

# Revisiting Divestiture

Selling off or closing parts of an integrated delivery network, despite the prevailing philosophy, can be good business practice.

By Alan Zuckerman

All providers have been battered and bruised by the Balanced Budget Act of 1997, the growth of managed care, and health care insurers who have taken on a variety of "me-too" local initiatives. Some health care organizations have fallen over the edge into severe financial distress. Continued declines or, at best, stable but suboptimal financial performance, are a strong possibility for almost all organizations. Were it not for the performance of the stock market and its impact on health care organizations' portfolios, financial panic and widespread bankruptcies might have already set in.

Integrated delivery networks (IDNs) are experiencing these financial difficulties more acutely than other health care providers. Rather than producing economies of scale, greater market leverage, and significantly improved quality of care, many IDNs merely overexpanded, paying too much for certain lines of business or entities and creating organizations that proved to be difficult and much more expensive to operate than anticipated. The upshot of this overexpansion is that most IDNs have begun to cut back, and administrators are looking beyond cost-cutting measures that are based primarily on productivity-type analyses. They're starting to look at divestiture for restoring organizational solvency.

## **Divestiture in health care**

I'm going to use a somewhat broader definition of divestiture than is traditionally found in the business literature. Divestiture is usually meant to refer to the sale or transfer of a business from one party (the divesting party) to another. In health care, the term is also frequently used to mean the termination of a business.

Historically, divestiture has been viewed by health care organizations as a last resort, employed only in times of extreme financial crisis. Most nonprofit health care administrators consider it good business practice to continually review all operations, and they see divestiture as an appropriate response to poorly performing business units. (In for-profit organizations, the sale of high-performing units also occurs.) But very few administrators have used divestiture until quite recently. The only period when divestiture was somewhat topical was in the late 1980s. After a period of rapid growth and organizational diversification, some health care organizations divested themselves of peripheral enterprises. Now, after another period of rapid

growth for the organizations that have embraced the integrated delivery philosophy and have functioned as local and regional "consolidators" of health care delivery, divestiture may become an appropriate and valid approach for health care organizations ready to downsize.

## **Types of divestiture**

Four general types of divestiture are encountered in nonprofit health care:

***Sale or termination of whole businesses.*** The most visible form of divestiture is when an entire, and usually fairly significant, business entity is sold or shut down. While this approach may be most obvious when a system hospital or nursing home is sold or closed, many less noticeable business divestitures have occurred. In the past year, a number of home care agencies have ceased operations or have been absorbed into other agencies. A growing number of free-standing, community-based ambulatory care centers have closed, including urgent care, surgery, and imaging centers. Some hospitals and health care systems have severely cut back or eliminated their owned physician practice networks. Others have sold their HMOs or otherwise disposed of their managed care companies. But whenever there is a free-standing, visible site for the service, or a large, well-known entity, divestiture is a very public process—especially in smaller, less urban communities. This can make it more difficult, or even impossible, to divest.

***Sale or termination of a business line.*** Selling or closing a business line is slightly less visible than the divestiture of a whole business. Usually, but not always, this approach does not involve the closure or transfer of an entire facility. Examples, which are occurring with some frequency, include divestiture of behavioral health, pediatric and maternity services, occupational health, subacute care, adult day care, and many others. The difference between business line divestiture and whole business divestiture is largely one of degree, size, and ability to isolate the entity from the rest of the enterprise. Regardless, the divestiture process is often just as difficult.

