Feasibility Studies: The Key to Evaluating Expansion Opportunity

By Phillip Laux, MS

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Hospitals faced with increasing financial pressures and market competition such as declining reimbursements, fragmented financing systems, lower operating margins, and consumers driving healthcare decisions are responding with innovative business approaches. One of the most common initiatives is to expand services, either enhancing existing care areas or venturing into a new service line. State of the art facilities for imaging, ambulatory surgery, outpatient diagnostics, cancer treatment, or one of the more profitable service lines: cardiac surgery are being designed & built throughout the country. Today, more than ever, hospitals must carefully consider the impact of all spending and financial return to the organization.

Taking these issues into consideration, hospital executives attempt to offset unprofitable services such as emergency rooms and inpatient psychiatric care with cancer care and heart surgery where contribution margins continue to be "healthy". New clinical services can position a hospital to generate new streams of revenue while addressing unmet need.

There are many risks involved with implementing new and unfamiliar services. Hospital executives can minimize these risks by making intelligent, data−supported decisions. Answers to the following three questions are the first steps in the planning process. 1. What is the market of the proposed service? 2. Is the proposed service a "right fit", both organizationally and operationally? 3. Does the proposed service project a sound financial picture? Feasibility studies are considered one of the more powerful, yet under utilized tools that hospital executives can use to test planning assumptions and substantiate their case for expanding services. A feasibility study can be used to solicit board approval; financing and bond review, and meet CON application requirements. Also, they serve as the foundation for the final business plan. The typical time commitment to conduct a comprehensive feasibility study ranges from 75−120 days, dependent on availability of financial and market information.

Case Study

Faced with financial challenges and significant out migration of the cardiovascular patient population, administrators at a 150−bed community−based hospital conducted a comprehensive cardiovascular feasibility study. "We kept seeing increased need and unmet demand. Diagnostic catheterizations have been offered here for nearly ten years, but patients had to leave the community to access advanced cardiovascular care," they said. This feasibility study was initiated for four purposes: (1) to determine a course of action: whether or not to enter the open heart surgery market (2) CON application support (3) financing and bond issuance testing (4) implementation business plan foundation.

Senior management conveyed the strategic goals and necessity of the feasibility study to key medical staff leaders and a selected project team. Support and direction from senior management was critical to the success of the project, which would be one of the biggest investments in the history of the organization. A senior executive assembled a project team from core hospital departments to discuss the timeline, project scope, and to review information on medical admissions and market need statistics. Information was gathered on appropriate data of market share, financial, capital, procedural volumes, and operational requirements.

As mentioned earlier, a feasibility study looks at three major areas: (1) Market (2) Operations (3) Finance. Beginning with the market analysis, hospital management and key stakeholders were identified and interviewed to assist in development of the strengths, weaknesses, opportunities, and threats (SWOT) of the organization for the proposed cardiovascular services expansion. Trends of

cardiac specific procedures were gathered at the national, regional, and local levels. For example, U.S. hospitals could expect cardiology services to increase 44 percent more than the average increase in other services in the next 5 years . Additional criteria analyzed in the feasibility study included mortality rates, out migration for advanced cardiac care, cardiac transfers to competitors, demographics, and procedure use rate statistics. These factors assisted in defining the hospital's Total Cardiac Target MarketTM (TCTM). The TCTM is the geographical area from which the hospital could expect to draw patients for advanced cardiovascular care. Demand projections incorporating all of the mentioned methodologies were developed and reviewed with senior management. Exhibit 1, demand projections for open heart surgeries within the TCTM, calculated by applying actual historical open heart surgery utilization rates, specific to the TCTM population.

Exhibit 1

TCTM Service AreaPopulationOHS Utilization RateTCTM Projected Volume
Primary TCTMTM211,0122.76582
Secondary TCTMTM76,0883.22245
* The primary TCTM utilization rates can differ from the secondary TCTM.

Utilization rates can be obtained through most state healthcare agencies or reports from third party data collection companies.

Following a thorough market assessment, a cardiovascular operational review provided senior management with a detailed summary of the current clinical area capability and what would be required for expansion. The operational analysis reviewed existing equipment, ancillary services capacity, staffing, and workflow processes. In addition, all future cardiac expansion needs were identified in a facility plan designed to provide a clinically and technically advanced program. The "state of the art" design, One Stop Post OpTM was chosen by this facility to provide a new approach to post surgery care and a distinct competitive advantage. The One Stop Post Op model allows the cardiovascular patient to remain in the same room from admission to discharge. The nursing care level adapts to accommodate changing patient needs.

