# First the Strategy, then the Bricks

*Douglas R. Rich, FAAHC, managing director, Tribrook Healthcare Consultants, National Healthcare Practice, American Express TBS, Chicago, and James E. Hosking, CHE, FAAHC, FHIMSS, managing director, TriBrook Healthcare Consultants, National Healthcare Practice, American Express TBS*

Replacing a facility is an activity that appeals to many hospital executives at an almost subconscious level. Why not? They have endured the ongoing headaches caused by their existing facility's aging infrastructure and inability to accommodate today's technology, let alone tomorrow's. The buildings, which were cobbled together with insufficient capital, may even look outdated, creating the nagging public perception that the hospital does not provide state-of-the-art care. So why not start with a clean slate? After all, boards will often get behind major capital campaigns, especially ones that can stand as legacies to their tenure. In addition, a new facility can neatly resolve all of the organization's facility-related issues. Although the arguments supporting replacement are logical and tempting, they should not drive the decision-making process. Executives must first perform a rigorous analysis through their strategic planning process, because the stakes in such an undertaking are very high. The size of a replacement facility project must neither be too big nor too small.

The cost of new hospital construction projects currently range from approximately $900,000 to $1.3 million per bed. For a 200-bed community hospital, the project cost of a complete replacement is expected to exceed $200 million (American Express National Healthcare Practice 2004). If the strategy behind the replacement project is not well thought-out, the debt service on even a percentage of these costs can drive the organization to insolvency. Conversely, if the strategy is successful, the organization can have an advantage over its competition that virtually guarantees its long-term viability. Ultimately, the success of a project is tied to its ability to capture patients, to improve operational performance, and to recoup the capital expense incurred.

As strategic and facility planning consultants, we recognize the importance of upfront planning to the ultimate success of replacement projects. This column presents an approach we have developed to evaluate a specific set of factors that are likely to affect the future utilization of capital projects. Some of these factors are discussed below.

## MARKET ENHANCEMENT OPPORTUNITIES

Although seemingly basic, knowing from which ZIP codes the organization currently draws its patients (both inpatients and outpatients) is one of the most important pieces of information. Create a map of the market areas that account for at least 85 percent of the hospital's activities, then review it. By looking at the physical map, the organization can see the gaps (if any) in its service coverage. Create maps for each product line, or at least each major service. These maps will reveal variations from service to service and product line to product line; most market areas are program specific.

"Holes" in the maps are not uncommon; these represent communities that are apparently bypassing the organization in some services. If the facility replacement plan includes the potential of relocating to another community (or elsewhere in the same community), the impact of the holes should be considered in defining the market. Will the new location draw more from markets that are currently not served or served in a limited capacity? Conversely, will the organization draw less in the future from certain markets because of the move?

## DEMOGRAPHIC OPPORTUNITIES

The relevance of the market definition becomes more apparent when the demographics of the residents in the market area are evaluated. Plot on a map the areas that are expected to have population growth. For example, a black dot can represent every 100 new residents entering a community over the next five years, and a red dot may stand for a loss of 100 residents in a community over the same period. If existing facilities are in the center of the anticipated population growth in the next five years and beyond, then the organization may have a strong argument for doing any replacement "in place." If, on the other hand, all the black dots on the map seem to be concentrated away from the location of the facilities or if the area is surrounded by red dots, then relocation may make more sense.

Knowing the age distribution of the population is also important. The population in general is aging, but determining where, specifically, the greatest concentration of seniors will be in the future is important. Where in the area will be the concentration of young families of childbearing age? Seniors will be the heaviest users of healthcare services, but young women and their children will be the users of obstetrics and pediatric services. Also, find out the income distribution pattern of the market area in the future. If the relative wealth of the community will move away from the facilities' current location, how will the organization atttract this market? Will the organization become more dependent on Medicaid and self-pay populations?

## MARKET SHARE OPPORTUNITIES AND STRATEGIES

Understanding what portion of a community currently uses the organization is critical in determining the viability of a replacement facility strategy. Inpatient market share data are readily available, and in most states areawide patient origin data that cover a multiyear period are accessible. These data enable a view of historical inpatient use rates and market share trends, even by ZIP code and product line levels, and thus can help organizations in predicting use rates. In most communities around the country, inpatient discharge rates are expected to continue to increase in the foreseeable future, but these rates will vary widely from community to community. Outpatient market share data are still much more difficult to access, which often forces organizations to rely on estimates generated from national or regional databases. Combined, these data paint an excellent picture of the organization's current competitive position in the marketplace and provide a firm basis for actions in the future. We recommend looking at market share information to identify geographic areas that may present opportunities if the organization had a physical presence there.

Organizations that proceed with replacement facilities typically see an increase in demand between the pre-completion and post-completion period, an occurrence labeled the "halo" effect (Hosking and Jarvis 2003). Some increases in demand cannot be completely explained by population growth and changes in use rates; they are the result of market share gain. The ability of the organization to accurately anticipate market share gain is a function of many interrelated factors, including the new facility's ability to provide a competitive advantage over other organizations that serve the same communities. Proximity will probably make a difference, as will ease of access. The image shift created by a replacement facility can also be expected to affect future utilization of the organization. On the other hand, the impact of competitor activity cannot be overlooked. If competing organizations are planning or are likely to plan the same type of project, the organization needs to assume that these activities will influence the market shares that it will be able to achieve. Therefore, a thorough competitor analysis is a critical component of the replacement facility planning process. The organization should ask, what are the current programmatic strengths of competitors? Do they have a strong and loyal medical staff? What is their economic position? Have they announced to the local media their own plans for the future?

Once armed with this information, the organization has to examine market share projections on a ZIP-code by ZIP-code basis. Only in situations where the replacement facility project has a clear and new advantage over the competition is it reasonable to assume that the organization will experience market share gain. As mentioned earlier, if the replacement project involves relocation, then the organization will likely experience market share decline in some ZIP codes.

## QUALITATIVE ANALYSIS

"Running the numbers" is critical in developing a replacement facility strategy, but knowing the attitudes of constituents is equally important. First, determine if the board supports the project. The board needs to understand that the issues involved in building a new hospital are substantially different from those in past expansion and renovation projects. Second, find out if the medical staff backs the plan. Physicians should realize that a replacement project can delay capital improvements and equipment acquisitions until the new facility is in place. Finally, ascertain if the community is on board. Community members may support the concept of a new building, but they may not be pleased with the issues concerning the facility's move into their neighborhood or departure from their area. Market research can be used to assess community attitudes toward a replacement facility. This research can be used both to identify market preferences and to begin building the case for the project. Without the support of these three constituent groups, many projects cannot go beyond the planning phase.

## CONCLUSION

The analyses presented in this column will enable most organizations to determine the strategic feasibility of developing a replacement facility project, as they yield a realistic set of demands and volume projections. These projections will serve as the basis for revenue projections, which in turn establish the economic viability of the project. However, only after factoring in the operational efficiencies of the new facility and the capital costs of the project can the organization determine the gains in volume that will make the project affordable. These latter issues will be addressed in the upcoming issues of this column.

### References

American Express National Healthcare Practice. 2004. Data from the Facility Planning Group. Chicago: American Express TBS.

Hosking, J. E., and R. J. Jarvis. 2003. "Developing a Replacement Facility Strategy: Lessons from the Healthcare Sector." *Journal of Facilities Management* 2 (3): 214-28.

For more information on the concepts in this column, please contact James Hosking at james.e.hosking@aexp.com or Douglas Rich at douglas.r.rich@aexp.com.