***Sale or termination of combined service and marketing ventures.*** This is a gray area and one that should come under increasing

scrutiny in the next few years. Many IDNs started a variety of combined service and marketing ventures during the past five to 10 years. The common rationale for these ventures was that, although the services were not expected to perform well financially, they would have purported marketing benefits and would function as loss leaders for other related services. Many health promotion and wellness ventures were started on this basis—some with philanthropic or contract funding that has now expired or was severely diminished. Not every one of these combined service and marketing initiatives needs to be cut back or eliminated, but they should all be assessed regularly for their costs and benefits, with changes made as appropriate. While many of these combined service and marketing ventures will be found in the health promotion and wellness area, they also exist in education. Continued support of graduate medical education programs may well be the most controversial divestiture decision that many health care organizations face over the next few years. Furthermore, such initiatives as child care, specialty clinics, medical staff relationship programs, and physician outreach may also fall into this category.

**Divestiture of nonclinical operations.** The first three types of divestiture apply to the organization's clinical or health service delivery business. But many hospitals and health networks are considering areas that are nonclinical in nature. Dietary, housekeeping, information systems, security, biomedical engineering, and many other nonclinical functions can be outsourced. Many IDNs have come to realize that certain specialty companies can provide better and less expensive support services than the IDN can and have aggressively pursued outsourcing opportunities. Needless to say, outsourcing does not apply solely to nonclinical areas, but it is a form of divestiture that is especially applicable to those core support services that must be maintained and are not otherwise candidates for divestiture or termination.

#### Divestiture as a management tool

In health care organizations, the decision to pursue divestiture is most often precipitated by extreme financial crisis. As the

financial performance of health care organizations has deteriorated, these organizations are using divestiture with increasing frequency. In fact, in the case of exceptional financial distress, divestiture is one of the principal methods of restoring financial stability. Reports of divestiture activities, especially of hospitals and managed care businesses, are increasingly common in the health care media and general business press.

While divestiture is a necessary option in times of crisis, divestiture should always be considered in ongoing health care planning and management. It is rare that IDNs routinely ana-

alyze, discuss, or actively consider these options. During the high-growth phase for IDNs and the building of a full continuum of care that occurred in the 1990s, curtailing or ceasing any service was in opposition to the prevailing philosophy of these organizations and simply did not pass muster.

To preserve IDNs and set a course for good financial stewardship, divestiture must be brought to the forefront of the tools and methods used in day-to-day planning and management of health care organizations. For many organizations, financial health and the capacity to carry out the organization's mission can be restored only by appropriately pruning and trimming marginal or peripheral areas. In other cases, divesting and creating strategic alliances with the new operator can accomplish more than the IDN is able to do on its own. In any event, selective downsizing is almost universally necessary for IDNs, and it is

better done before financial crisis sets in and the organization is disabled for some period or, in some cases, torn apart completely. If IDNs are to survive and realize more of the potential benefits that may be attainable, divestiture must be considered a primary tool for planning and management. ●

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### Guidelines for Divestiture of Services

	<b>Reinvest</b>	<b>Divest</b>
1. Were the actual financial results equal to or better than those anticipated in the strategic plan?	<b>Yes</b>	<b>No</b>
2. Has the organization been in operation less than 18 months?	<b>Yes</b>	<b>No</b>
3. Is there at least an example of a known profitable operation of approximately the same size as your operation?	<b>Yes</b>	<b>No</b>
4. If utilization targets have not been achieved, what is the reason?	<b>Not achieved, but reasonable</b>	<b>Overestimated</b>
5. Is your payer mix the same as or better than you expected?	<b>Yes</b>	<b>No</b>
6. Is this a high fixed-cost operation with excess capacity?	<b>Yes, could increase utilization without adding much expense</b>	<b>No, expanding services means adding expenses</b>
7. Can you quantify spin-off benefits to the system?	<b>Yes</b>	<b>No</b>
8. Can you identify any real competitive advantages this service has in the marketplace?	<b>Yes</b>	<b>No</b>
9. Can you identify specific management actions that can reverse the losses?	<b>Yes</b>	<b>No</b>
10. Is this a mature product or market?	<b>Yes</b>	<b>No</b>
11. Would you use your own money to invest in the venture?	<b>Yes</b>	<b>No</b>

Source: Society for Healthcare Strategy and Market Development