The next step was to develop an accurate financial assessment of the proposed expansion. The financial assessment was developed with historical information sources and assumptions for sensitivity and impact modeling. The finance department provided information on payor mix, reimbursement, salary, supply and indirect expense, capital investment, and projected facility expansion costs. Due to vulnerability of the health care environment, senior management challenged the financial model to test the impact of various cardiac expansion scenarios. Return on investment of each scenario was analyzed and evaluated to determine the profitability and margins. The demand projections were the basis for the financial model to produce a financial summary and the following financial statements: Revenue & Expense, Cash Flow, Balance Sheet, and Revenue. The financial summary provided senior management with a five year pro forma projecting average return on investment and payback period for the cardiac expansion project. In this instance, the five year average ROI was 20.4% and projected payback period at 5.61 years.

The Cardiovascular Expansion Feasibility Study provided senior management with a concise overview of the needs of the patients and community that the hospital served. Feedback and guidance from the medical staff was solicited and considered before a decision to proceed was made as physician support and acceptance is vital to program success. A through due diligence to accurately estimate the level of resources, both operational and capital was essential to the process and permitted the organization to carefully evaluate the financial viability of expanding services. In essence, the study enabled the key stakeholders to strategically decide on a course of action that could have a significant short−term effect and impact the organization's long−range future position as an acute care provider. The community based hospital in this case study approved the cardiovascular expansion project and

used the feasibility study in multiple ways. They were able to document need and identify an underserved population as support for state application for a CON, the feasibility study provided the documentation necessary to secure financing and provided a "road map" for implementation of the project. The report was used as a guide often during the preplanning and start−up phase and after the implementation of interventional cardiology and open heart surgery as a benchmark for review against actual program performance.

Conclusion

Hospitals experiencing increasing levels of financial and market risk are turning to feasibility studies to determine if they should offer new or expanded services. This case study analysis is an overview and discusses thoroughness of the entire feasibility process. The process proved to be essential to this hospital's strategic financial planning. Organizations, making substantial investments to expand into unfamiliar territory cannot make sound business decisions without the proper tools. The cost of a feasibility study is a relatively small expenditure in light of the overall project cost, but hospitals are finding it to be essential and vital to expansion success.

Phillip Laux, MS is the finance manager with Health Care Visions, Ltd a leading cardiac consulting firm. He earned his Master of Science in Management and Technology from Carlow University in 2000 and Bachelor of Arts in Administration from the University of Pittsburgh in 1994. Phillip has over 8 years of financial reporting, statistical analysis, revenue modeling for hospitals and physicians.

A Field of Multiple Opportunity

By Tony Papajohn

Opportunity is all around us and has many facets, but it's not always obvious.

It hides behind the same appearance that everyone else sees, but it reveals itself depending on who you are.

Even though everyone sees the same appearance, different people recognize different aspects of opportunity.

What you see depends on the vision with which you start.

Consider a farmer's field.

Sam Walton had his own vision regarding fields.

The founder of Wal−Mart needed to open stores and lots of them.

His discounting philosophy meant that he needed to drive costs down, cut profit margins to the bone, and generate huge volume.

He did this by seeing opportunity where others saw a field.

Walton flew his own airplane. He would fly low over an area of potential expansion, especially noticing any new subdivisions growing around existing small communities.

When he found a key intersection between a few small towns and in the path of growth, he would land his plane, buy a piece of farmland, and build a new store.

To most people, it looked like a field. To Sam Walton, it looked like a field of opportunity.

But it was a field of opportunity for others as well.

The same land upon which now stands a thriving Wall−Mart looked very different to different people.

It was a farm for the farmer, an thumbnail sketch of economic indicators for the commodity speculator, a microcosm of the local environment for the scientist, a trend indicator for the demographer, a rustic landscape for a photographer, and a source of tax revenue for the county assessor.

The field was the same, but it embodied multiple opportunities.

What makes the difference is your vision.

If you know your vision, you will recognize your opportunities.

Tony writes and speaks on success. Subscribe to his free SuccessMotivator e−zine at

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