



# Capitalizing on Master Planning

By Harvey J. Makadon, MD, and Larry Sterle

Cost cutting is a top priority for leading health care organizations responding to the industry’s changing dynamics, according to a recent HealthLeaders Media survey.<sup>1</sup> Yet many may be unintentionally handicapping themselves during this process due to the fact that cost cutting is only a short-term fix to a long-term problem. We have witnessed many institutions actively deferring capital expenditures and putting “band-aids” on the most pressing facility issues, potentially wasting money in the long term. By providing a complete picture of an organization’s current situation and opportunities for growth, a holistic master facility plan will help reign in spending and empower leadership to make the right strategic decisions to ensure success over the long term.

In our experience, leading organizations share two hallmarks: They are continuously preparing for the future, and they are fiscally conservative. These organizations take time to develop sound strategic plans and a solid framework that defines the organization’s capital strategy and incorporates its potential demand for capital, as framed in a comprehensive capital asset master plan.

A comprehensive capital asset master plan is not a promise to spend money. Quite the opposite. If done thoughtfully, it can provide a rationale for why money should not be spent or how it can be spent incrementally. Conversely, if there is a need to invest in capital assets, a good plan provides leadership with the rationale to commit to the required investments with a high level of confidence.

Financial executives at industry-leading organizations are raising their demand for the level of analytical rigor underpinning their capital strategies. Three primary questions are being raised:

**1. What are we doing from a strategic perspective and why?**

Answering this question requires a well-defined strategic framework with clear and realistic strategic goals based on sound, thorough analysis.

**2. What will it take to accomplish these goals?**

A complete understanding of capital needs and cash-management goals is necessary to get a full picture. A comprehensive capital asset master plan defines the demand for facilities, information technology and major equipment. At the same time, the plan defines

at a minimum the corresponding key measure for days cash on hand and cash reserves for potential strategic investments. The plan also provides the organization with an understanding of where they need to be from an operational efficiency perspective to attain certain financial benchmarks for future capital investment.

**3. Can we afford to implement the strategy?**

The plan will contextualize the above goals in a robust financial analysis. This analysis is more than an ROI projection for select projects, but is also a comprehensive analysis that considers the overall financial performance of the organization. Depending on the outcome, adjustments can be made to target market and volume projections, proposed capital investments and implementation timelines, and strategic goals can be adjusted to ensure affordability.

These questions are not traditionally addressed by a master plan, but leadership is expecting a higher standard, and with good reason. Leadership can make effective decisions only when they are fully informed, so to help answer the above questions, a complete capital asset master plan will have the following elements:

- *Strategic thinking* — Not reinventing the organization’s strategic plan, but having the ability to interpret critical points that impact facility decisions. Beyond how much space is needed now and in the future, what are the investment’s implications for physicians and service lines, market reach and opportunity, competitive positioning, prioritization of mission, medical staff development and financial positioning?
- *Operational integrity* — How care is arranged, delivered and supported underlies quality, safety, satisfaction and cost of care. Anticipating efficient (or lean) operations is a basic tenet for assessment and planning. Understanding organizational structures that deliver superior functionality and envisioning how those structures fit your programmatic goals is critically important when considering future care delivery models.

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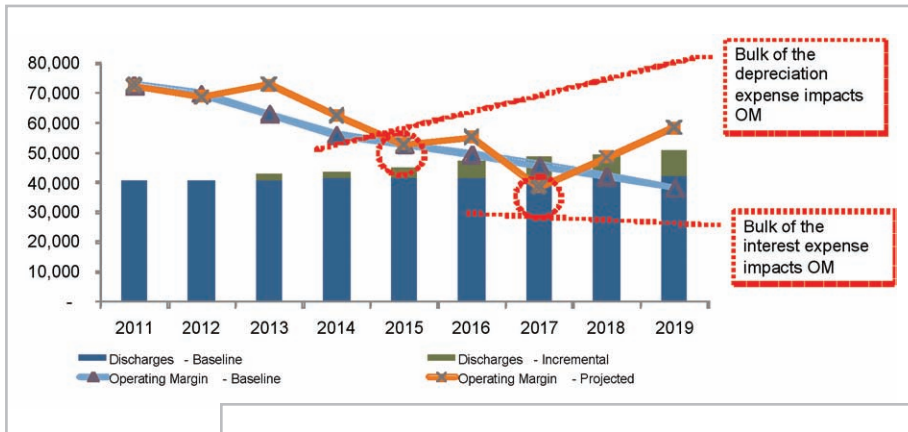
<sup>1</sup> 2011 HealthLeaders Media Industry Survey.

