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Do Hospital Affiliations Risk Becoming the Next Brexit?

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The European Union is an affiliation. Unlike a federal government, the United States for example, where members combine into a single sovereign nation, each member state of the EU remains independent. The EU member countries gain a measure of collective strength and influence by ceding control over certain decisions, regulations and institutions to a central authority, but they remain sovereign and free to exit.

Sound familiar? This is the same type of arrangement as hospital affiliations.

Over the last several years, hospitals have rapidly formed collaborative regional partnerships. These relationships are designed to address challenges that small systems and independent hospitals are ill-equipped to efficiently navigate on their own. Hospital affiliations include accountable care, population health, purchasing, information technology, academic, management and many other agreements. In consulting presentations and at conferences, community hospitals are encouraged to pursue affiliations rather than fully combine to realize the benefits of scale without ceding ownership or control. As Britain's vote to leave the EU, or Brexit, showed us last week, this argument is a dangerous fallacy. By definition, affiliations require participants to cede control, either to the collective (accountable care agreements) or to another party (IT and management agreements).

The problem with affiliations is that their greatest selling point — sovereignty — is also their greatest weakness. Affiliations do exactly what they are set up to do, they work until they don't. The often overlooked truth is that when they come to an end, organizations and countries typically find themselves worse off than before they entered the partnership.

It is no surprise when affiliations end — if they were not intended to be temporal, the parties would cede sovereignty to gain the enhanced stability and the benefits of full integration. More often than not, affiliations end when money becomes an issue. In Britain, it was how disillusioned workers who felt left behind perceived the EU's immigration policies. With hospitals, these points of friction include disputes over where high margin cases go in clinical affiliations, fair sharing of preventive medicine costs in accountable care organizations, disagreements over where to invest capital or place centers of excellence in joint operating agreements, and disputes over implementing or deferring the latest system upgrade in IT affiliations, among many, many other questions. The objectives of independent companies change and diverge over time. When that happens, the

affiliation unwinds.

Unfortunately for both Britain and the remaining members of the EU, the dissolution of health system affiliations that we have worked on indicate that all parties are in for a rough ride. Hospital systems that leave face the immediate challenges of backfilling corporate resources, contracts and clinical relationships while attempting to restore stability. We see this playing out in parallel for Britain. They have yet to formally initiate their departure from the EU, but are already seeing their senior politicians flee for the exits, Scotland in near-open revolt, their currency drop as interest rates spike and their companies cutting back employment.

What does this mean for the organizations that remain in the affiliation? Those that stay typically don't stay for long. Affiliations draw their strength from scale. As they begin to shrink, the benefits of staying shrink while risks grow. Those that linger (Germany) bear responsibility for the weak (Greece). The strongest participants (Britain) tend to leave first, because they can, and the remaining block ends up with less to offer, so the next tier of participants complete their own cost-benefit analysis and are much more likely to leave. Unfortunately for those participants (Italy or France) they tend to be even less prepared for their departures than those that were out the door first. The last to leave are left cleaning up the mess. This incentive causes a 'run on the bank' once initiated.

Finally, the Brexit saga has the potential to inform nonprofit hospital leaders about the ability to reconstitute oneself following divisions. Unlike large sophisticated countries that can go back to being independent, hospitals rarely have that luxury. Once part of an affiliation, it is extremely difficult to 'unscramble the egg' or 'put Humpty Dumpty back together.' Such realities can force an emergency sale out of distress, eroding value and forego the potential to achieve favorable terms. The best partnerships are entered into based on careful consideration of alternatives with a decades-long view. Being forced to quickly find an alternative or new partner as an affiliation pulls apart results in poor decision making and lost value for the community.

Monitoring Greece's fate will be interesting. Hopefully the draconian outcome of bankruptcy is avoided. Bankruptcy or closure, however, have been regular outcomes of failed health partnerships.

This same phenomenon of centralization is true in the nonprofit hospital world. Full scale change-of-control transactions are infinitely more difficult to create, but have proven to be more powerful and permanent. The ability of a combined entity to affect positive change is much greater when owned, controlled and operated as one.

This lack of durability comes with costs. History has shown that groups that take the more difficult leap upfront of fully combining (e.g., by pursuing a merger, sale or consolidation) fare better in the long run compared to those that dip their toes in ready to pull them out at the first sign of trouble.

Witness the success of the United States in the post-WWI era. While extremely difficult to form (the Revolutionary War, Civil War), the United States' economy took off when it completed its interstate highway system and knocked down the final vestiges of interstate tariffs and frictions. Similar success stories exist within vertically integrated and centrally governed healthcare companies.

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