Hospital Board Seats

May 21, 2019

- Elected Jack Po, MD to the El Camino Hospital Board of Directors for a three year term effective July 1, 2019 expiring on June 30, 2022
- Elected Don Watters to the El Camino Hospital Board of Directors for a term effective immediately expiring on December 4, 2020.

C. <u>Finance Committee & Compliance and Audit Committee Actions</u>

- Approved Annual Report of Physician Financial Arrangements

D. <u>Executive Compensation Committee Actions</u> **-** None since last meeting

4. <u>Assessment</u>: N/A

5. <u>Other Reviews</u>: N/A

6. <u>Outcomes</u>: N/A

<u>List of Attachments</u>: None.

<u>Suggested Committee Discussion Questions</u>: None.

El Camino Health

EL CAMINO HOSPITAL
COMMITTEE MEETING COVER MEMO

To: Executive Compensation Committee
From: Dan Woods, CEO
Date: May 30, 2019
Subject: Proposed FY 2020 Organizational Goals

Recommendation:

To recommend that the Board approve the FY20 organizational goals (with or without modifications based on the Committee's discussions).

Summary:

1. Situation: Each year, the Executive Compensation Committee ("ECC") along with the Finance and Quality Committees review leadership's proposed organizational goals.

2. Authority: The ECC will review and recommend that the Board approve the organizational goals as part of the Executive Performance Incentive Plan.

3. Background: The leadership team has worked over the past few months to develop and recommend the FY20 organizational goals

4. Assessment: N/A

5. Other Reviews: The Quality Committee reviewed and recommends approval of the Service and Quality goals at its May 6, 2019 meeting. The Finance Committee will be reviewing the financial threshold at the May 28, 2019 meeting.

6. Outcomes: The Board's approved organizational performance incentive goals will be used for management performance incentive plan and employee engagement and recognition program as well as for the executive performance incentive plan.

List of Attachments:

1. Proposed FY20 Organizational Goals

Suggested Committee Discussion Questions:

1. Does the Committee have any questions about the goals, benchmarks, or measurements?
2. Does the Committee propose any modifications to leadership's recommended measurements?

FY20 PROPOSED ORGANIZATIONAL INCENTIVE GOALS

DRAFT 5/16/19

STRATEGY	Weight	GOAL	OBJECTIVES/OUTCOMES	Benchmark		Measurement Defined			Measurement Period	Owner
Finance	Threshold	Budgeted Operating Margin				95% of Budgeted			FY20	Iftikhar
	To Total 100%	What will be achieved to make strategy a success?	Define specific outcome and measurement	Internal Benchmarks	Provide source and benchmark data	Minimum	Target	Stretch	Whenever possible goal should be based on full fiscal year	
Quality and Safety	30.0%	Zero Preventable Harm	Risk-Adjusted Inpatient Mortality Index	1.05 in FY 18. 0.90 FY19 through 11/18. FY 19 target: 0.95	Premier Standard Risk Calculation	Lower of actual FY 19 or 0.95 (FY19 target)	1/3 gap to P85	1/2 gap to P85	FY20	Mark
			Risk-Adjusted Readmission Index	1.08 in FY 18. 1.00 through 11/18	Premier Standard Risk Calculation	Lower of actual FY 19 or 1.05 (FY19 target)	1/3 gap to P85	1/2 gap to P85		
Service	30.0%	Exceptional Personalized Experience, Always	HCAHPS : Staff Responsiveness	65.1 through 12/18. FY19 goal 67.0	HCAHPS baseline: 65.1 (Q417-Q318)	Improvement over FY 2019 = top 50% of improvers	Improvement over FY 2019 = top 30% of improvers	Improvement over FY 2019 = top 10% of improvers	FY20	Cheryl
			HCAHPS: Discharge Information		Improvement based on Press Ganey data for FY19 all hospitals	Improvement over FY 2019 = top 50% of improvers	Improvement over FY 2019 = top 30% of improvers	Improvement over FY 2019 = top 10% of improvers	FY20	
People	20.0%	Teams Empowered with Trust and Purpose	Management: Overall employee satisfaction on Employee Engagement Survey for El Camino Hospital	ECH results last two surveys: 4.09 and 4.27. FY19 target 4.14	Press Ganey 4.32 is 90th percentile for FY19	4.24	4.27	4.30	FY20	Kathryn
			Employees: Participation in Employee Engagement survey	Last two surveys: 79% and 87%. FY19 target 80	Press Ganey average participation-75%	80	85	90	FY20	Kathryn
Growth	20.0%	Market Relevance and Access	Adjusted Discharges	Adjusted discharges 0.7% below budget through P8FY19. Planned growth is 4% in FY20		98% of Budget	100% of Budget	102% of budget	FY20	Jim