- **Information technology integration** — Communications across the care continuum, quality and safety of care are all premised on seamless IT services. Like facilities, these systems require significant capital investment, so it is critical to have a firm grasp on the status of the IT systems' capabilities to balance the overall demand for capital and ensure that future facility investments are capable of handling future system advancements.
- **Evolution framework** — Near-term capital asset investments are valuable only if they are integrated with the long-term direction. Saving money on a project in the short run could cost a lot more in the long run if that project leads to future workarounds in terms of capital expenditures and operating costs.
- **Financial performance** — The implications of any capital investment plan on future activity volume, reimbursement expectations, enterprise-wide capital and operating costs, philanthropy, and other sources and uses of capital must be understood and evaluated. A longitudinally modeled implementation plan will enable an organization to achieve "managed continuity," through the evolution of its investments, to achieve its goals and vision with a high level of confidence.

When developed correctly, a financial performance assessment can provide significant value as part of a capital asset master plan, as demonstrated by the following example. A health system comprised of ten acute care campuses was initially prepared to reinstitute investing in its capital assets as it emerged from the Great Recession. The system's plan was to pursue a sequential series of investments, one campus at a time, across three campuses over a seven- to eight-year period. A master plan was developed for each campus incorporating the elements discussed above.

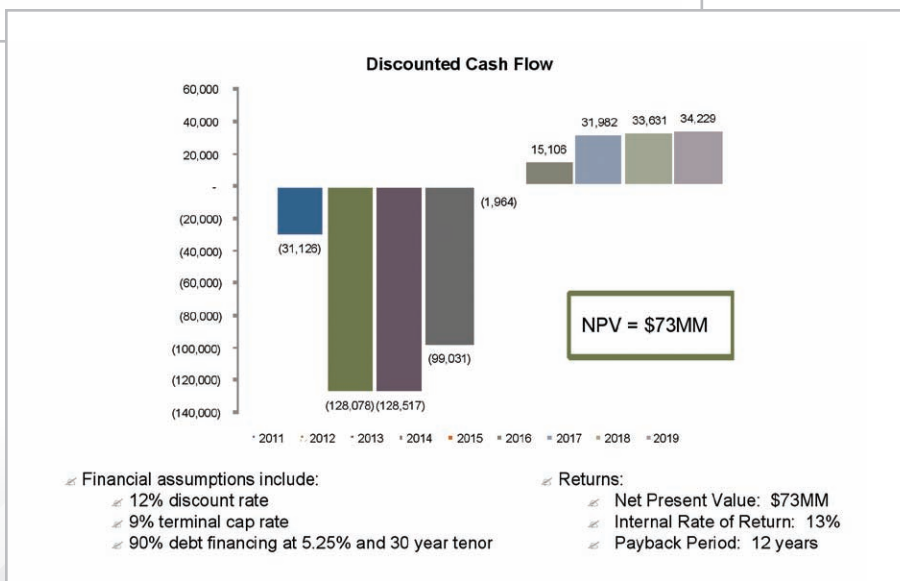
Once the strategic imperatives and opportunities for each campus were fully understood, a complete financial model was developed for each campus demonstrating the impact on performance and accounting for a variety of sensitivities and assumptions about reform, payor mix, expenses and other factors.

With this financial analysis in hand, the system chose to make select additional investments on a more accelerated schedule to capture strategic opportunities while they existed. The system also decided to intermix investments alternatively and incrementally across campuses to pursue the most financially advantageous projects. Armed with a complete financial analysis, the system felt more confident making tough choices to delay projects or find near-term alternatives in support of its overall financial health.



As this case shows, the industry is changing, and leading organizations will equip themselves with all the facts to make decisions that position them for future success.

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- Financial assumptions include:
  - 12% discount rate
  - 9% terminal cap rate
  - 90% debt financing at 5.25% and 30 year tenor
- Returns:
  - Net Present Value: \$73MM
  - Internal Rate of Return: 13%
  - Payback Period: 12 years