Executive Compensation Committee
Prepared 5/16/2019

<table>
<tr><th colspan="3">FY20 ECC Pacing Plan – Q1</th></tr>
<tr><th>July 2019</th><th>August 2019</th><th>September 19, 2019</th></tr>
<tr><td>No scheduled Committee meeting</td><td>No scheduled Committee meeting</td><td><u>Discussion</u>:
- Review CEO FY19 Performance Review Process (including proposed FY20 Process)
<u>Committee Actions</u>:
- Approve Minutes
- Recommend approval of FY19 Organizational Score
- Approve FY19 Executive Individual Goal Scores
- Approve FY19 Executive Performance Incentive Payout Amounts (*pending Board approval of FY19 Org Score)
<u>Board Actions</u>:
- Approve FY19 Organizational Score</td></tr>
<tr><th colspan="3">FY20 ECC Pacing Plan – Q2</th></tr>
<tr><th>October 2019</th><th>November 7, 2019</th><th>December 2019</th></tr>
<tr><td>No scheduled Committee meeting
<u>Board Actions</u>:
- Approve FY19 Financial Audit
<u>Informational Report to Board on</u>:
- FY19 Executive Individual Goal Scores (closed)
- FY19 Executive Payout Amounts (open)</td><td><u>Discussion</u>:
- Assess Effectiveness of Delegation of Authority
- 6-Month Exec Comp Consultant Review
<u>Committee Actions</u>:
- Approve Minutes
- Recommend Letter(s) of Reasonableness
- As needed: Review Compensation Philosophy, Base Salary Administration (salary range increase cap/no decreases), and Performance Incentive Plan Policy</td><td>No scheduled Committee meeting</td></tr>
<tr><td>*Mercer to prepare Letter(s) of Reasonableness
October 23, 2019
Board and Committee Educational Gathering</td><td>*Mitch Olejko to prepare cover letter for rebuttable presumption action</td><td><u>Board Actions</u>:
- Approve Letter(s) of Reasonableness</td></tr>
</table>

Executive Compensation Committee
Prepared 5/16/2019

FY20 ECC Pacing Plan – Q3		
January 2020	**February 2020**	**March 2020**
No scheduled Committee meeting	***No scheduled Committee meeting***	***No scheduled Committee meeting***

FY20 ECC Pacing Plan – Q4		
April 2, 2020	**May 28, 2020**	**June 2020**
Discussion: - Leadership Development and Succession Plan Update - Strategic Plan Update (and progress against FY20 organizational goals) Committee Actions: - Approve Minutes - Approve FY21 Committee Goals **April 22, 2020** **Board and Committee Educational Gathering**	Discussion: - 6-Month Exec Comp Consultant Review - Review Committee Self-Assessment results Committee Actions: - Approve Minutes - Approve FY21 Pacing Plan - Approve FY21 Executive Base Salaries - Approve FY21 Executive Salary Ranges - Approve FY21 Executive Individual Goals - Review and recommend proposed FY21 Organizational Goals - Review and recommend proposed FY21 CEO Salary Range and Base Salary	***No scheduled Committee meeting*** Board Actions: - Approve FY21 Organizational Goals - Approve FY21 CEO Salary Range and Base Salary Informational Report to Board on: - FY21 Executive Individual Goals - FY21 Executive Base Salaries - FY21 Executive Salary Ranges

COMPENSATION CONSULTANT FEEDBACK

Technical Expertise	Consistently demonstrates valuable expertise, technical depth, industry knowledge, leading edge ideas, and market-driven information to support decisions.	
Analysis and Due Diligence	Presents thorough, accurate analysis that is placed in the context of industry practice, market data, and the organization's compensation philosophy and practices.	
Responsive	Anticipates emerging issues and red flags, and demonstrates initiative in understanding ECH culture, stakeholders, strategy, and success drivers.	
Forward-Thinking	Brings new ideas on an ongoing basis, appropriately asks questions, shares divergent perspectives, and presents alterative solutions for consideration.	
Communication	Engages regularly and appropriately with key stakeholders. Produces clear, focused, accurate deliverables demonstrating understanding of audience knowledge and dynamics. Highlights and prioritizes critical points of materials for committee.	
Independence/Objectivity/ Balance	Understands reporting relationship; manages relationships between Board, Compensation Committee, and management appropriately; maintains objectivity and avoids conflicts of interest.	
Trusted Advisor	Strives to build a long-term partnership; places organization interests ahead of their owns; understands perspectives of various stakeholders; appropriately challenges and questions.	
Project Management	Establishes a methodical course of action and drives plan to completion according to agreed-upon ownership and timelines. Develops and adheres to a thorough process for working with management, Committee and Board.	